Corporate Governance Reform in Japan

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Popular perceptions

- Few outside directors
- Board independence in question
- Persisting corporate fraud and scandals
- Insufficient corporate disclosures
- Cross-shareholding structure

Some Improvements

- Duties of directors severely tested, leading to the appointment of more outside, independent members
- *Kansayakus*, non-voting board members and performing much of the roles of audit committees, are more outspoken and visual
- Preserving substantially low level of remuneration
- Structure of shareownership fast changing: overseas investors replacing domestic banks
- Well-designed and versatile disclosures on corporate governance using XBRL taxonomy

Drive to accelerate changes

- Influence from Overseas
  - Intensive discussions on corporate governance
  - Active institutional investors
- Lessons from accounting frauds and wrongdoing
  - Kanebo, Seibu, Olympus
  - Classic corporate crimes such as payments to racketeers or corruption are decreasing
- From participation by general public
  - As ultimate owners of companies
  - As taxpayers

Japan Revival Vision by LDP

(May 2014)

1. Japan Revival through Strong, Sound Companies
2. Public Asset Management Reform to Enhance Prosperity
3. Strengthening Human Capacity
4. Bold Financial Reform for Japanese Revival
5. Becoming a Number One Country for Entrepreneurship
6. Promotion of Involvement by Active Women
7. Achievement of Growth in Local Economies

New initiatives led by the government

- Company Law Review (MoJ, May 2015)
- Stewardship Code (FSA, Spring 2014)
- Corporate Governance Code (FSA, Spring 2015)
- Effective communication between companies and investors (METI, Spring 2015)
- Effective Board conducts (METI, Spring 2015)

“*Seme no*”「攻めの」Governance

- ‘Growth-oriented Governance’ for seeking higher performance and sustainable growth

- Achieving effective Board practices
  - Advisory role of outside directors
  - Clarify supervisory and executive functions
  - Assisting outside directors (D&O cover, supporting staff)

- Encouraging institutional shareholders to behave responsibly
  - Application of measures showing capital efficiency and yield (Return on Equity)
  - Dialogue (engagement activities) with investee

How different, from previous discussions

- Board structure
  - Companies reluctant to appoint outside directors will from now required by law to explain their reason.
- Strict test on independence
  - More difficult to appoint outside directors from major shareholders or with business relationship
- Capital efficiency

- How investors apply in practice
- Institutional investors

Two models of corporate governance (1)

- Rhineland Model, including Japan (Hierarchy Conscious)
  - Higher ratio of affiliated shareholders
  - Many stakeholders, including shareholders are loyal to organization and its hierarchy
  - Existing relationships rather than competition in the market
  - Duties of directors focus on the avoidance of conflicts of interest, while business judgment rule are ambiguous
  - Motivation of managers proportional to position within organization rather than compensation
  - Low mobility of employees, wage level fixed within organization
  - Entry into new markets through internal planning and development

Two models of corporate governance (2)

- Anglo-Saxon Model (Market Conscious)
  - Intuitional investors represent dominant shareholders
  - Nexus of contracts, shareholders are mere residual owners
  - Market price determines the contracts with stakeholders
  - Duties of director determined by equity and fiduciary obligations, and judgment rule prevails
  - Motivation of managers proportional to compensations rather than position within organization
  - High mobility of employees, wage level determined in the labor market
  - Entry into new markets through external mergers and acquisitions

New issues on corporate governance

- Business corporation within democratic society
  - One share one vote (NOT one head one vote). Limited liability on shareholders. In return for the advantages business corporations enjoy, they are made to implement proper check and balance
- Discipline required for companies grown very big
  - Banking crises, big oil split and accident at nuclear stations indicate the damages by huge business corporations cannot be compensated by shareholders whose liabilities are limited.
  - Irresponsible behavior by large corporation and institutional investors cost taxpayers
- Government involvement in corporate governance
  - How should taxpayers and government involve in corporate governance issues, including excessive pay and damages
  - Institutional investors with many taxpayers as ultimate owners need to be aware of their responsibilities in the society

Will there be some changes

- Code of best practice: will it be accepted as a principle or will it be regarded as another set of law

- Will it encourage companies or investors not being able to meet market and social expectation, to leave quietly

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