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Asian Corporate Governance Association (ACGA)

"Corporate Governance Reform in Japan: A Comparative Analysis"

Presentation by

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Agenda

1. Causes of global investor concern on Japan
2. Benchmarking Japan
3. ACGA White Paper on Japan (2008)
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5. Japan in 2010
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Origins of ACGA

- Formed post-Asian financial crisis in 1999 to bring an independent perspective on corporate governance reform in Asia, raise awareness of the positive benefits of governance, and assist with implementation.
  - Independent research, commentary and analysis of 11 major Asian countries and markets.
  - Focus on how governance can benefit companies and investors. It is not just compliance!
  - Work with regulators where appropriate.
  - Later, we added "advocacy " to the mix: engagement with regulators and companies, working with investors.

Funding of ACGA

- **1999:** One founding sponsor (a private equity fund) that put in seed funding and then helped to incubate the organisation.
- **2001:** Three more "founding sponsors" brought in.
- **2002:** Corporate membership drive started.
- **2010:** More than 80 corporate members
  - Two thirds based in Asia-Pacific and one third in Europe and North America.
  - AUM of US$10 trillion among global investor members.
  - Multilateral banks: ADB and IFC
  - Leading listed companies, law and accounting firms.
  - Two universities

1. Causes of global investor concern on Japan

- Despite perception that foreigners are obsessed about independent boards and independent directors, the catalysts for much of the early concern were more basic:
  - Low dividends relative to other developed markets
  - Inability to talk to management teams
  - Low standards for annual shareholder meetings (eg, final agendas released only 14 days before)
  - Limited translation of agendas
  - No proper counting and publication of voting results
  - The use of cross-shareholdings and friendly equity stakes to protect incumbent management and obstruct mergers & acquisitions and shareholder proposals

ACGA Asian Proxy Voting Survey 2006:
Market rankings and scores

	Score (%)	Qualitative assessment
1. Hong Kong (SEHK)	67	Fair
2. Singapore (SGX)	61	Fair
3. Malaysia (BM)	58	Poor to Fair
4. India (BSE/NSE)	57	Poor to Fair
5. Philippines (PSE)	56	Poor to Fair
6. Thailand (SET)	54	Poor to Fair
7. Indonesia (JSX)	53	Poor to Fair
8. Korea (KRX)	51	Poor to Fair
9. Taiwan (TSEC)	50	Poor
10. Japan (TSE)	47	Poor
China (SSE/SZSE)	47	Poor
Benchmark markets		
1. US (NYSE/NASDAQ)	79	Fair to Good
2. UK (LSE)	77	Fair to Good
3. Australia (ASX)	76	Fair to Good

Source: Asian Corporate Governance Association

Leading to some relevant questions

- Who is management accountable to?
- How do boards in Japan really work?
- If Japanese companies respect their stakeholders, why do they disregard their shareholders (an important stakeholder group)?
- Is hoarding cash good for companies, the capital markets and the national economy?

Why does this matter?

- **Economic stagnation:** Japanese companies have been making decisions that seem entirely rational to them, yet in aggregate are damaging for the financial markets.
- **A global member:** Japan is part of a global economic community; so dismissing global CG standards as a matter of principle, or for emotional reasons, is counterproductive.
- **Fairness:** Japanese public equity markets heavily reliant on foreign capital—hence foreign investors should have some rights to a "voice". Deny this and they will go away.
- **Cross-fertilisation of ideas**: Japanese companies and investors are welcomed abroad—and contribute to the vitality of foreign economies. Why shouldn't the reverse be true for Japan?

2. Benchmarking Japan:
ACGA – CLSA "CG Watch" Survey

Market	2004[1]	2005[2]	2007[3]
1. Hong Kong	67	69	67 ↓
2. Singapore	75	70 ↓	65 ↓
3. India	62	61 ↓	56 ↓
4. Taiwan	55	52 ↓	54
5. Japan	-	-	51
=6. Korea	58	50 ↓	49 ↓
=6. Malaysia	60	56 ↓	49 ↓
8. Thailand	53	50 ↓	47 ↓
9. China	48	44 ↓	45
10. Philippines	50	48 ↓	41 ↓
11. Indonesia	40	37 ↓	37

1. Introduced a detailed survey and scoring methodology in 2004.
2. Made the methodology more regorous in 2005.
3. Enhanced the methodology further in 2007. (No survey in 2006.)

Source: "CG Watch", a joint report by ACGA and CLSA Asia-Pacific Markets

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"CG Watch 2007" category scores (%)

Market	CG Rules	Enforcement	Political/ Regulatory	IGAAP	CG Culture	TOTAL
1. Hong Kong	60	56	73	83	61	67
2. Singapore	70	50	65	88	53	65
3. India	59	38	58	75	50	56
4. Taiwan	49	47	60	70	46	54
5. Japan	43	46	52	72	49	52
=6. Korea	45	39	48	68	43	49
=6. Malaysia	44	35	56	78	33	49
8. Thailand	58	36	31	70	39	47
9. China	43	33	52	73	25	45
10. Philippines	39	19	38	75	36	41
11. Indonesia	39	22	35	65	25	37

Source: "CG Watch 2007", ACGA & CLSA Asia-Pacific Markets

Figures in %

Corporate governance in Japan (2007)

Positives:

- A new Company Law and Financial Instruments and Exchange Law (including "J-Sox" on internal controls)
- Regulatory enforcement becoming more vigorous
- Active voting by institutions at AGMs
- An active Pension Fund Association
- Asia's only electronic voting system for shareholder meetings

Negatives:

- Only a handful of independent boards; no real concept of the "independent director"
- No national code of best practice on corporate governance
- Poison pills being adopted (unnecessarily) by listed companies
- AGM agendas still released late (14 days before meetings)
- No voting by poll

3. “ACGA White Paper on Japan” (2008)

- ACGA’s first policy paper on corporate governance in a single country (May 2008).
  - Followed our annual conference, which was held in Tokyo for the first time in November 2007.
- Address six key issues and provided practical recommendations on each:
  - ‘Shareholders as (responsible) owners’
  - Capital efficiency & management
  - Supervision of management / independent boards
  - Poison pills
  - Pre-emption rights (third-party allotments)
  - Shareholder meetings / proxy voting

4. “ACGA Japan Statement” (2009)

- Early to mid-2009 brought a series of CG policy statements and papers from major Japanese organisations: Keidanren, METI, FSA, TSE
- We published a detailed response in December 2009, with additional recommendations.
- Five main issues covered:
  - Role of independents directors and statutory auditors
  - Shareholder meetings and voting
  - Private placements and other capital raising issues
  - Cross-shareholdings and other equity investments
  - Company-Investor dialogue

5. Japan in 2010

- **Improvements since 2007:**
  - Introduction in 2009/10 of concept of "independent director"
  - New FSA disclosure rules (March 2010) on cross-shareholdings and AGM voting results, among other things
  - New TSE rules in mid- to late-2009 on pre-emption rights, independent directors, among other things
  - Increasing openness of some companies to new CG ideas
  - Decline in adoption of new poison pills

- **Selected obstacles & issues:**
  - Many new rules are quite vague; could be better written
  - Emotional focus on alleged "failure" of Western corporate governance model. But what alternatives are being offered?
  - Domestic institutional investors remain conflicted
  - Continued propensity to hoard cash

6. Toyota: a turning point?

- For 10 years, Toyota and Canon have been held up as the argument against global CG standards, especially on independent directors.
- Will Toyota's recent recall crisis mark a turning point in the way it (and certain other firms) view governance?
- The jury is out, but how could a different governance system have helped Toyota?
  - Board discussion on rapid growth strategy (which led to the quality problems)
  - Toyota's handling of communications after crisis started
  - Reputational and financial benefits

7. The role of institutional investors

- Despite the poor performance of the Japanese stock market, many global investors remain supportive of CG reform in Japan.
  - Voting shares
  - Engaging with companies & regulators
  - Participating in ACGA delegations
- They also appreciate the need for more consistency between stated views and voting behaviour
  - A greater focus on how to use voting rights sensibly to communicate with companies
  - Increasing focus on voting against companies with no independent directors

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