Will Corporate Governance Reform Change Japanese Capitalism?

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Corporate Governance Reform

- Political agenda
- Impacts on corporate management
- Macroeconomic implications
- Implications on workers

- Challenges and Future

Corporate Governance Reform as a Political Agenda

- Top of the Growth Strategy (Third Arrow) Agenda of *Abenomics*
  – Narrow objective: Dividend increases; and stock price increases → Stimulate consumption and investment
  – Broader implication: Attempt to change executives' mind toward efficient use of capital
  – Governance Reform is to make corporations to use resources more efficiently → more profitable

Instruments for the Policy Push

- JPX Nikkei 400, emphasizing ROE
- Corporate Governance Code
  - Circulated in March 2015, to be implemented on 01 June 2015 by JPX
    - E.g., two independent outside board members
- Pressure from pension funds
  - Stewardship code, April 2014
  - Along with pension fund reform (e.g., GPIF reform)

Impacts on Corporate Management: Stakeholder Capitalism to Shareholder Capitalism?

- "Japanese management" was in vogue in the 1980s
  - Low dividends but high growth and stock price increases
  - Cross-share holdings (no M&As) allows management to focus on long-term issues
  - Stakeholder capitalism (workers; communities) over shareholder capitalism → Hostile M&A can be bad
  - American capitalism forces short-term views
- After lost two decades, superiority of Japanese management is gone (in many industries)
  - Shareholders are important
  - Fiduciary duty of institutional investors is important
  - Earning higher profits and paying higher dividends are good
  - Lots of resources were wasted in loss-making subsidiaries and projects → need to reform

Macroeconomic Implications

- Rising stock prices stimulates consumption
  - Along with the first and second arrows
- Management will allocate capital efficiently → potential growth rate becomes higher
  - Close down money-losing operations
  - Accept M&A (create values)
  - Unwind interlocking shares
- This is a key
  - Paying higher dividends (higher ROE) is easy
  - Allocate capital efficiently (higher ROE) is difficult, but most important

Implications on Workers

- Will improved corporate governance be bad for workers?
  - More layoffs?
  - No "life-time employment"?
  - Less labor shares (more capital shares) of profits?
  - Rich vs. Poor; Regular vs. Irregular; "inequity"?
- Corporate governance reform is about increasing the size of a pie; not necessarily how to slice a pie
- Labor market issues and inequality issues have to be addressed separately
- Workers have to develop skills that make them qualified for globally-demanded jobs

Challenges and Future

- "Will Corporate Governance Reform change the (stereotypical) Japanese Capitalism?"
  - Yes. But not all the way to the stereotypical American capitalism
- In order to have intended effects,
  - Corporate executives should embrace and implement corporate governance reform
    - Life-time employment may have to be modified
    - Wages have to be raised for workers with higher skills
  - Capital markets should differentiate good and bad companies
    - Investors should become "active"
    - Mutual fund (Toshin) has to be reformed to pursue long-term values
- Political push has to be maintained
  - Concerns among workers and the public have to be addressed
  - Universities have to be reformed to produce workers with higher (and demanded) skills