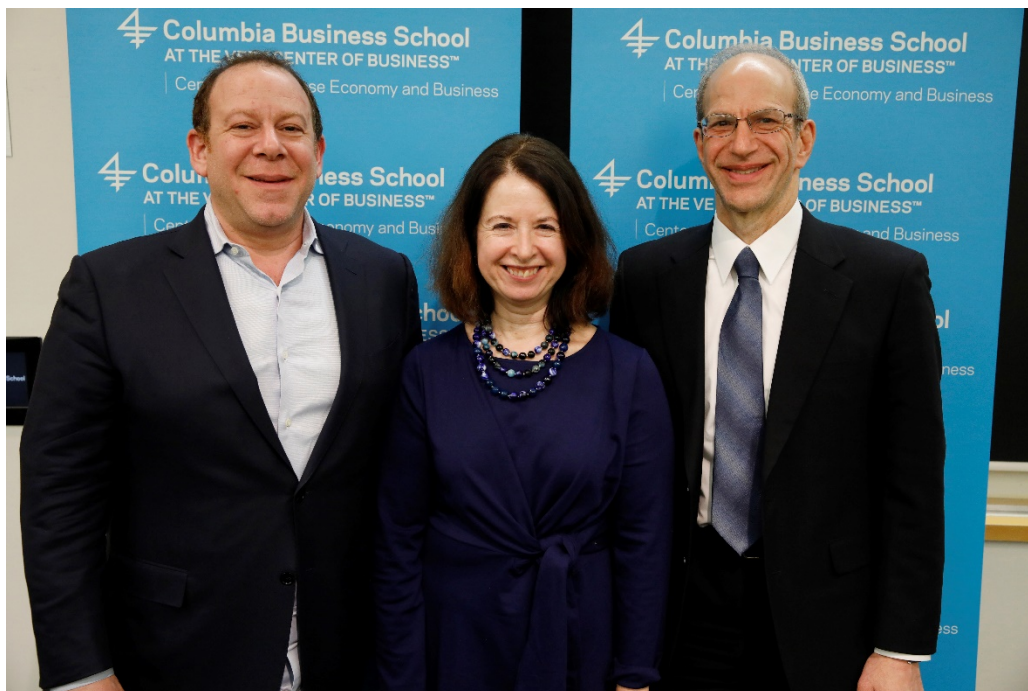


A Tale of Two Systems: What Went Wrong at Toshiba and Wells Fargo

Thursday, March 22, 2018



Featured Speakers:

Bruce Aronson – Professor, Business Law Department of Hitotsubashi University

Shane Goodwin – Senior Fellow and Project Director, Richard Paul Richman Center for Business, Law, and Public Policy at Columbia University; Former Managing Director, Investment Banking (Southwest U.S. Division) at Wells Fargo

Josh Rosner – Managing Director, Graham Fisher & Co.



Alicia Ogawa

On Thursday, March 22, 2018, the Center on Japanese Economy and Business (CJEB) at Columbia Business School hosted a panel on corporate governance failures, with special attention placed on the cases of Toshiba in Japan and Wells Fargo in the United States. This event was part of the Project on Japanese Corporate Governance and Stewardship, an

initiative directed by Professor Alicia Ogawa, an adjunct associate professor at the School of International and Public Affairs. This project is rooted in the importance that Prime Minister of Japan Shinzo Abe has placed on corporate governance reform as a driving factor for revitalizing the Japanese economy. As Professor Ogawa noted in her opening remarks, Japanese firms have suffered from low stock valuations for many years. Essentially, the Abe administration aims to reform corporate governance practices to incentivize firms to take greater risks in order to benefit the Japanese economy.

The corporate governance landscape in Japan stands in contrast to corporate governance practices in the United States, where there is a need to reduce risk-taking and develop more robust regulation of corporations. This panel examined the cases of the Toshiba and Wells Fargo scandals related to corporate fraud in recent years, and the lessons that should be taken away when it comes to designing and implementing a healthy, productive corporate governance model that lies between the extreme cases of Japanese and American corporate governance.

Professor Ogawa first invited the panelists to share their perspectives on what they believed created the issues that led to the cases of massive corporate fraud at Toshiba and Wells Fargo. Shane Goodwin, Senior Fellow and Project Director of the Paul Richman Center for

Business, Law, and Public Policy at Columbia University, attributed the Wells Fargo scandal to the roots of Wells Fargo’s corporate culture. Mr. Goodwin observed that Wells Fargo’s initial business in retail banking and associated practices related to compensation for a retail banking structure led to the development of a sales-



Bruce Aronson

-driven corporate culture. The pressures stemming from this sales-driven culture led many Wells Fargo employees to take shortcuts to meet goals by illegally creating new customer accounts.

Bruce Aronson, professor of business law at Hitotsubashi University in Tokyo attributed the two major corporate governance scandals at Toshiba, which happened within 1.5 years of each other, to the overly aggressive goals of top management and the messages that employees conducting their day-to-day work were receiving from management. Due to the pressures created by management and its unattainable goals, employees falsified accounting and financial statement details for 8.5 years prior to the crisis surfacing. The amounts were \$1.2



Joshua Rosner

billion falsified in the first scandal and \$6.3 billion lost in the second scandal. Professor Aronson noted that Toshiba, similar to nearly all Japanese electronics companies, was facing very difficult competition in the market and needed to find additional areas in which to expand its business. The difficulties it faced likely caused leadership within

Toshiba to send certain messages that forced employees to make decisions about voicing any complaints, meeting goals, and engaging in fraudulent activities to preserve their jobs.

Professor Ogawa noted that difficulty in finding alternative employment in Japan may have also motivated employees to participate in fraud.

Mr. Josh Rosner,
Managing Director of Graham
Fisher & Co., an independent
research firm, also
underscored the importance
of the astounding pressures
created by sales targets at
Wells Fargo and motivational
mechanisms. Employees
received daily pressure to



report on progress made on targets and were required to explain any failures to meet targets. Moreover, Wells Fargo had a long history of firing whistleblowers, and employees were incentivized to cheat as opposed to voicing complaints in order to avoid losing their jobs. The conversation turned to factors that permitted the internal crises to develop for such an extended period of time before finally surfacing publicly and being addressed. Loyalty ties around board nomination and succession practices in both Japan and the United States were discussed. Extended tenure at firms was also highlighted as one reason for management crises.

Mr. Goodwin explained that poor management was inevitable given the emphasis Wells Fargo placed on “home-grown” employees and the preference for keeping employees for twenty to thirty years as opposed to reevaluating whether an employee was still the best person for the job at hand. Mr. Rosner also highlighted the credibility Wells Fargo received from repeated endorsements by Warren Buffett. Additionally, Professor Aronson and Professor Ogawa both discussed the adverse effects caused by the lack of transparency related to

investor voting for management plans in Japan. They were optimistic about new reforms that disclose which investors voted for which management plans as ways to improve corporate governance in Japan. The panelists also touched on the lack of investor activism, a practice that is less frequently observed likely due to the tremendous amount of effort and resources required by a single investor in order to be able to build a coalition and meet the legal requirements for effecting some type of change in corporate governance.

The panel then opened the floor for audience Q&A. The first question from the audience pertained to ways to cultivate “in-house activism” within corporations among employees, while the second question centered around whether low interest rates may have had any impact on lax corporate governance practices in the U.S. and Japan. Mr. Rosner observed that as both the U.S. and Japan have not had high interest rates since the 1970s, the corporate governance issues mostly appear to stem from cultural as opposed to regulatory factors.

The conversation then turned to the role of auditors in keeping corporations accountable. Mr. Rosner expressed his belief that reforms in auditing regulations would not alter the competitive landscape, which he views as the driver of aggressive



management targets and behavior. Professor Aronson mentioned that while there is a relatively strong system of external auditors, the tendency for external auditors to go along with information given to them by corporations is problematic and contributes to difficulties in uncovering auditing fraud. Mr. Goodwin pointed to the decentralized operating model of Wells Fargo as contributing to the difficulty in accountability and surfacing of issues. Professor Ogawa

also noted that many of the financial examiners have not worked at banks and, therefore, often are not able to independently assess whether there are issues based on the answers they receive to audit questions, which follow a script.



A question from the audience brought the conversation back to “in-house activism” and what employees and investors can do to identify and voice issues before they become crises. Another audience member asked why more severe measures, such as prosecution, are not taken against leaders who have sent the wrong messages to employees and have promoted adverse behaviors within their respective corporations. There are many structural barriers preventing or discouraging actors from all parts of a corporation (on the board, among investors, management, employees, and external auditors) from speaking up. However, Professor Ogawa and Professor Aronson concluded that best hope for improving corporate governance may be to have “activist managers,” that is, internal managers at firms who welcome the presence of external directors and expect the external directors to fulfill their role of pushing back on practices they believe may be harmful for the company, employees, and investors in the long run. Mr. Rosner expressed doubt regarding the extent to which CEOs would welcome such frequent challenges to their management approaches and plans.