

1. Abenomics and Corporate Governance Reforms (CG) reforms: context and what is new?
2. Brief overview of the evolution of CG in Japan
3. Understanding CG in Japanese firms: Hybrid forms
4. Did/does Corporate governance really matter?
5. Five points for fine tuning of Hybrid structure

ABENOMICS AND CG REFORMS

Brief chronology

The First wave

- 1997: Banking Crisis
- 2002: the amendment of Company law (firm with committee system), the guideline of voting among the pension funds
- 2004: Reorganization of banking sector, finish solving non-performing loan problem, the desolving cross shareholding

Intermezzo:

- 2005: Using voting right, and the small boom of activism 2006: “revival of cross shareholding”
- 2008: World Financial Crisis ⇒ Reverse Direction
- 2011: Olympus incidents

The Second Wave

- 2013: Abe cabinet - CG reforms as growth strategy
- 2014: Japan Revival Plan

Corporate Governance Reforms in Abenomics: Overview

- 2014 Japan Revival Strategy (日本再興戦略) ⇒ Enhancing “earning power” by improving corporate governance
- 2014-15: Second wave of CG reforms in Japan
- **After Abnomics from 2013**
 - = J-version of Steward-ship code (2014, February)
- Ito Report (2014, August)
- The Amendment of corporate law (2014, June)
- J-version of CG code: the draft, 2014, Dec, and implemented 2015, June

- **Aim:** Encouraging engagement of institutional investors
- Caveats: less impact of portfolio investors.
- Positive side:
 1. Changes of behaviors among insurance companies = reducing holding stocks and make clear the investment policy: ex. Daiich Insurance Co, Nissai Insurance changed their investment strategy. (from 'silent partner' to independent investors)
 2. Strict monitoring of pension funds (ex. GPIF) over asset management firms
 3. Voluntary organization of institutional investors (Forum of Investors Japan) <http://investorforum.jp/en/>

Ito Report (2014, August)

Emphasis on ROE at least 8%

JPX 400 by TSE, including governance arrangement (completion for being included)

Amendment of Corporate law

- Independent director
- Firm with auditing committee (監査等委員会設置会社)

CG code (2015, June)

- more than two independent directors
- more information disclosure on holding stock (政策保有)

- **Back to** the US model as a reform model again: enhancing the shareholders interests
- **Careful stance** of confrontational activism \Rightarrow emphasizing the long-term firm growth
- Corporate governance reform as a **growth strategy**
: Unique to the US and UK, where myopia or too strong governance is problem, in Japan weak shareholder influence is to be reformed.
- Based on **Comply or Explain Rule** (not mandatory)

EVOLUTION OF CG IN JAPANESE FIRMS

Stylized features of Corporate Governance Arrangement in Japan

WiAS

The heydays of J-firms in the 1970s and 1980s. Varieties of Capitalism- CME

Stable shareholders (insider ownership)
- main bank system



Boards dominated by insiders



**Lifetime employment - shop floor-oriented,
firm specific skill**

Preference of public listing

- Strong preference for **public listing** among Japanese firms.

⇒ 50% of large firms

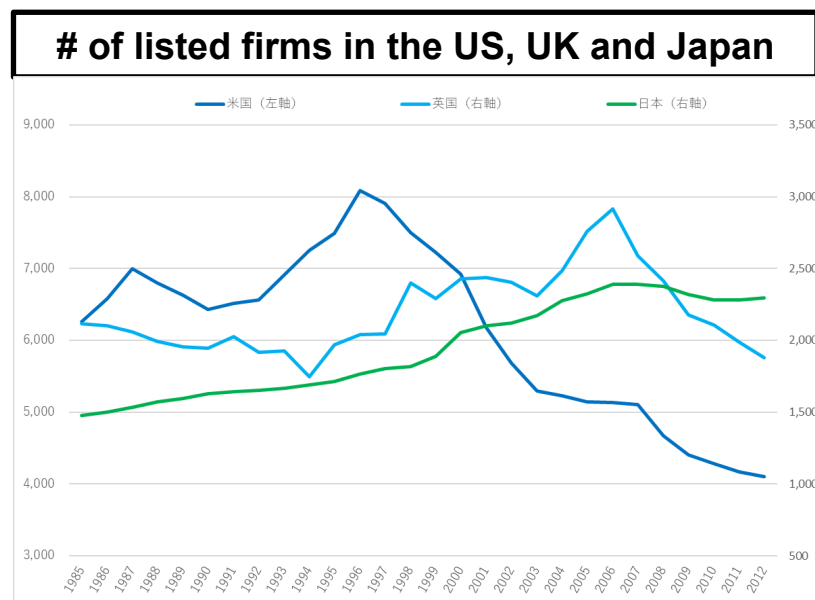
(contrasting to UK28%)

implying CG code could cover large number of firms

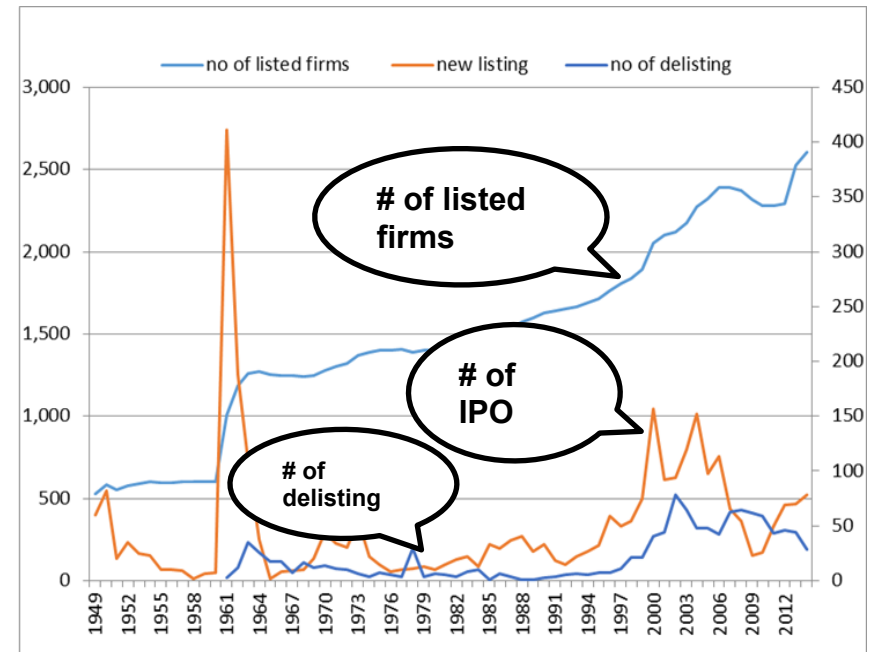
- # of listed firms increased or at least stable in Japan
- Contrasting to the US and UK, where there is strong trend of **going private** (Eclipse of public corporation, Jensen 1989)

The weight of listed firms in top 1000 firms (sales)

	Germany	France	UK	Italy	Japan	
	1996				2006	2013
Listed firms	134	132	272	80	559	531
%	14.5	13.6	27.8	8.4	58.4	54.2



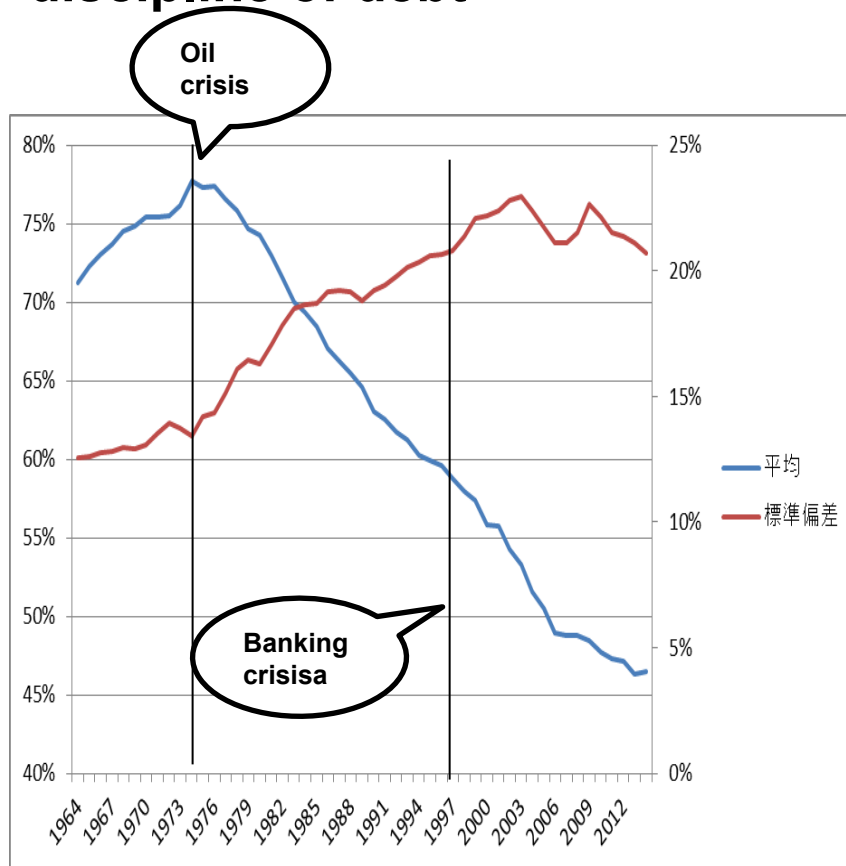
- Co-existence of listing (IPO) and delisting (due to M&A)
- The asset size of firms in consolidated base expanded due to the overseas sales and group formation.



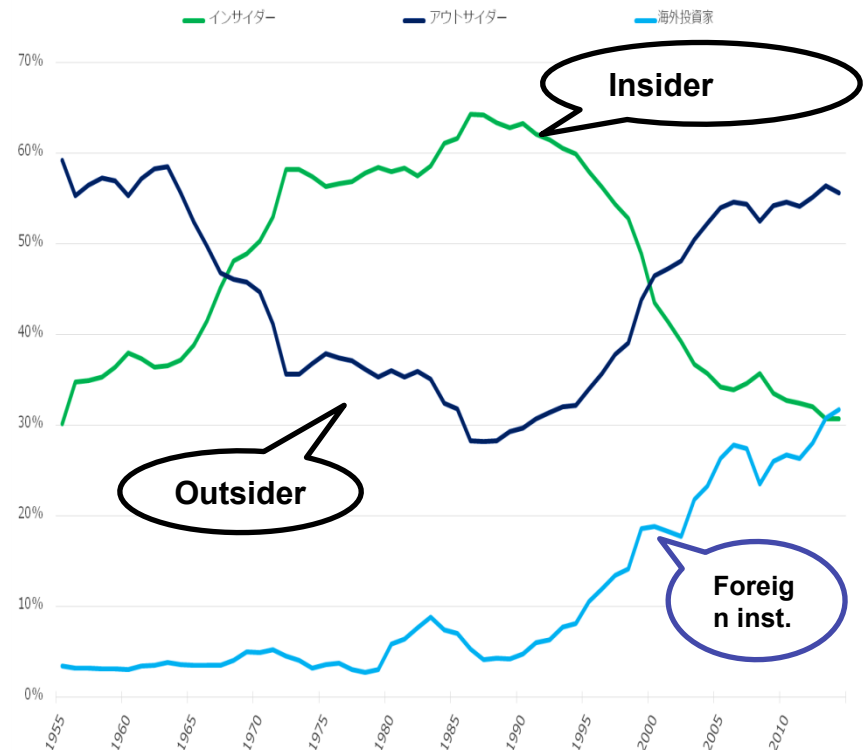
FY2007					FY2014			
	name	consolidated assets	consolidated/ non-consolidated	Overseas sales ratio	name	consolidated assets	consolidated/ non-consolidated	Overseas sales ratio
Top	Toyota Motor Corp.	32,458	3.11	76.7	Toyota Motor Corp.	47,729	3.15	77.6
10th	Panasonic	7,443	1.62	49.9	Sumitomo CO.	9,021	2.12	-
20th	Canon INC.	4,512	1.62	78.9	DENSO	5,283	1.45	58.9
30th	Brigstone Corp.	3,359	1.93	76.4	INPEX	4,499	1.28	46.5
Aggregated top 10		134,918(145)	2.60	65.4		191,204(205)	3.29	70.5
Aggregated top 20		186,010(131)	2.17	55.2		260,121(183)	2.70	54.8
Aggregated top 30		223,456(132)	2.01	48.5		308,136(182)	2.31	53.4

Deleveraging and increasing Outsider Ownership

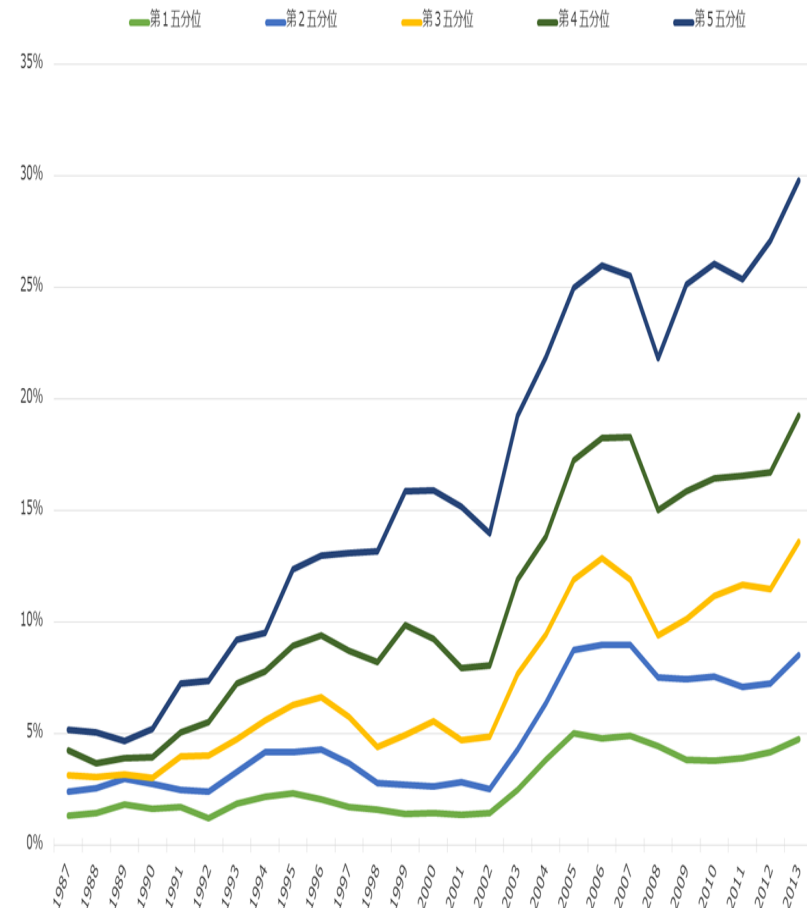
Declining debt/assets =
decreasing bank influence and
discipline of debt



Declining insider dominated
ownership structure



- Only **large leading (MSCI Japan) firms** are facing pressures of the capital market.
⇒ Under the threat of exit
- **Medium size** firms are not the target of foreign institutional investors, and still kept the insider ownership.
⇒ Less pressure of capital market



- Large board, insider dominated board ⇒ Gradually changed
- Down sizing board
- Introducing

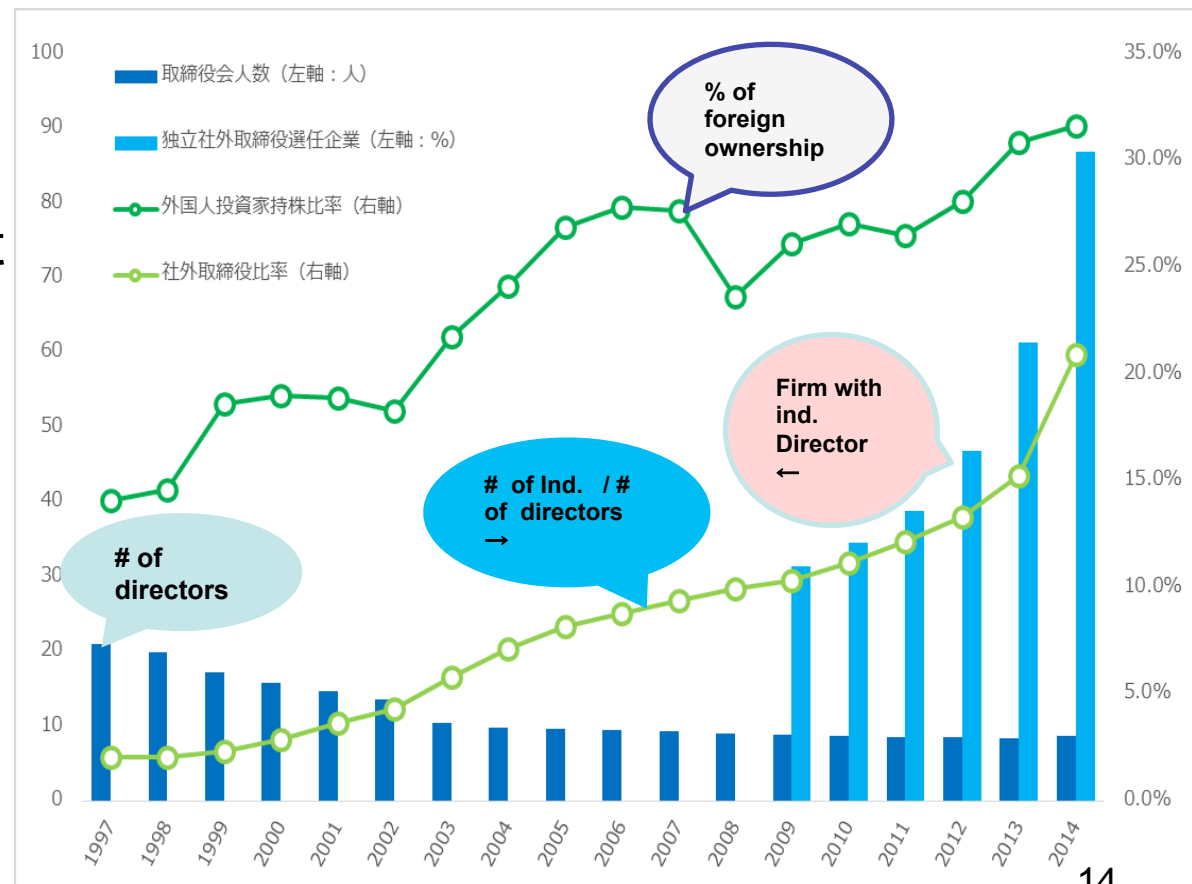
Independent directors

- Internationally, low.

Firm with independent directors is less than 50%,

- Recent boost
- ← Direct results of CG code

The trend of the boards



Gradual Change of Compensation

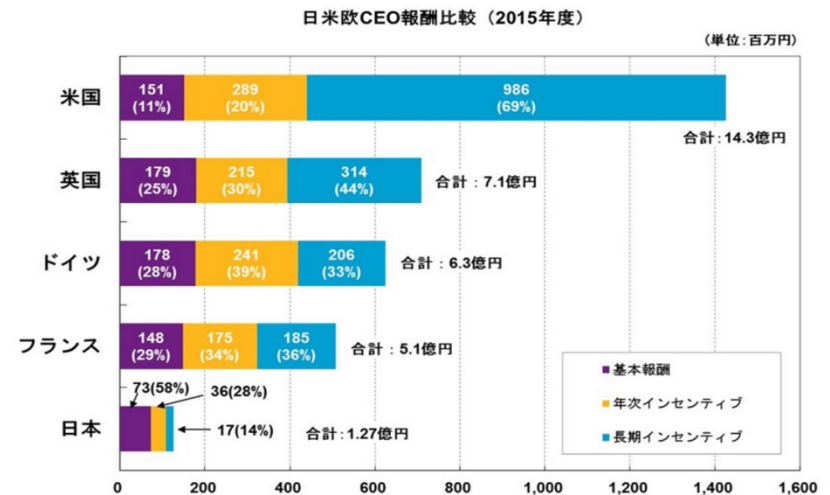


- Compensation level and its sensitivity to performance is low in Japanese firms
- Long debate on introducing the high powered incentive, and the amendment of law for stock option.
- Its changes are very gradual, the difference with the other developed countries were rather enlarged

Compensation among five countries (2015)

JPY million

	Total	Base		Bonus		Stock option	
Japan	126	73	57.9%	36	28.6%	17	13.5%
FRANCE	508	148	29.1%	175	34.4%	185	36.4%
GERMANY	625	178	28.5%	241	38.6%	206	33.0%
UK	708	179	25.3%	215	30.4%	314	44.4%
USA	1426	151	10.6%	289	20.3%	986	69.1%



UNDERSTANDING CG IN JAPAN: HYBRID FORMS

How to understand current governance structure ?

- The evolution of listed Japanese firms ⇒ "Lost decade" is misleading in CG arrangement
⇒ decades of transformation (Aoki 2013)
- The diversification of governance structure among firms.

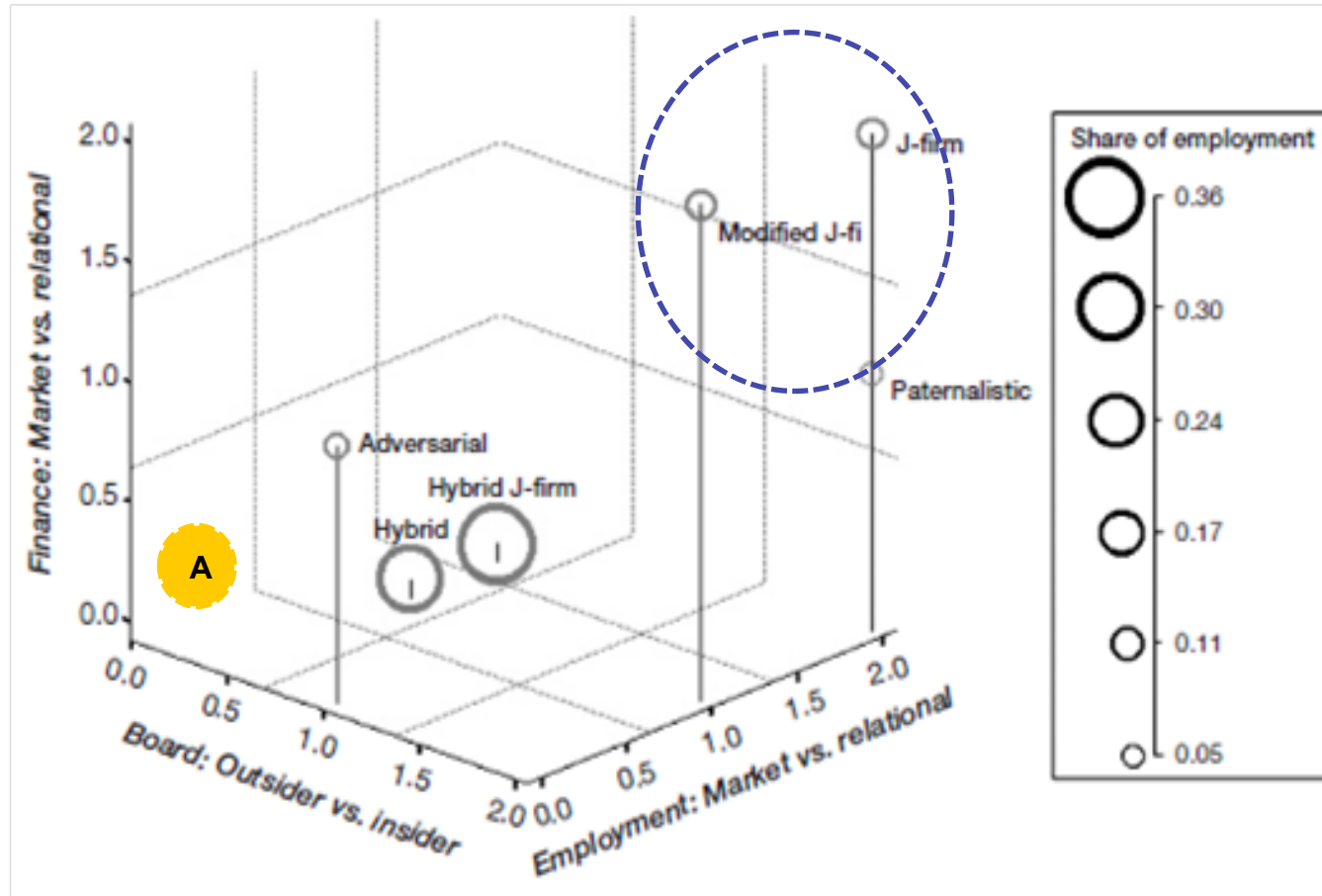


How to understand this diversification?

Hybrid Structure

(Jackson and Miyajima 2007)  WIAS

the combination or co- existence of market based external governance (external) and relational based employment system and organizational architectures



Leading firms, Medium and Family Firms (TSE 1st section in 2015)

	Firm s in M S C I index	Firm s excluding from M S C I	Fam ily firm s (w ith over 5%)
# of firms	262	1113	349
share of # of firms	15.2%	64.6%	20.2%
shae of Market cap	79.5%	17.0%	3.5%
Marcket cap per a firm (10billion)	14,266	717	478
share of turnpver	70.6%	25.2%	4.2%
turnover per a firm (10billion)	1,809	152	80
share of employee	67.4%	28.3%	4.4%
emplyee per a firm	34,478	3,404	1,679
Outsider (average)	42.4	21.8	17.9
Insider (average of banks, other co	27.8	39.6	43.7

Leading firms (JPX400、MSCI Japan) — Hybrid structure

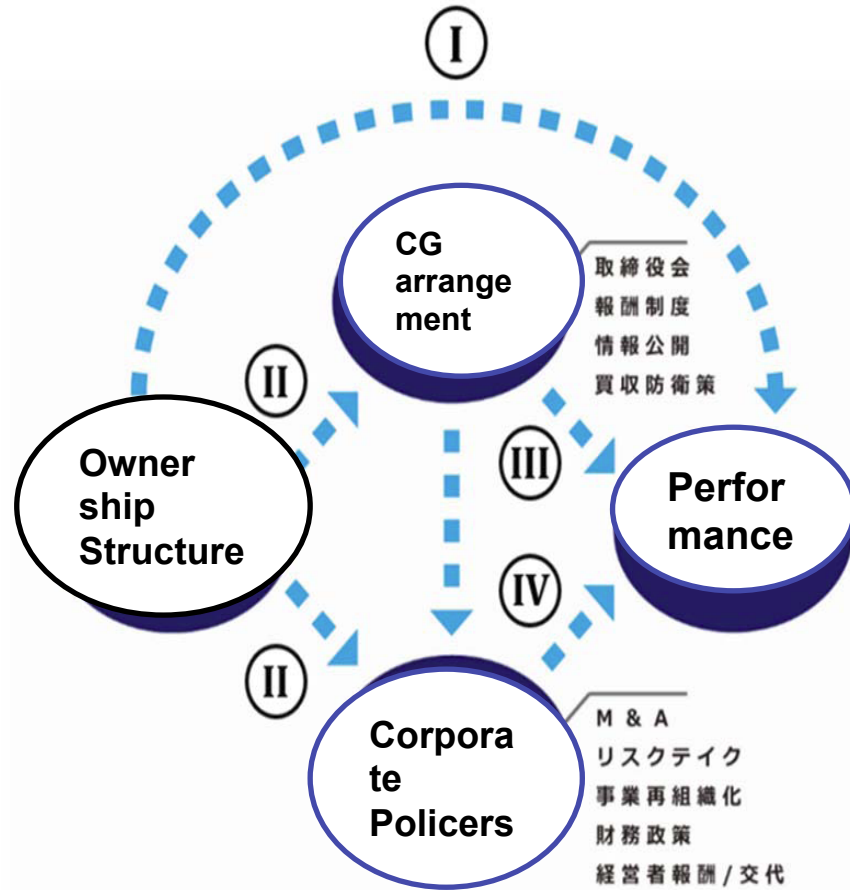
- Dissolving tight relation with bank, less shareholding/ dispatching bankers, various financial choice, outsider dominated ownership
- Board reforms
- Changing employment system
- Exit is main mechanism

Traditional J-firms/ family firms :

- Long-term relations between banks and firms, but, bank intervention has been changing.
- Insider ownership still dominated, less market pressure.
- Delay of board reforms/ keeping long-term employment

DID/DOES CORPORATE GOVERNANCE REALLY MATTER?

Mutual Relationship between CG, behavior and Performance

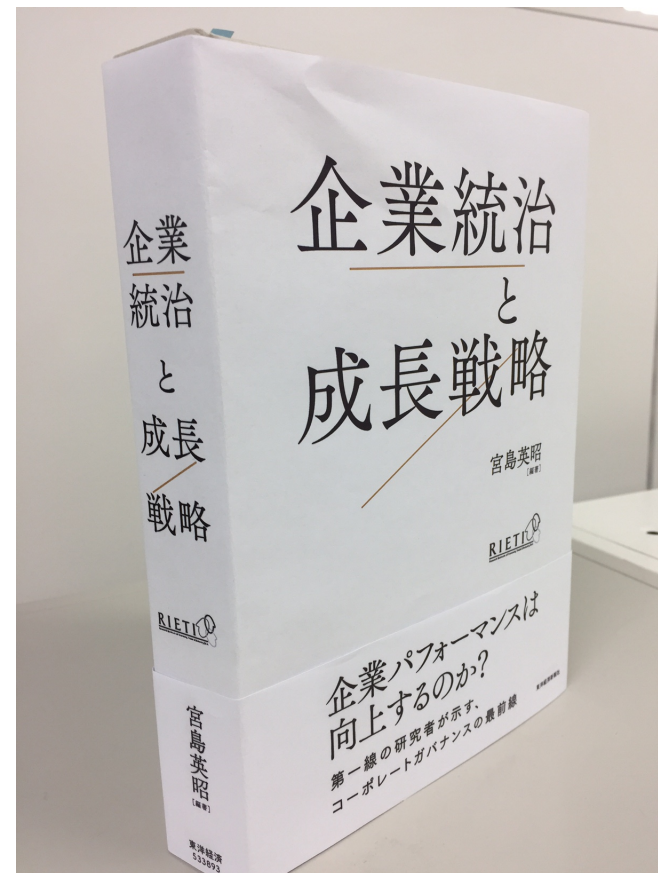


Focal points

- ownership
- CG arrangement (board/compensation)
- Corporate policies
- Presidential turnover/Scandals
- Performance

What do we know on CG and Performance? From Miyajima eds forthcoming

- Foreign institutional investors was a driver of CG reforms. (chap.2)
- Foreign investors also encouraged real investment, R&D, and M&A, while the cross shareholding discouraged them. (quiet life/ Inoue)
- Foreign investors facilitated corporate restructuring (measured by employment adjustment), but its magnitude was not so large. (Ahmadjian 2007, chap.7)
- Foreign investors could affected the corporate financial policies (dividend, stock repurchase and cash holding)



What do we know on CG and Performance? II

- Foreign investors began to affect on the presidential turnover, but not clearly related to stock return yet (Chap.9)
 - The CG arrangement really related to the probability of corporate scandals : both window dressing and tax avoidance (chap.10).
 - Foreign institutional investor has raised the corporate performance, while J-type CG likely associated with low performance (chap.2/chap12)
- ⇒ Changing CG arrangement, particularly ownership changes affected on corporate policies, and performance
- ⇒ Introducing independent directors, and dissolving cross shareholding by CG code could be right direction for reforms

- CG did affect on the corporate policies and performance, partly
 - Inoue et al (**chap.12**) estimated that CG factor can explain only 30-35% of the low performance of Japanese firms to the other countries
- Do not hold too much hope on the board reforms
 - Empirical evidence did not show positive effect of outside directors in general.
ROA (Q) = F (Xi, independent), where Xi is control variables
 - The board reforms does not have “one size fits all solution”. It would be effective, only if firms, which should have independent directors, would introduce it by this institutional change.

- Unwinding cross shareholding is **rational** for both corporate governance and efficient use of money.
- Insider ownership or cross holding is not always value decreasing (ex. insider blocks)
- **Which way** the money used: stock repurchase, physical investment, M&A or R&D
- Set clear policy for holding stock, considering transactional relationship

FIVE ISSUES AS AGENDA OF FURTHER REFORMS

Hybrid firms: Ownership of institutional investors is so fragmented, whereas there is less block shareholders (compare to 85% in the US: Holderness 2009) who had enough incentive to monitor. \Rightarrow a classical free rider problem would appear.

Outsider blocks shareholders are expected.

Traditional J-firm: insider block given weak outsider, no threat of exit

Candidates: Focus funds, insurance firms, other corporation, main banks

	Medeans (billion yens)	% held by foreign shareholders		% held by institutional shareholders	% Share of firms with more than 3% block holders		
		FY 1990	FY 2013		内外機関 投資家	保険会社	メインバ ンク
単純平均	415	3.3	15.2	23.4	40.8	22.4	26.1
Q5	5,615	5.2	29.9	40.3	49.1	30.7	15.8
Q4	1,327	4.0	19.2	29.9	56.6	17.2	20.8
Q3	523	3.0	13.6	22.3	46.4	24.1	30.3
Q2	273	2.8	8.5	15.2	36.1	23.8	34.2
Q1	122	1.6	4.7	9.0	16.0	16.3	29.4

II Refining ownership structure in WIAS

the post cross-shareholding

Myopic pressure of the capital market ?

If myopia is serious, how to cope with?

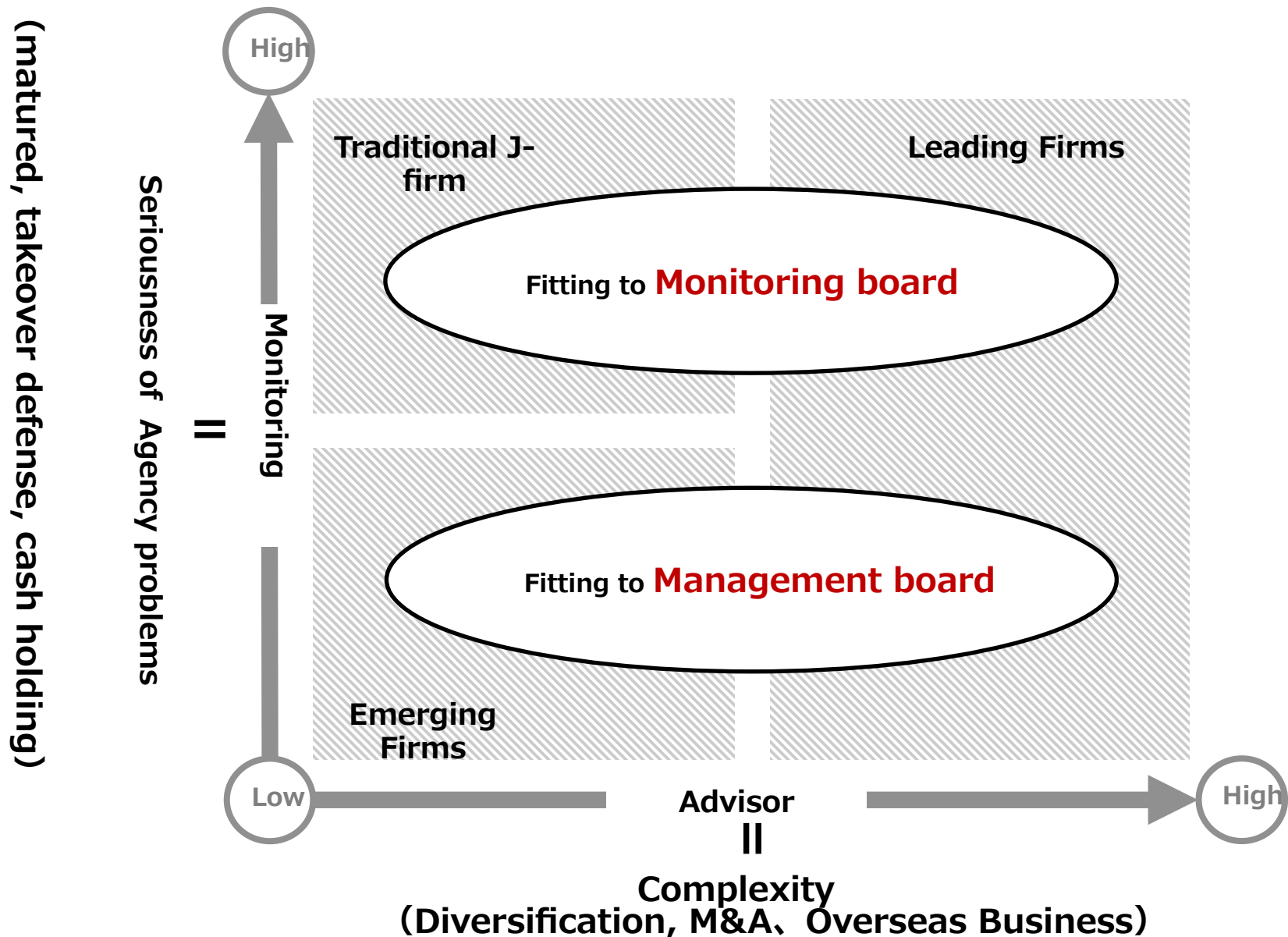
- Managerial and employment ownership
- Dual class shares (Toyota AA class shares)
- Stock repurchase :
 1. repurchases of blocks of shares from investors that threaten interventions or induce mis-valuation.
 2. Sales of shares to friendly investors;
 3. Retention of repurchased shares as Treasury stock for future use in the event of control threats.

Note: there is a trade off between long-term management and managerial entrenchment

III: Choice of monitoring and management board

- Japanese board are insider dominated, management board which is different from the monitoring board.
- The role of outsider directors, or choice of board characteristics depends on firm characteristics: **the complexity of business, the extent of agency problem, the difficulty of getting information** by independent directors
- Some of leading firms which businesses are complex, had better to introduce multiple outside directors, and other firms which are active to M&As would move to monitoring boards.
- **Traditional J-firm** is expected to introduce independent directors and move toward the monitoring boards.
- Who should be independent directors ?
 - ⇒ Do not be pessimistic for recruiting issues, retired CEO
 - ⇒ Formal qualifications are not appropriate.
 - ⇒ Busy directors are now problematic.

Firm characteristics and the role of board directors



of the powered incentive

- In theory, high powered incentive can encourage top management team (TMT) to take higher risk.
 - But, there are no driving force for its introduction.
 - Institutional investors supported it, but not drive.
 - TMTs are hesitating to raise their compensation.
 - This is consistent to the long-term employment system remaining at the core of J-firm. TMT promoted with in firms
- ⇒ Gradual introduction of pay for performance, or stock option is realistic, associated with the change of wage system among employees, encouraging the ESOP (employee stock ownership plan) , which is also expected to enhance the productivity (Owan et al. 2017)

V: Fine Turning of the market for corporate control

Role of activism

Trend of activism in Japan

	Case of Activist funds (Hamao et al 2010)	Factsets		# of firms with Takeover defense TSE
		More than 5%	More than 3%	
2001(2002.3)	32			-
2002	56			-
2003	62	0		
2004	119	7		
2005	168	35	53	
2006	189	62	83	175
2007 (2008.3)	189	80	108	409
2008	76	56	97	569
2009	11	33	64	565
2010	NA	29	46	540
2011	NA	26	40	521
2012	NA	33	53	514
2013	NA	41	66	511
2014	NA			496
2015	NA			479

- There was a small boom of activism in the middle of 2000s.(Murakami funds, Steal Partners)
- Confrontational activist has gone since 2008.
- Activism is now taking a **quiet** form (Buchannan et al. 2012), but still weak.
- Their role is important for both leading and medium size firms

V: Coordinated market for corporate control WIAS

Comparison of TOB among four countries; 2010-2014 (Inoue et al. 2016)

	JP	US	UK	GER
Cross boarder	3.4	19.6	45.5	16.5
Hostile takeover	1.7	15.7	11.6	6.3
Multiple bidder	0.0	8.1	17.0	2.5
Shareholding before TOB	26.3	3.6	6.1	43.3
Premium	48.9	42.9	41.7	33.0
N	171	233	112	76

- Low cross boarder M&A
- Less hostile takeover, multiple bidders case is extremely rare.
- Shareholding before TOB is high: most of TOBs are group-restructuring

⇒ Predicting the low premium, but rather higher than other countries — the market for corporate control has been arranged and less exploiting minority shareholders



various forms of restructuring:
PE, business partner, banks

