Guideline on Seven Actions for Management’s Full Utilization of Legal Function

November 19th, 2019
Ministry of Economy, Trade and Industry

1. Importance of Effectively Partnering with Legal Function

1) The top priority for the management is to “increase corporate value.” However, in recent years the business environment changes quickly. Sometimes businesses suddenly become obsolete and unprofitable. Therefore, an important challenge for the management is to “create businesses” providing new value to society and generating a new source of profit.

2) However, when considering how to “create businesses”, especially starting new businesses, there are always some legal risks involved.

   For this reason, some experts have some doubt that the management may have overlooked the current situation in which new businesses ideas are rejected immediately merely because there would be legal risks.

   In other words, there is a doubt in Japanese companies that merely pointing out the existence of potential legal risk may “excessively” hold off the creation of new businesses, without: (a) striking the best balance between the positive outcome/value realized by taking the risk; (b) adequately considering for alternative options and risk mitigation measures. Opportunity loss caused by “not making business opportunities happen” is very difficult to be assessed later in reality and in nature, therefore Japanese companies have been too much focusing on failures which may arise after taking risks.

   Regardless of the name of the Legal Department, anyone responsible for legal functions in a company may sit on the frontline to point out that legal risks existing in a business in some form. However, it is necessary not to simply stop there, but identify risk impact such as whether it would be a serious risk to be avoided undermining the corporate value loss, such as an acceptable risk that can reasonably be taken. Furthermore, they must overcome the legal risks and enable “business creation” by finding measures to eliminate or reduce legal risks.

   In other words, the executives and management can overcome legal risks, enable “business creation,” and “improve corporate value” by effectively partnering with “legal function.”

Examples of overcoming legal risk to succeed at business creation

○ DeNA Co., Ltd., Internet service company based in Tokyo, launched individual car sharing service business. Although this new service would be legally gray in terms of no precedents in Japan, DeNA achieved legal compliance in cooperation with the government, and navigated their business model to success, creating over 10 billion JPY in value.

○ Airbnb’s home-sharing business in Japan was legally gray under the Japanese Hotel Business Act. However, Airbnb successfully established its business by legalizing its business with the
Private Lodging Business Act in June 2018. The economic benefit of home sharing in Japan was calculated to total 221,990 million JPY by a 2016 corporate survey.

Examples of Japanese companies not adequately using their “legal function”
  Japan: Several times per week: 18.9%, Several times per month: 53.0%, Once per year: 26.1%
  USA: Every day/several times per week: approximately 70%

The Ministry of Economy, Trade and Industry (METI) published the “Report on the Legal Function of Japanese Companies” in April 2018. Since then, METI has continued its studies among the study group and conducted interviews with companies. However little progress has been made in corporate management with efforts to create new businesses and actively increase corporate value in the form of legal affairs integrated with the management, so called “management legal affairs.”

METI issued a report by the study group dated November 19, 2019, (subtitled “Focusing on approaches to legal functions and legal human resources required in the Reiwa Era”). In addition to that, METI proposes the following guidelines for stakeholders, mainly business owners.

2. Guidelines on Action for Company’s Executive/Management
1) Has a company’s executive/management fully supported the legal department to transform into an organization that contributes to “business creation” as well as created an environment in which the legal department can fully contribute?
   ○ Legal risk can arise at any stage in the process of planning, implementing, executing, and managing a business. The legal department should get involved at an early stage to eliminate or mitigate risks. Therefore, the legal department need to be involved in all scenarios across departmental boundaries, and collaborate with other departments. Is the management keeping the legal department to be an organization that is “only dedicated to reviewing completed contracts?”
   ○ Has a company’s executive/management been able to cultivate a corporate culture where it is assumed that the legal department will work across departments, and if necessary has the legal department been given a position to contribute to the work of other departments?
   ○ Is a company’s executive/management able to allocate and train human resources to have legal literacy in departments other than the legal department?

2) Has a company’s executive/management fully established a clear strategy on how to partner with legal function as a part of the entire company’s business strategy?
   ○ Has a company’s executive/management clarified the strategic position of legal functions in the company strategy and business strategy?
   ○ Has a company’s executive/management stated a clear policy to the legal department
regarding what they expect in terms of legal functions? (Whether it is supposed to only avoid risks, to support taking risks, or to build a business by the active use of the legal function to create new businesses and increase corporate value)

3) Has a company executive/management appoint (top-notched) talented personnel capable for “management legal affairs” as a part of the company’s executive/management team and as the head of the legal department?
○ Personnel responsible for “management legal affairs” need to be able to understand the function of legal affairs, and avoid serious corporate risk, while at the same time promoting business creation and making it legally possible to do business creation. Has the management inadvertently assigned a poorly qualified employee to be in charge of legal affairs on the management team or to be the head of the legal department?
○ Does a company’s executive/management have criteria for evaluating the qualities of the head of “management legal affairs?”

4) Has a company’s executive/management been communicating very closely with the head of the legal department?
○ Does a company’s executive/management have opportunities to consult regularly with the head of the legal department? Is there a trust relationship?
○ Does a company’s executive/management adequately communicate business strategy issues and the significance of business to the head of the legal department?
○ Does a company’s executive/management have the literacy to understand and evaluate remarks made by the head of the legal department?

5) Has a company’s the executive/management fully appreciated and evaluated outcomes as the creation of new businesses and improvement of corporate value added by “management legal affairs?”
○ Are effects on management and improvement of corporate value obtained by “management legal affairs” properly evaluated and reflected in HR evaluations and remuneration?
○ Considerable expertise is required in order to actively demonstrate legal functions. In order to properly evaluate the aptitude and performance of personnel responsible for legal functions within the company, it is not always adequate to see things from the perspective of the management and general human resources managers. Sometimes, it also necessary to have the perspective of people who have expertise in “management legal affairs.” Has the management given the head of the legal department adequate authority over human resources, assuming the head of the legal department has proper ability to make evaluations?
○ Does a company’s executive/management correctly evaluate the contribution to the business and creation of value made by the legal department, and allocate an adequate budget to the legal department?
6) Does a company’s executive/management make herself/himself to take responsibility for making smart business decisions, by taking smart legal risk to create business opportunities?
○ In the context of making business decisions, for a rational business decision, the overall balance between the value and the risk of a business is the authority and responsibility of the management. Based on sufficient information gathering and consideration, the management must not only avoid significant legal risk, but also take measures to overcome risk by eliminating or reducing risk, in order to properly achieve “business creation.” Is the management doing this?
○ Does a company’s executive/management require the legal department to make adequate consideration and explanation, and has this been fully incorporated into management decision?

7) Has a company’s executive/management established a company’s strategy regarding the recruitment and training of “legal talents with business acumen”?
○ Because “legal talents with business acumen” need to have expertise combining business and legal affairs, they need to have a strategic perspective for recruiting, training, and utilizing such personnel. Does the management have a strategic policy based on these traits?
○ “Legal talents with business acumen” are thought to have potential to be future business leaders. Does the management have a systematic and consistent program for training and utilizing leadership personnel with consideration for “legal talents with business acumen”?  

- 4 -