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## **How corporate governance weaknesses led to financial distress in Toshiba – some reasons and consequences (a case study)**

### **Introduction**

Toshiba Corporation is a famous Japanese conglomerate dealing in heavy electric machinery, light electric appliances and electronics. It was established, as a result of a merger between Shibaura Seisakusho and Tokyo Denki in 1939, but its roots could be traced back to the 1873. Although it was always called Toshiba, only in 1984 it changed the official name into Toshiba Corporation<sup>1</sup>.

Toshiba Group (having more than two hundred thousand employees), which for years had led the development of the Japanese economy, was not long ago in a critical situation. In spring of 2015 a problem of illegal accounting was revealed, and its President was obliged to resign. As the independent investigation committee (third-party committee) and other specialists pointed out, there was a serious problem with its corporate culture, and the company was requested to implement a drastic reform. In December 2016 it was revealed that Toshiba had a much more serious problem, i.e. an enormous debt, which was incurred by Toshiba's American subsidiary Westinghouse Electric Corporation (WH). Thus Toshiba's nuclear energy business recorded a pretax loss of 700 billion yen in March 2017. It recorded a huge deficit for the first time in its history for two consecutive years. To rescue itself, the corporation was forced to sell the flash memory division, which was the best earner in Toshiba. It was downgraded from the position of a company listed on the First Section of the Tokyo Stock Market to that of the Second Section in August 2017. If the excess of debts is recorded in two consecutive years, this company will be delisted even from the Second Section of the Tokyo Stock Market immediately [*New Listing Guidance*, 2016].

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<sup>1</sup> For Toshiba's history see the following link [[https://www.toshiba.co.jp/worldwide/about/history\\_chronology.html](https://www.toshiba.co.jp/worldwide/about/history_chronology.html)].

When the Stock Exchange has reasons to demand an inquiry concerning corporate information of a listed company (deeming that it is necessary to do so), such listed company shall make an accurate report on an inquiry matters. In 2015 (12 February) Toshiba became the subject of such a disclosure inspection. In order to maintain the highest credibility of the investigation it was conducted by the specially established Independent Investigation Committee. It acted in accordance with the guidelines prescribed by the Japan Federation of Bar Associations, and on the 20-th of July 2015 published the 334 pages Investigation Report. Currently, those matters are regulated by the Principles for Listed Companies Dealing with Corporate Malfeasance, which were released by the Japan Exchange Regulation (the JPX) in early 2016. It is the first document of such kind in the world. It sets out four broad principles that Japanese public companies must follow when investigating suspected cases of corporate misconduct [The JPX Principles, 2017]. The Principles are not legally binding and, as Japan's Corporate Governance Code, are principle-based, and implemented on the "comply or explain" basis. However, the JPX is going to consider the extent to which a company has followed them, when determining penalties and delisting.

The Investigation Report concerning Toshiba characterizes in detail the malfeasances, and when, why and by whom they were committed. What is important, it points out the possible ways of rescuing the company.

The aim of the paper is to show, how the weaknesses in corporate governance led a big company with a long history in the area of electric machinery, to financial distress and fraud. The analysis of the Toshiba case proves usefulness of the J-SOX regulations, especially the Independent Committee's Report, in detecting the causes of this situation. The influence of the scandal on improvement of corporate governance regulations in Japan is pointed out.

## **1. Toshiba's History**

Toshiba Corporation is a huge Japanese conglomerate, consisting of many departments called companies, which produce various products ranging 'from a battery to a nuclear power plant'. Toshiba has a long history (Table 1). For years it had been very influential in business circles, for example, two presidents of Toshiba became Chairman of the Japan Business Federation – called "Prime Minister of the Japanese Business Circle".

Toshiba has been following the classic model of Japanese management by maintaining a close relationship with the government, by adapting its development to the government's policies. The Corporation always has been able to adapt itself well to the situation and requirements of the market.

Japanese companies may choose one of the three main forms of organizational structure under the Companies Act : Company with Kansayaku Board, Company with Three Committees (Nomination, Audit and Remuneration)<sup>2</sup>, or Company with Audit and Supervisory Committee [Company Act, 2012, art. 2; Japan’s Corporate Governance Code, 2015, 4.16]. Toshiba has chosen the less popular form i.e. “Company with Three Committees (Nomination, Audit and Remuneration)”.

**Table 1. History of Toshiba Corporation**

1875	Mr. Hisashige Tanaka, an inventor, started operations.
1882	Tanaka factory was established. Later this became Tokyo Denki.
1893	Shibaura Works was span off.
1930	The company produced and sold electric washing machines for the first time in Japan.
1939	Tokyo Denki, a company famous for lamps, and Shibaura Works, a heavy electric machinery producer, merged to form a new company Tokyo Shibaura Denki.
1949	Mr. Taizo Ishizaka (1986–1975) served as President of Toshiba in the period 1949–1957 and served as Chairman of the Japan Business Federation in the period 1956–1968.
1960	The company produced color television sets for the first time in Japan.
1965	Mr. Toshio Dokoh (1896–1988) took the post of the 6th President of Toshiba. He is known as a restorer of the company. He served as President of the Japan Business Federation (1974–1982). At the Government’s request, he took the post of chairman of the second provisional board of inquiry for administration (Rincho) in 1981.
1985	The company produced laptop computers for the first time in the world.
1991	The company produced NAND type flash memory for the first time in the world.
2006	The company acquired an American company Westinghouse.

Source: Compiled by Yoji Koyama based on various data.

Table 2 presents the Toshiba’s structure of business, which may be considered as one of the reasons for the company’s failure, as it was not successful enough in struggling to remain competitive in the industry. Table 2 shows that the content of Toshiba’s business had substantially changed during the last quarter of century. In the 1990s the personal computer division was the best earner in Toshiba. Then smartphone appeared.

<sup>2</sup> A majority of the members of each committee must be outside directors. Listed KKs (*kabushiki kaisha*) must have one or more independent officers.

Toshiba's personal computer business was gradually becoming unprofitable, and finally this department was closed in March 2017.

**Table 2. Percentage of Various Branches in Toshiba's Total Sale**

1997		2015	
35.8%	Information technology such as computers and medical equipment	26.0%	Nuclear power plant and energy
22.0%	Semiconductor and electronic components	25.9%	Semiconductor and electronic components
18.3%	Electric power and industrial system	22.3%	Infrastructure
17.0%	TV, home appliances, etc.	8.9%	Cash register, printer, etc.
6.9%	Others	16.9%	Computer, TV, information system, etc.

Source: [Asahi Shimbun, 2017].

Looking at sales in 2017, the first place (26.0%) is occupied by construction of nuclear power plants and energy, and the second place, albeit almost the same percentage (25.9%), is occupied by semiconductor and electronic components, followed by infrastructure, etc. Before long, Toshiba came to be overwhelmed by East Asian rivals.

## 2. Problem of illegal Accounting

### 2.1. Revelation of Problem

After whistle-blowing in late January 2015, a section at the Securities and Exchange Surveillance Commission (SESC)<sup>3</sup> (pursuant to Article 26 of the Financial Instruments and Exchange Act, Act No 65, 2006) started an inquiry into the accounting department at Toshiba concerning disclosure inspections of some projects. Following that, self-investigation performed by Toshiba revealed that some matters required a thorough investigation. Therefore The Independent Investigation Committee<sup>4</sup> (IIC) was established and an investigation of the relevant facts was commenced. The Board of Directors appointed the members of the IIC (comprising independent, external experts who do not have any interests in Toshiba) on 8 of May 2015. Such Committee is appointed in serious, potentially

<sup>3</sup> SESC was established as a commission within the Ministry of Finance in July 1992. It is responsible for "ensuring fair transactions in both securities and financial futures markets. It became a commission affiliated to the Financial Services Agency (FSA) in June 1998 when FSA split off from the Ministry of Finance. FSA is the administrative authority in charge of the Financial Instruments and Exchange Law, and the regulation of listed KKs (*kabushiki kaisha*) [www.fsa.go.jp/en/index.html].

<sup>4</sup> In Japan this is called Daisansha linkai, which literally means 'the third-party committee'.

company-destroying cases of malfeasance. It is obliged to investigate and publicly report on the misconduct, and by doing so it may rescue, at least to some extent, corporate value and reputation.

That third-party committee<sup>5</sup> conducted an investigation and published a report on the result of it on July 20 in the same year [Investigation Report, 2015]. Immediately after the announcement of the report Mr. Hisao Tanaka, President of Toshiba at that time, as well as three former Presidents who stayed and served at the corporation as advisors, resigned taking responsibility for the illegal accounting. These executives had “systematic” involvement in the improper accounting, and were responsible for the failures in internal controls<sup>6</sup>. In this report the problem with Westinghouse Electric Corporation (WH) was only mentioned, as at that time, the huge debts had not come to the surface yet.

## **2.2. The Independent Committee Report**

The Independent Committee Report concluded that Toshiba committed accounting fraud in order to conceal the real state of its financial difficulties. It explains the methods of accounting fraud as follows.

1. In the infrastructure company<sup>7</sup> prime costs were attributed less than they actually were, sales were inflated and losses were put off to the next period.
2. In the visual products company ‘carry over’ was made: postponing the time of allowance for bad debts and inclusion of costs to later periods. In spite of the fact that the company actually received services of advertisement, physical distribution, etc., it requested the business partners to postpone the issue of bills to the next quarter. In addition, it recorded the costs in the next quarter. Fraud related to inventory appraisal was revealed, prices of products which Toshiba sold to overseas local subsidiaries (FOB prices) were increased at the end of periods.

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<sup>5</sup> The committee consisted of 4 people with Mr. Koichi Ueda, former chief public prosecutor at Tokyo High Public Prosecutor’s Office as chairman, as well as a lawyer and two certified public accountants. Besides, 18 lawyers and 77 certified public accountants as its supporting staff cooperated with the committee. The investigation was conducted from May 15 through July 20 [Investigation Report, 2015, p. 19–21].

<sup>6</sup> J-SOX – Japan’s Financial Instruments and Exchange Law (the Japanese version of Sarbanes-Oxley Act (SOX)). The standards were introduced by the Business Accounting Council of the Japanese Financial Services Agency on 7 June 2006. It is applicable to companies quoted on Japanese Stock Exchanges and has been effective since fiscal year beginning on 1 April 2008. It introduces strict rules for the internal control of financial reporting in order to protect investors by improving the accuracy and reliability of corporate disclosures. Non-compliance with J-SOX could involve criminal litigation, and penalties for company officers [www.eisneramper.com/j-sox-sarbanes-oxley-act].

<sup>7</sup> Each business department within Toshiba Corporation has been called ‘company’.

3. A decrease in cost was included in the account settlement ahead of schedule. For example, Toshiba's company requested panel producers or ODM [Original Design Manufacturing] producers to decrease its purchase price of components. In spite of low certainty of gaining the intended effects, a method of decreasing its purchase price was adopted on the assumption that such effects would be gained.
4. The personal computer company adopted a method of 'Buy-Sell', i.e. this company overstated its profit by selling components to its ODM producer at a price higher than usual.

The Independent Investigation Committee report explains the causes of the occurrence of inappropriate handling of accounting as follows.

1. Pressures from the head office in the face of deteriorating performance. In the pictures company the oversea business had been in a slump since 2007 due to the subprime mortgage financial crisis, etc. In 2011 at the head office meeting the President of Toshiba had repeatedly requested the presidents of companies (business departments) and their accounting directors to accomplish the planned profit as well as the increased targets during the period. It was called 'challenge' in Toshiba corporation. Mere rough estimates, which were originally companies' targeted amounts expected by the head office, had all too soon become targets of absolute necessity within Toshiba corporation. These numerical values were not set from a perspective of a long-term goal but from a perspective of profit maximization in the current term, i.e. the current term profit supremacy.
2. Crime of omission by leaders at the head office based on the current term profit supremacy. It can be judged from contents of reports that Mr. Norio Sasaki, the previous President, noticed the 'carry over' for inflating profits in appearance in the pictures company in November 2011 at the latest and also Mr. Hisao Tanaka, at that time President, noticed it in March 2014 at the latest. Although they should have given instructions to correct such a practice, they had done nothing.
3. A lack of awareness of suitable accounting practices. Inflation of profits in appearance by unsuitable 'carry over' is incompatible with suitable accounting practices.
4. Flaws in internal control in companies, etc.
5. Flaws in internal control in the head office. There were problems in the financial section, managerial inspection section and inspection committee. The chairman of the inspection committee served as CFO from June 2011 through June 2014 and was able to grasp the content of carrying-over in great detail, but from June 2014 when he

became chairman of the inspection committee he had never pointed out inappropriate carrying-over as a problem. The inspection by the accounting auditor was not adequate either. It seems that this was because companies did not provide him with materials or information from which he could sense any implementation of carrying-over and because they devised explanations in order for him not to notice the implementation of carrying-over<sup>8</sup>.

### **2.3. Accounting Practice concerning Business Transactions of Components in the Personal Computer Business**

The method called Channel Stuffing of ODM [Original Design Manufacturing] Parts was intentionally used to overstate the current-period profit in an institutional manner involving certain top management<sup>9</sup> [Investigation Report, p. 242].

Toshiba outsourced the design, development, and production of PC's to overseas ODM. Since 2004 Toshiba Taiwan International Procurement company [TTIP], a 100% subsidiary of Toshiba, was purchasing main components such as memory, HDD, etc. and selling these components to ODM producer. When selling these components to ODM producer, a specific price higher than the purchase price (which was called a 'masking price') was used, because Toshiba was afraid that its purchase price of this component might be leaked to other rival companies. Within the whole Toshiba Corporation the difference between a purchase price from a supplier and a selling price to ODM producer was called 'difference value of masking'. ODM producer, who supplied components, produced personal computers using his own components and delivered finished personal computers to Toshiba through TTIP. Within the whole Toshiba Corporation such transactions had been called 'Buy-Sell transactions'. The current-period profits were overstated by selling a higher volume of parts than the amount required for normal production to ODMs at the end of the quarter (Channel Stuffing of ODM Parts), causing the ODM to hold the inventory, and causing the Masking Difference for those parts to be recognized as the negative

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<sup>8</sup> For a concise English explanation of Toshiba's case see the following link [<https://www.japantimes.co.jp/news/2015/07/21/national/probe-finds-pressure-management-contributed-toshiba-wrongdoing/#.WbVA1fljbc>].

<sup>9</sup> The inappropriate accounting treatments in the Buy-Sell Transactions consist of two factors: 1) the appropriateness of the accounting treatments to recognize the negative costs of manufactured goods as Masking Difference of Toshiba at the time when parts are supplied to ODMs in a normal parts transaction, and 2) misusing this accounting treatments in overstating the current period profit by selling a higher volume of parts than the amount requiring for normal production to ODMs at the end of the quarter (Channel Stuffing of ODM Parts), causing the ODM to hold the inventory, and causing the Masking Difference for those parts to be recognized as the negative costs of manufactured goods for the quarter [Investigation Report, p. 54].

costs of manufactured goods for that quarter. The Investigation Report analyses these transactions on pages 51–56. They are explained in a following way. Toshiba records an amount equal to the Masking Difference as an account receivable from TTIP so that the Masking Difference can be deducted from the product price when the completed PCs are delivered from TTIP, and simultaneously records profits by deducting costs of manufactured goods. When Toshiba subsequently purchased the completed PC from TTIP, the Masking Difference added by TTIP (the factor of an increase in costs of manufactured goods) offsets the negative amount of costs of manufactured goods recorded at the time of the parts transaction. As a result, the purchased product price becomes a figure from which the Masking Difference has been deducted. Recently, the Masking Difference of parts to be supplied to ODMs was almost five (5) times as TTIP's procurement price.

Since the end of FY 2013, after Hisao Tanaka took over the position as the CEO, the measures to resolve the overstated profit from Channel Stuffing of ODM were considered. As a consequence, from the second quarter of FY 2014 the amount of the overstated profit started to decrease. The Balance of Buy-Sell Profit Recorded was reduced to JPY 39.2 billion in the next quarter.

As a result of enormous amounts of Channel Stuffing of ODM Parts from 2008 until recently, monthly profits in the PC business were in an abnormal state to the extent that the operating profit of the last months of the quarter sometimes exceeded the sales for that month. As a result, the price of the product purchased from ODM producer, had been changed to a price which was deducted as 'difference value of masking'. Lately, the 'difference value of masking' for components supplied to ODM producer amounted to a staggering nearly 5 times the purchasing price of TTIP.

In the first half of Fiscal Year<sup>10</sup> 2008 (from April through September 2008) in the whole of Toshiba there was an increasing fear about poor business performance because of the world economic recession triggered by the subprime mortgage problem. At the quarterly debriefing meeting in July 2008 and the monthly meeting in August Mr. Atsutoshi Nishida, President of Toshiba at that time, requested the PC Company to raise its forecast of operating profit in the first half of FY 2008 by 5 billion yen as its 'challenge'. In response to that request (challenge), in September 2008 the PC Company executed Channel Stuffing of ODM Parts to overstate the profit in September of FY 2008. As a result of these actions the total amount, which is calculated as the quantity of unused Toshiba-supplied

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<sup>10</sup> In Japan the Fiscal Year starts on April 1 and ends on March 31 next year. Almost all social activities including schools, business, etc. are adjusted to this.



parts held by ODMs (including those subject to normal parts transactions) multiplied by the Masking Difference<sup>11</sup>, was estimated to reach to JPY 14.3 billion at the end of September. This Balance of Buy-Sell Profit Recorded is mostly presumed to be the overstated current-period profit achieved by Channel Stuffing of ODM Parts.

The PC Company continued Channel Stuffing of ODM Parts into the ODM producer. The total profit from its Buy-Sell transactions was estimated to amount to 27.3 billion yen at the end of the first quarter of F Y 2009 (i.e. the end of June 2009) immediately after Mr. Nishida retired from President.

Although President Sasaki, Mr. Nishida's successor, thought that the amount of overstated current-period profit based on Channel Stuffing of ODM Parts should be decreased, in the phase of recession, he strongly requested the PC Company to increase its profit using that method. During the monthly meeting held on September 27, 2012 President Sasaki strongly requested Digital Products & Services (DS) Company to increase its operating profit by 12 billion yen within three days, demanding it report the result of its reconsideration on the next day, i.e. September 28. DS Company reported the result of this reconsideration, explaining that the company would take measures to increase its profit by 11.9 billion yen in total including 'Buy-Sell' of 3.9 billion yen, and carrying over of 6.5 billion yen by the end of September. The Top Management of Toshiba, including President Sasaki, approved the explanation. In this way, at the time of Mr. Sasaki's retirement the total profit through 'Buy-Sell' transactions was estimated to amount 65.4 billion yen.

#### **2.4. Current Profit Supremacy and Strong Pressure to Achieve Targets**

During the period when President Nishida and President Sasaki managed Toshiba Corporation, presidents of companies were especially strongly requested at monthly meetings to be sure to accomplish their budget targets. When they had managed to achieve those targets they were ordered to be sure to accomplish newly raised targets. In this way presidents of companies were under strong pressure to be sure to accomplish the imposed targets on the pretext of 'challenge'. Such 'challenges' were requested at monthly meetings, in the presence of the President, even at the times when only a few days remained till the end of quarters. It was difficult to take measures to achieve a significant amount of profit within the short period of time remaining till the end of the quarter, even

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<sup>11</sup> The Masking Price was four to eight times Toshiba's original procurement price. Toshiba recorded the Masking Difference for these transactions as an account receivable from TTI and recorded profits by deducting costs of manufactured goods.

making maximum business efforts. Presidents of companies were driven into the situation, in which they had to use inappropriate methods of Channel Stuffing of ODM Parts in order to overstate profits as the only way available to them to achieve the Challenge.

## **2.5. Internal Control in Sections of Toshiba**

### **2.5.1. Financial Section**

In account settlement this section only did put each company's account settlement into a consolidated settlement of accounts and did not check whether each company's accounting practice was suitable. On the contrary, the financial section drafted original plans for 'challenges' at monthly meetings in the presence of President. Moreover, in the current profit supremacy circumstances, it was involved in imposing pressure on each company to be sure to accomplish their targets. What's more in some cases financial managers were aware of the fact that improper accounting practices were being implemented, but did nothing to point it out and correct the problems.

### **2.5.2. Managerial Inspection Section**

As the Managerial Inspection Section was directly controlled by the President of Toshiba Corporation, it could not make any necessary comments about the matters which were contrary to the President's intention. As a consequence, the function of internal control (function of supervision) by the Board of Directors did not work. According to the rules of the Board of Directors, presidents of companies and President of the head office, should report 'performance and situation' during the managing board meetings held for the quarterly account settlement. However, in spite of the fact that there were matters which at the time of the order were expected to incur, and in reality incurred, a loss of tens of billion yen, the investigation committee could not find any evidence that some reports were made on the losses from these crucial matters at the managing board.

### **2.5.3. Internal control function (audit function) of the Audit Committee**

According to the Companies Act (revised in 2014) Toshiba has implemented the Three Committees Model of Business. It turned out, that in the audit committee there was only one full-time member who was in charge of inspection of finance and accounting. Among outside members of the committee nobody had enough expertise in finance and accounting. During the period when improper accounting practices were used, the full-time member of the committee in charge of finance and accounting was an experienced CFO, and it was one of the reasons, why the improper accounting practices could not be detected.

## **2.6. Audit by the accounting auditor**

The control performed by the outside auditor was not sufficient. One of the reasons for this was the intentional manipulation of accounting practices within the company. For example, methods not easy for the accounting auditor to investigate were used, and when the auditing corporation made inquiries and requested materials, the facts were concealed or explained by showing documents, which made up stories different from the truth.

It was very difficult for the outside auditor to verify estimates based on intra-company data prepared by the specialists who were professional accountants. For example, accounting practices based on the criteria of construction progress, were very difficult to be independently evaluated, especially with respect to the reasonableness of the estimates.

The internal control cannot function effectively without the will of the top management to make it work effectively and be supported by related organizations. It was quite difficult for the independent auditor to obtain strong evidence which could overthrow the concealment of facts and making up of stories different from facts.

We would like to add that the Independent Investigation Committee limited its mission as follows: "The purpose of this investigation was to inquire into the fact including the contents, causes, background, etc. about Toshiba's improper accounting practices, and it did not aim at evaluation of the validity of the audit by the auditing corporation which should express its opinion on the financial statements as whole, in other words, it did not aim at examination of whether or not its auditing procedure and its auditing judgement had any problems"<sup>12</sup>.

After having fallen into deficit at the accounting settlement of FY 2015, Toshiba Corporation implemented workforce reduction of 10,000 employees. Toshiba sold the home appliances company and the medical equipment company.

## **3. Launching Nuclear Power Plant Business**

The reason why Toshiba concentrated on nuclear power plant business is that it did 'selection and concentration' of business after recording net loss of 254 billion yen in its account settlement in March 2001 due to the Internet bubble (dot-com bubble). Toshiba's top management decided that social

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<sup>12</sup> Professor Emeritus Katsuhiko Matsumura at Ritsumeikan University (2017) makes an in-depth analysis (in Japanese) of Toshiba's illegal accounting and points out the limit of the above-mentioned report by the Independent Investigation Committee. He says that there were three points that were omitted in the Report: 1. Fierce rivalry between Mr. Nishida and Mr. Sasaki; 2. Financial health of Toshiba's subsidiary Westinghouse; 3. Responsibility of Shin Nihon Kansa Hojin (New Japan Audit Corporation), which audited Toshiba's account settlement [Matsumura, 2017, p. 6].

infrastructure business, especially medical care and nuclear power plant business, should be the important pillars of its business.

WH was a famous American company in the area of electric machinery. It was acquired by Viacom, a US media conglomerate, in 1999 and became its subsidiary with another name. WH's department of nuclear power plant business inherited the name of WH from its previous parent company. The new WH was sold to BNFL, a British company in nuclear fuel, for US\$ 1.2 billion (estimate). Recklessly enough, Toshiba acquired WH in 2006. According to Asahi Shimbun (March 10, 2017), the bid for WH was in a fierce competition. The competing company was Mitsubishi Heavy Industries, Ltd., which had a partnership with WH. Although a person in charge of negotiations feared that recovery of investment funds would be impossible, President Nishida was aggressive and decided to acquire WH even at a higher price. Its price had soared from 200 to 600 billion yen. Toshiba won a bid for WH with US\$ 5.4 billion, which meant over four times the purchase price when BNFL acquired it.

It is the Japanese Ministry of Economy and Industry (METI) that was behind this scramble. "It persistently repeated 'buy, buy' to Japanese companies", said a person in charge of the negotiations. The Agency for Natural Resources and Energy (an organization affiliated to the METI) decided '*Plan for Nuclear Energy-based Country*' in August 2006 and set a target of promoting export of nuclear power plants by joint efforts of the government and the private sector. Later, this policy became one of the development strategies of Japan as 'a package type of infrastructure export' in which manufacturers sell power plants in cooperation with power companies ["Asahi Shimbun", March 10, 2017].

At that time, as an expression '*Renaissance of Nuclear Energy*' showed, nuclear power plants were again highly praised as countermeasures against global warming and a tight supply-demand situation for energy. Several countries resumed construction of nuclear power plants. Also the USA, where a new construction had been completely stopped since the Three Mile Island accident in 1979, resumed construction of new plants. WH, which became a subsidiary of Toshiba, accepted orders for construction of 10 nuclear power plants in total in China and the USA from 2007. Toshiba decided a mid-term plan in August 2009. President Nishida declared an ambitious target of 33 nuclear power plants by 2015 ["Asahi Shimbun", March 10, 2017].

On March 11, 2011 suddenly the Great East Japan Earthquake and Tsunami occurred, causing the nuclear accident at Fukushima Daiichi Nuclear Power Plant complex. This had drastically changed the environment for Toshiba. In the USA authorities requested power companies to make design

changes and take additional safety measures for nuclear power plants in order to respond to a possible aircraft crash. Strengthened safety regulations and increased construction costs caused a delay in construction of nuclear power plants. A lawsuit battle began between WH and a construction company over the problem of which should bear the additional cost for the construction of 4 power plants which WH dealt with in the USA. As WH was afraid that the trouble might come to the surface, it acquired this construction company in October 2015. This acquisition brought a fatal result to Toshiba, which was obliged to appropriate a loss of over 700 billion yen at the end of FY 2015. Toshiba Corporation, as its parent company, gave WH debt guarantee of about 800 billion yen. There was a possibility that Toshiba's loss would increase to a trillion yen due to WH's filing for bankruptcy. In spite of such a delicate situation, at a briefing session held in Japan in November 2015, Toshiba aggressively announced a plan aiming to order acceptance of 64 nuclear power plants in the coming 15 years, while concealing that its nuclear power plant business may incur a loss.

In 2017, however, Toshiba finally decided to withdraw from its overseas projects by the sale of part of its stake in WH. In order to shutdown risk in the overseas nuclear energy business, it aimed to exclude WH from its list of consolidated subsidiaries by decreasing its stake in WH from 87% to less than 50%. WH filed for Chapter 11 of the U.S. Code – Bankruptcy on March 29, 2017.

Toshiba's equity capital was over a trillion yen as of the end of March 2015, when the problem of illegal accounting had not yet been revealed, but it had decreased to about 360 billion yen at the end of September 2016. As of the end of March 2017 liabilities exceeded its assets by 650 billion yen. This was the first excess of debts at the end of term since 1962 when the consolidated settlement of accounts began to be disclosed ["Asahi Shimbun", April 1, 2017]. This miserable situation forced Toshiba's top management to decide to overcome the excess of debts by selling the semiconductor business. 'Toshiba Memory' company had a Yokkaichi factory where 5,800 employees were working, and its main product 'flash memory' had been the best earner in Toshiba. Nevertheless, in order to overcome the excess of debts this excellent company was going to be separated from Toshiba. Top management of Toshiba was expecting to obtain profit on a sale of over a trillion yen.

In March 2017 Toshiba was scheduled to disclose its financial accounts report, but it was obliged to postpone the disclosure two times. At last on April 17, 2017 Toshiba disclosed its financial accounts report, but this time it was disclosed without any opinion (a kind of guarantee) of PWC, an auditing corporation which had been in charge of Toshiba by a contract.

This was an unprecedented situation. The top management had been strongly criticized, and 11 trust banks were filing lawsuits for damages against Toshiba.

The business value of “Toshiba Memory” was estimated 2 trillion yen. Purchase of more than half of this amount was a condition for entry into the open bid. It was not easy for a company alone to prepare necessary funds, therefore there was a possibility that multiple companies will cooperate for this. More than 10 companies, including overseas major semiconductor manufactures and investment funds, were interested in it. A leader of the Japanese business community expressed concerns saying, “it would be a serious problem that technology and talented people, the nucleus of Japan, would flow out of the country” (Mr. Sadayuki Sakakibara, the chairperson of the Japan Business Federation, at a press conference in March 2017) [“Asahi Shimbun”, April 17, 2017]. The Japanese Government was also afraid of an outflow of technology and was prepared to request Toshiba to stop the sale of the semiconductor business depending on whom it was to be sold.

However, in September 2017, Toshiba Corporation made a contract on selling Toshiba Memory, its subsidiary earning 90% of the total operational profit, with a corporate alliance [syndicate] of Japan, USA and South Korea with Bain Capital, a US investment fund, as a leader. Then the contract had been under screening by competition authorities of related countries. Originally Toshiba Corporation planned to finish the transfer by the end of March 2018, but the transfer was delayed because Toshiba Corporation could not get approval by the Chinese competition authorities. The Chinese authorities finally approved the transaction on 17 of May, and Toshiba Memory was sold on June 1, 2018 for two trillion yen in total as planned.

Also, Toshiba Corporation succeeded in its capital increase in December 2017 and it became able to solve the excess of debts problem. Thus, the financial situation of Toshiba Corporation has completely changed. The profit on sale is currently about a trillion yen. It is forecasted that the shareholders’ capital will be 1.87 trillion yen and its proportion will rapidly increase to 40% as of the end of March 2019.

## **Conclusions**

The Investigation Report prepared by the Independent Investigation Committee (Third-Party Committee) created by Toshiba presents information concerning the kinds of malfeasance, time, reasons and methods of their commitment, as well as persons responsible for breaking the laws and regulations. It may be said that, the document prepared by the outside,

independent specialists, enabled working out a rescue plan for the corporation. At a press conference President Tsunakawa said that the poor situation of Toshiba was caused by problems in communication and governance. Mr. Hiroshi Ando, President of the company New Horizon Capital which had dealt with rehabilitation of many companies, explained Toshiba's problem as follows. "As Toshiba Corporation organized the nomination committee and actively appointed outside directors earlier than many other companies, it has been in appearance an honor student in corporate governance. In reality, however, it was different. Retired Presidents had often been involved in the process of selecting new President. There were widespread 'challenges' in which bosses requested their subordinates to accomplish unattainable targets. It is necessary for Toshiba to change its corporate culture in which subordinates cannot express their frank opinions to their bosses" ["Asahi Shimbun", May 3, 2017]. Similar views could be heard.

The problems of Toshiba were also connected with bad management and lack of prudence. It was the consequence of a weak board, bad structure of it, and lack of adequate competences of its members, who were mostly dependent directors. Toshiba's top management had lacked a long-term vision for a transformation of industrial structure in the world economy, i.e. a transformation from nuclear energy to clean and renewable energy. Therefore, they easily followed the recommendations of the Japanese Government's METI. If they had a sound vision for the future they would not have followed such a recommendation. The weak supervision and internal control should be mentioned among the factors responsible for the financial distress of Toshiba and deteriorating the quality of corporate governance<sup>13</sup>. Toshiba was accused of derogating good practices of corporate governance and also its Code of Conduct that served the interests of stakeholders and required sound and ethical business activities.

The tendencies pointed out by Mr. Ando are often found in many, albeit not all, companies, public offices and other organizations. According to the Japanese corporate culture, an important determinant of corporate governance, 'employees cannot act contrary to the intent of superiors. Vertically-structured society, which has been historically inherited from old times to the present Japan [Nakane, 1970] will not change soon, but the younger generations are required to change it. In addition

<sup>13</sup> Mr. Nobuaki Kurumadani aged 60, following the request of the nomination committee, took office of chairman of the board of directors and CEO of Toshiba Corporation in April 1, 2018. He had served as vice president of Mitsui Sumitomo Bank and chairman of CVC Capital Partners, a British Investment Fund. It was also decided that Mr. Tsunakawa remained in office as President and COO, Mr. Kurumadani was responsible for medium and long-term managerial strategies and Mr. Tsunakawa was responsible for business operation.

to the old-fashioned corporate culture and traditions mentioned above, illegal accounting, which might jeopardize the continuation of the Corporation, can be viewed as a consequence of market pressure and profit supremacy in the world economy, where neoliberalism has become the mainstream. That orientation may depict the cultural changes that have taken place in Japan since the end of the WW II. It is possible to formulate a general conclusion, that the malfeasances in Toshiba may stem from lack of experience (understanding) in mixing the traditional Japanese corporate culture with the Internal Americanization taking place lately in the business environment in Japan.

It should be underlined that the analysis and the conclusions formulated by the Third Party Committee proved to be very credible and fair, and helped Toshiba to restore its good financial health. As it was mentioned above, the company received antitrust clearance from China in May 2018 for the \$18bn sale of its memory chip business to Bain Capital. According to the Financial Times, this gives “the green light to one of the biggest private equity deals since the global financial crisis” [Financial Times, 2018].

Finally, we would like to note that Japan constantly, and even revolutionary since 2014, improves its corporate governance by updating the hard and soft laws, and introducing new ones, orientated towards American regulations.

The Toshiba scandal has played a crucial role in inducing the preparation of new regulations and amendments of the ones currently being in force. The change of the Companies Act 2014 caused the necessity of updating the two very important documents creating regulatory framework, i.e. 2015 Financial Instruments and Exchange Act, and Japanese Corporate Governance Code (1.06. 2015). In July 2015 Japanese Ministry of Economy, Trade and Industry (METI) issued guidance for companies on complying with Japanese and other foreign anti-bribery laws, which were supplemented by the “Guidance” worked out by Japan Federation of Bar Associations (JFBA). They clarify certain aspects of Japan’s foreign anti-bribery laws, as well as guidance on foreign risk management issued by the Small and Medium Enterprise Agency [Hough, Yakura, 2016]. The JFBA Guidance takes into account *Japan’s Unfair Competition Prevention Act (UCPA)* and foreign bribery laws such as the *United States’ Foreign Corrupt Practices Act (FCPA)* as well as *United Kingdom’s Bribery Act 2010 (UKBA)*. In February 2014, the FSA released Japan’s Stewardship Code. It is modeled upon the U.K. Stewardship Code, and follows a “comply or explain” approach. The Act concerning whistleblowers (2004) should not be forgotten as well.

We would like to add that Toshiba’s malfeasances have urged JPX (Japan Exchange Group including Tokyo Stock Exchange, Osaka Stock Exchange,



etc.) to work out and release a document the Principles for Listed Companies Dealing with Corporate Malfeasance in 2016. It sets out four broad principles – 1. Ascertain Fundamental Cause of Malfeasance. 2. Establish Independent Neutral and Expert Third-Party Investigation Committee. 3. Promptly Implement Effective Remedial Measures. 4. Prompt and Appropriate Information Disclosure. As Shiozaki, Coney and Suzuki (2016) say, “the Principles appear to be the first example of a national stock exchange setting out specific guidelines on how a corporation should behave when faced with a corporate scandal”, and will be very useful in promoting high quality corporate governance in Japan.

Thus, the weaknesses of corporate governance were responsible for the very poor state of the Toshiba Corporation, but improvement of its quality is enabling rescuing the company.

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## Summary

The aim of the paper is to show how weaknesses in corporate governance, corporate culture and communication led Toshiba Corporation to commit accounting fraud and led the company into financial distress. The Investigation Report prepared by Toshiba’s Independent Investigation Committee reveals the kinds of malfeasances, the methods used, the reasons for their use, and persons responsible for them. This document enabled the working out of a rescue plan for the company.

The Toshiba scandal played a crucial role in the introduction of new regulations, and amendments to the ones in force, oriented towards improving the quality of corporate governance in Japan. The most important of them were mentioned, among them, the document (the first in the world) entitled Principles for Listed Companies Dealing with Corporate Malfeasance (JPX, 2016). It contains best practices that Japanese public companies must follow when investigating suspected cases of corporate misconduct.

The analysis and the conclusions included in the document helped Toshiba to solve its problems, and restore good financial health.

## Keywords

regulations, corporate governance, malfeasances, Toshiba