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Organizational Structure of a Stock Company

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I. Introduction

This article provides an overview of the various types of organizational structures of a stock company ("*kabushiki kaisha*") established under the Companies Act of Japan (the "Act"), along with an examination of the duties of the organizations associated with each structure. Additionally, it outlines important factors to consider when selecting the most appropriate structure.

II. Organizational Structure under the Act

a. Types and duties of each organization

The types of organizations that can be established in Japanese stock companies and their respective duties are as shown in Chart A below. Each organization's roles and responsibilities are outlined, providing a high-level overview of the corporate governance framework within these companies.

【Chart A】Types and duties of each organization

Types	**Duties**
Shareholders Meeting / General Meeting of Class Shareholders	The Shareholders Meeting decides matters related to the organization and operation of the company, such as the election of officers.
Directors	The Directors represent the company on behalf of the Shareholders Meetings and execute the operations of the company. At a Company with a Board of Directors, the Representative Directors and Executive Directors take on the above role.
Board of Directors	Composed of three or more Directors. The Board of Directors performs the following duties: (i) deciding the execution of the operations of the Company with a Board of Directors; (ii) supervising the execution of the duties by Directors; and (iii) appointing and removing Representative Directors.
Accounting Advisors	The Accounting Advisors, together with the Directors, prepare the Financial Statements.
Company Auditors	The Company Auditors audit the execution of duties by Directors; provided, however, that in a company that is not a Public Company and does not have either a Board of Company Auditors or a Financial Auditor, it is possible to limit the scope of the audit conducted by the Corporate Auditor to accounting audits.
Board of Company Auditors	Composed of three or more Company Auditors. The Board of Company Auditors performs the following duties; (i) preparing audit reports;

	(ii) appointing and removing full-time Company Auditors; and (iii) deciding audit policy, methods for investigating the status of the operations and financial status of a Company with a Board of Company Auditors, and other matters regarding the execution of the duties of Company Auditors.
Financial Auditors	The Financial Auditors audit the Financial Statements.
Audit and Supervisory Committee	Composed of Audit and Supervisory Committee members who are elected separately from the other Directors. The Audit and Supervisory Committee audits the execution of duties of Directors.
Nominating Committee	One of the committees established in a Company with a Nominating Committee, etc. The Nominating Committee determines the contents of proposals regarding the election and dismissal of Directors to be submitted to a Shareholders Meeting.
Audit Committee	One of the committees established in a Company with a Nominating Committee, etc. The Audit Committee audits the execution of duties by Executive Officers, etc.
Compensation Committee	One of the committees established in a Company with a Nominating Committee, etc. The Compensation Committee determines the contents of the remunerations for individual Executive Officers, etc.
Executive Officers	The Executive Officers execute the operations of a Company with a Nominating Committee, etc.

b. Patterns of organizations

Under the Act, the only mandatory bodies are **the Shareholders Meeting and the Directors**. The requirement to establish additional bodies depends on (i) whether the company is private or public,[1] and (ii) whether it qualifies as a "Large Company" or not.[2] The specific organizational requirements vary based on the company's size and status.

An outline of these organizational requirements is shown in Chart B below. "Company with an Audit and Supervisory Committee" described in Chart B is a stock company in which the Audit and Supervisory Committee described in Chart A audits the execution of duties by the Directors and was introduced as a new organizational structure by the 2014 amendment to the Act. "Company with a Nominating Committee, etc." is a stock company with an organizational structure in which the three committees described in Chart A (Nominating Committee, Audit Committee and Compensation Committee) are established and the authority to execute the operations of a company is delegated to the Executive

[1] "Public Company" means any Stock Company the articles of incorporation of which do not require, as a feature of all or part of its shares, the approval of the Stock Company for the acquisition of such shares by transfer.

[2] "Large Company" means any Stock Company which satisfies any of the following requirements:
(a) that the amount of the stated capital in the balance sheet as of the end of its most recent business year is 500,000,000 yen or more; or
(b) that the total sum of the amounts in the liabilities section of the balance sheet as of the end of its most recent business year is 20,000,000,000 yen or more.

Officers.

【Chart B】The outline of the obligation to establish an organization

<table>
<tr><th rowspan="3"></th><th colspan="4">Company other than those with a Committee</th><th rowspan="3">Company with an Audit and Supervisory Committee</th><th rowspan="3">Company with a Nominating Committee, etc.</th></tr>
<tr><th colspan="2">Private Company</th><th colspan="2">Public Company</th></tr>
<tr><th>Non-Large Company</th><th>Large Company</th><th>Non-Large Company</th><th>Large Company</th></tr>
<tr><td>Shareholders Meeting[3]</td><td colspan="6">Required</td></tr>
<tr><td>Directors</td><td colspan="6">Required</td></tr>
<tr><td>Board of Directors</td><td colspan="2">Optional[4]</td><td colspan="4">Required</td></tr>
<tr><td>Accounting Advisors</td><td>Optional[5]</td><td colspan="5">Optional</td></tr>
<tr><td>Company Auditors</td><td>Optional[6]</td><td colspan="3">Required</td><td colspan="2">—</td></tr>
<tr><td>Board of Company Auditors</td><td colspan="3">Optional</td><td>Required</td><td colspan="2">—</td></tr>
<tr><td>Financial Auditors</td><td>Optional</td><td>Required</td><td>Optional</td><td colspan="3">Required</td></tr>
<tr><td>Audit and Supervisory Committee</td><td colspan="4">—</td><td>Required</td><td>—</td></tr>
<tr><td>Nominating Committee, etc.</td><td colspan="5">—</td><td>Required</td></tr>
<tr><td>Executive Officers</td><td colspan="5">—</td><td>Required</td></tr>
</table>

The pattern of organizational structure is as shown in Chart C below. This chart highlights the various options available for structuring a stock company under the Act, depending on factors such as company size and whether it is publicly or privately held. Chart C provides a clear overview of the potential organizational frameworks that stock companies may adopt based on their specific needs and legal obligations.

【Chart C】Patterns of organizational structure[7] [8]

	Private Company	**Public Company**
Non-Large	(1) Directors	(1) Board of Directors + Company Auditors

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[3] A Company with Class Shares is also required to establish a General Meeting of Class Shareholders.
[4] Required for Company with a Board of Company Auditors.
[5] Company with a Board of Directors is required to establish Accounting Advisors or Company Auditors. Usually, the latter is chosen.
[6] Required for Company with Financial Auditor(s).
[7] Establishing a Shareholders Meeting is mandatory in all cases.
[8] With the exception of case (4), at a Private Company and Non-Large Company, establishing Accounting Advisors is optional in all cases.

Company	(2) Directors + Company Auditors (3) Directors + Company Auditors + Financial Auditors (4) Board of Directors + Accounting Advisors (5) Board of Directors + Company Auditors (6) Board of Directors + Board of Company Auditors (7) Board of Directors + Company Auditors + Financial Auditors (8) Board of Directors + Board of Company Auditors + Financial Auditors (9) Board of Directors + Audit and Supervisory Committee + Financial Auditors (10) Board of Directors + Nominating Committee, etc. + Financial Auditors	(2) Board of Directors + Board of Company Auditors (3) Board of Directors + Company Auditors + Financial Auditors (4) Board of Directors + Board of Company Auditors + Financial Auditors (5) Board of Directors + Audit and Supervisory Committee + Financial Auditors (6) Board of Directors + Nominating Committee, etc. + Financial Auditors
Large Company	(1) Directors + Company Auditors + Financial Auditors (2) Board of Directors + Company Auditors + Financial Auditors (3) Board of Directors + Board of Company Auditors + Financial Auditors (4) Board of Directors + Audit and Supervisory Committee + Financial Auditors (5) Board of Directors + Nominating Committee, etc. + Financial Auditors	(1) Board of Directors + Board of Company Auditors + Financial Auditors (2) Board of Directors + Audit and Supervisory Committee + Financial Auditors (3) Board of Directors + Nominating Committee, etc. + Financial Auditors

c. Points to consider when deciding the organizational structure (Private Small and Medium-sized Companies)

This section describes the key points to consider in deciding the organizational structure for a Private Company and a Non-Large Company (hereinafter referred to as a "Private Small and Medium-sized Company"). As shown in Chart C, Private Small and Medium-sized Companies are only required to establish a Shareholders Meeting and Directors, while the establishment of other bodies is optional, allowing for a flexible organizational structure.

The main consideration in the organizational structure of Private Small and Medium-sized Companies is **whether or not to establish a Board of Directors and Company Auditors**. The advantages of having a Board of Directors and Company Auditors include increased management flexibility and appropriateness, stronger governance, and external credibility. On the other hand, the disadvantages include difficulty in securing personnel and increased costs.

For example, in the case where a Private Small and Medium-sized Company is established as a wholly owned subsidiary, even without a Board of Directors and Company Auditors, the parent company can make decisions as the sole shareholder, and thus management flexibility is not considered to be impaired. Also, the parent company can develop and operate a governance system for the entire group company as a whole to secure appropriateness. On the other hand, when a Private Small and Medium-sized Company is established as a joint venture with another company, it would be necessary to determine what kind of organizational structure should be adopted, taking into consideration the needs of the majority shareholders to establish a Board of Directors and nominate a majority of the Directors, and/or the needs of the minority shareholders to nominate a Company Auditor of the joint venture. The decision would be based on the needs of the majority shareholders for a Board of Directors and the minority shareholders for an Auditor of the joint venture company.

Thus, deciding the specific organizational structure requires specific consideration based on the shareholder composition, company size, and other factors.

III. Organizational Structure of Listed Companies

As shown in Chart C, Public Companies and Large Companies can choose from three types of organizational structures: a Company with a Board of Company Auditors, a Company with an Audit and Supervisory Committee, and a Company with a Nominating Committee, etc.

In addition to the Act, listed companies are also subject to the rules of the stock exchange, etc., so even if they do not fall under the category of a Large Company, they are still required to choose one of these three types of organizational structures.

As of September 2024, there are 3,827 listed companies on the Tokyo Stock Exchange that had submitted reports on corporate governance, of which 2,112 (55.2%) are Companies with a Board of Company Auditors, 1,620 (42.3%) are Companies with an Audit and Supervisory Committee, and 95 (2.5%) are

Companies with a Nominating Committee, etc.

In recent years, the general trend shows a steady decline in the percentage of companies choosing to adopt Companies with a Board of Company Auditors, while the percentage of those adopting Companies with an Audit and Supervisory Committee has been steadily rising each year. Unlike the Board of Company Auditors, the Audit and Supervisory Committee is composed of Directors appointed separately from other Directors. In addition to auditing the execution of duties of Directors, it may exercise a certain degree of supervisory authority over the Directors' appointment, dismissal and compensation. Based on this enhanced auditing and supervisory framework, the Board of Directors at a Company with an Audit and Supervisory Committee is allowed to delegate a wider range of authority to execute the operations of a company to the Directors than in a Company with a Board of Company Auditors. Therefore, in addition to the purpose of enhancing governance, companies with a need for delegation of authority are likely to choose a Company with an Audit and Supervisory Committee in order to increase management flexibility by delegating authority from the Board of Directors to the Directors. In addition, the revised Corporate Governance Code of Japan has increased the number of Outside Directors that should be appointed by listed companies. It is possible that listed Companies with a Board of Company Auditors changed their organizational structure to a Company with an Audit and Supervisory Committee and appointed an individual who had previously been an independent outside Company Auditor as an Audit and Supervisory Committee member who is also an independent outside Director, to meet the requirements of the Code.

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If you have any questions regarding the matters covered in this memorandum, please reach out to your usual TMI contact or the attorneys listed above.
