# A New Japan: the Changing Corporate Governance Regime

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# What is Corporate governance, anyway?

- The balancing of interests of many stakeholders:
  - Shareholders
  - creditors
  - Management
  - Workers
  - Customers
  - Suppliers
  - Banks
  - Government
  - The community

# Which are the 3 most important stakeholders?

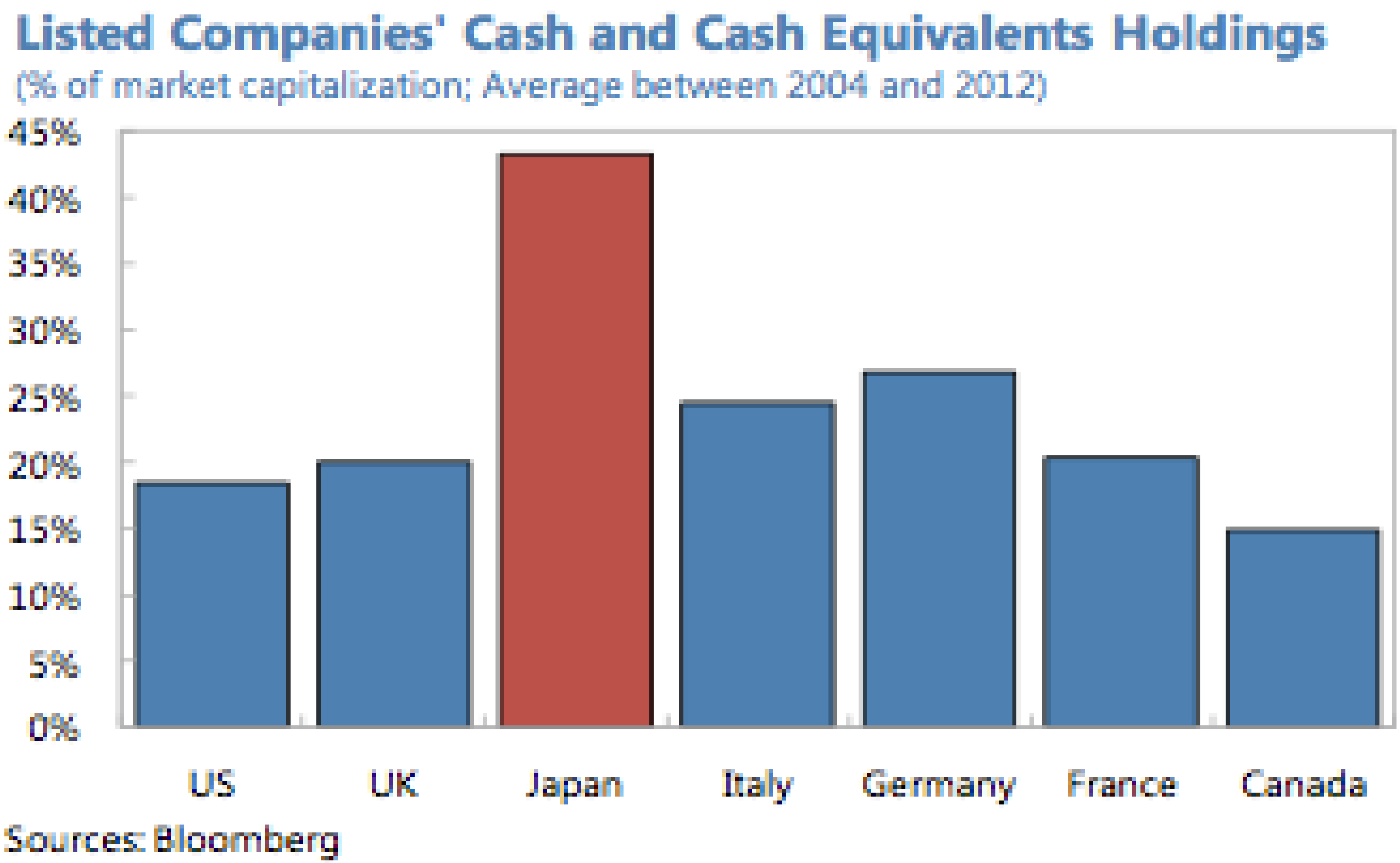
- Customers 90%
- Employees 62%
- Suppliers 30%
- Individual shareholders 29%
- Domestic institutional shareholders 21%
- Foreign shareholders 8%
- Banks 11%

- Source: METI IR Survey, 2013

# Why is Japanese Corporate Governance a Problem?

- Low profitability, low returns to investors
- Low productivity, decline of competitiveness of workforce
- High cash balances: a drag on investment and on aggregate demand
- Bad governance creates opportunities for fraud, inhibits dynamism, innovation, risk-taking
- Misallocation of resources (no consolidation)
- Barrier to inward FDI

# Why is Japanese Corporate Governance a Problem?



# The Abe Administration’s main goals of stronger corporate governance

- Encourage companies to spend cash balances, increase investment
- Raise wages to help exit deflation
- Increase diversity of the workforce
- increase full-time/permanent jobs
- Support higher stock prices
- GPIF reform to support stock prices, reduce portfolio risk

# What can be done/is being done to improve governance?

- New Corporate Governance Code & TSE requirements for outside directors
- Revisions to the Company Act
- New JPX 400 index
- Stewardship Code
- Revision of Corporate Tax Code
- Reform of Government Pension Investment Fund

# Company Act: Types of Corporate Organization

- Companies with Committees (US-style)
- Companies with Board of Statutory Auditors ("kansayaku")
- New category : Company with audit/supervisory committee
- New definition of "independent director"

# Corporate Governance Code/Stewardship Code

- “comply or explain”
- Stewardship code requires of investors:
  - Active dialogue with management of invested companies
  - Disclosure of conflicts of interest
  - Transparency of voting policy

# Benefits of improved governance

- More disciplined allocation of resources
- Consolidation and rationalization of companies
- Rise of the professional CEO
- Shift to a merit-based system of pay/hiring
- Increase of global competitiveness
- Decline in the power of the mega-banks
- Rise of a professional fund manager class in Japan
- More adversarial corporate/government relationship?

# Costs of Improved governance, need for policy response?

- increase of income inequality
- Reduction in job stability
- Faster shift of resources outside of Japan
- Downward pressure on wages
- Reduction in level of customer service
- Increase in bankruptcies
- Decline in loyalty to the employer
- Institutional Investors will dominate the markets

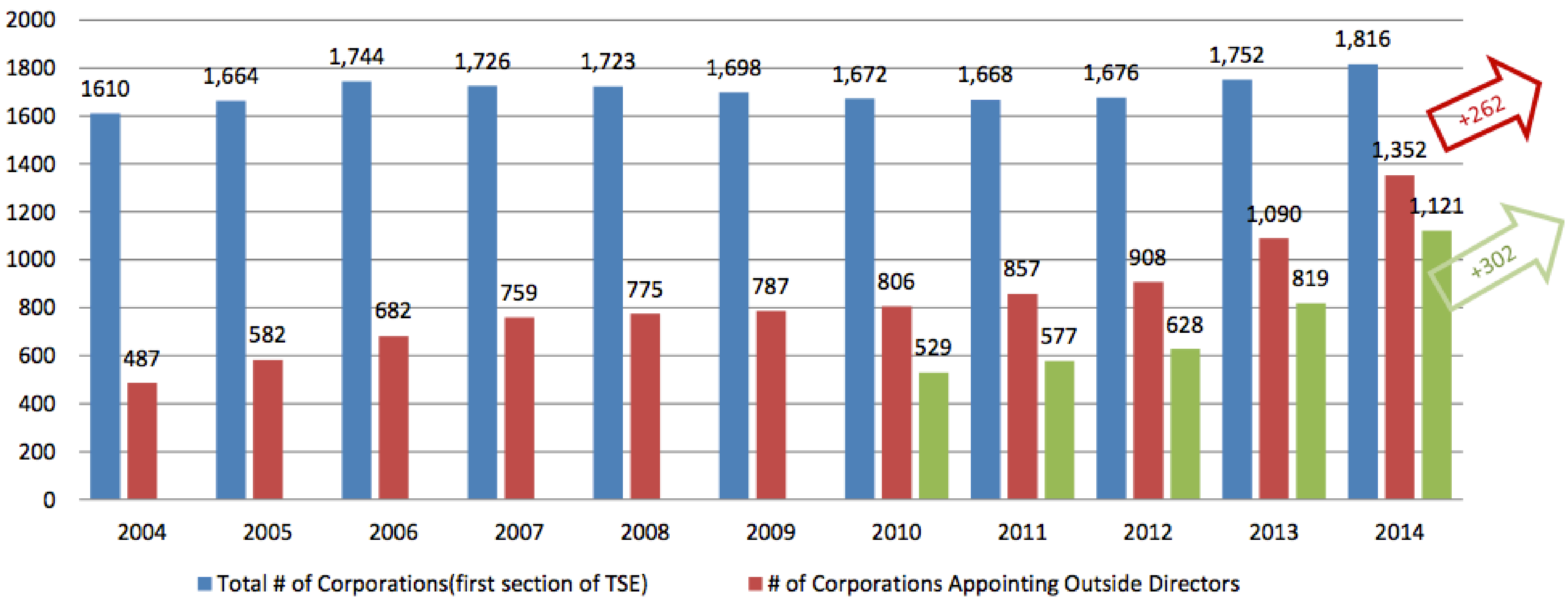
# Countervailing Currents

- GPIF Reform
- Government paternalism
- Corporate IR/competence and tenure
- Short life of US yen equity managers (2-3 yrs)
- Timing of Shareholder meesings
- Takeover rules/bankruptcy (Prepackaged) and legal (discovery)
- Boards: pay, language, offsites
- “Comply or explain”

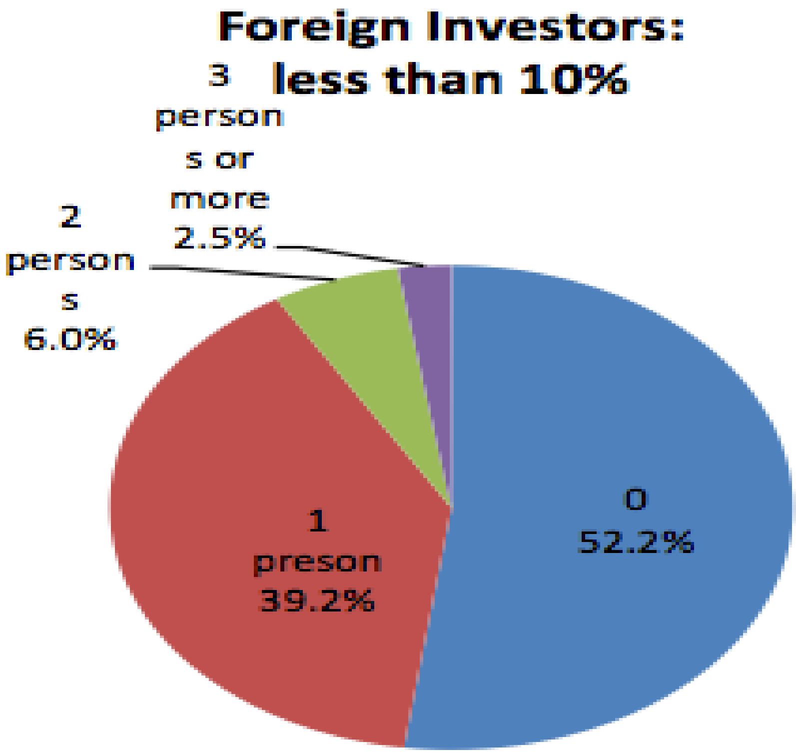
# Conclusions/Early reactions

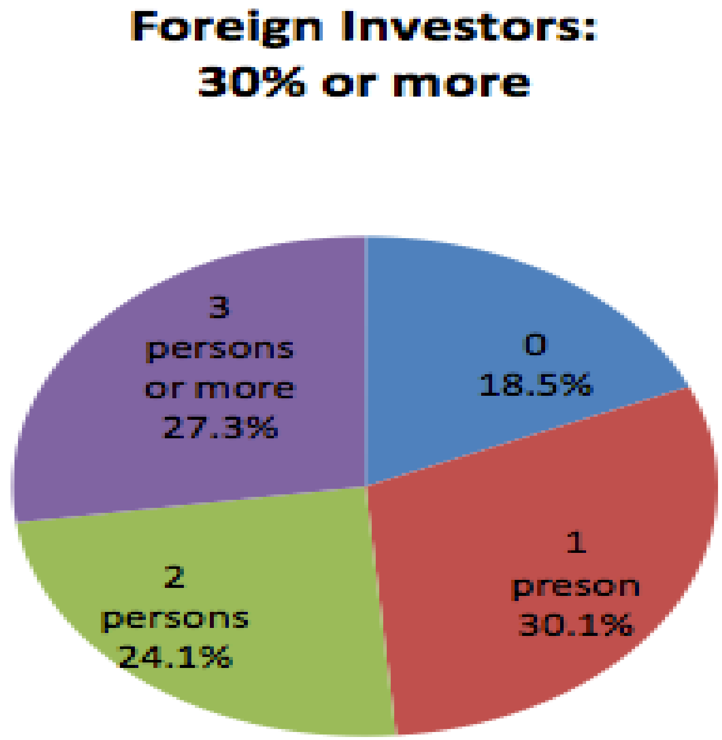
- More than 100 companies have signed the Stewardship code, including GPIF
- Fanuc
- Kagu
- Resistance to buybacks
- First female Keidanren executive
- Impact of GPIF/BoJ?

# Percentage of Corporations Appointing Independent Directors, TSE-1



# Foreigners pressure for more outside directors



# Why is Japanese Corporate Governance a Problem?

Table 1. Number of Bankruptcy Procedures in Selected Countries (2003−12)

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|---|---|---|
| United States (Chapter 11) | 9,762 | 10,882 | 6,250 | 5,701 | 4,688 | 6,274 | 10,348 | 13,583 | 11,093 | 9,616 |
| Germany (Insolvenzordnung) | 23,061 | 23,898 | 23,247 | 23,291 | 20,491 | 21,359 | 24,301 | 23,482 | 23,586 | n.a. |
| Japan (Reorganization) | 856 | 551 | 592 | 536 | 601 | 906 | 716 | 529 | 519 | 420 |

Source: Kinoshita (2014)