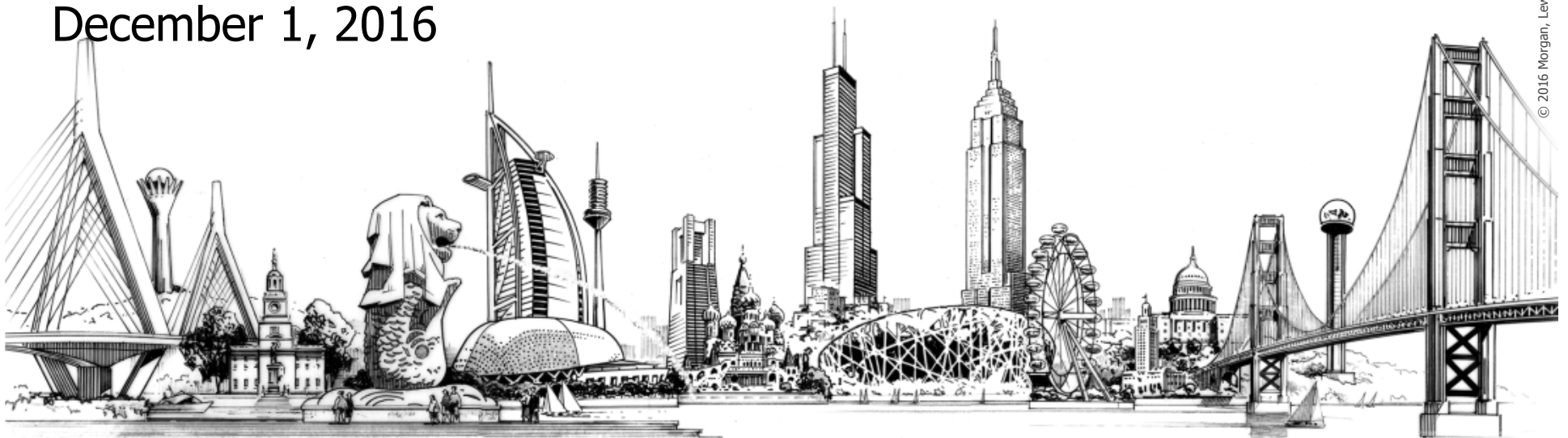


Morgan Lewis

# HAS THERE REALLY BEEN A JAPANESE CORPORATE GOVERNANCE REVOLUTION?

Center on Japanese Economy and Business  
Columbia Business School

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December 1, 2016



# Morgan Stanley Thinks Japan Is 2017's "Top Market"

As the end of 2016 is finally nigh, market predictions for the new year begin to roll in. The latest report from Morgan Stanley on where best to invest in 2017 is bullish on equities in one particular country — at the expense of the U.S.

"Japan becomes our top market," analysts from the investment bank's cross-assets strategy unit wrote in a report Sunday. According to *Bloomberg*, the report suggests that the Japanese market in 2017 would come "with attractive long-run valuations" and "some cyclical strength" as well as prospects for positive earnings growth.

*Source:* Fortune Magazine, November 29, 2016

# Why the Current Focus on Corporate Governance?

- ✓ Prime Minister Abe's economic revitalization strategy (Abenomics) -- corporate governance to stimulate Japanese corporate growth
  - Japan's Stewardship Code took effect on Feb 26, 2014
  - Japan's Corporate Governance Code took effect on June 1, 2015
  - Government driven corporate governance
- ✓ Attracting foreign direct investment ("FDI") and investors
  - Japan's Shrinking Economy
  - Low Economic Growth
  - Low Return on Equity ("ROE")
  - Over 30% of listed companies' shares are held by foreign investors in recent years
- ✓ Corporate Scandals (Not the main focus)
  - Little transparency about the underlying issues, legal or judicial actions
  - Limited outsider oversight
  - Weak shareholder input/control
  - Weak journalistic reporting (press club approach)

# Low ROE in Japan

## Pre-Abenomics ROE Comparison (Japan, EU and US)

|       | ROE   |
|-------|-------|
| Japan | 5.3%  |
| USA   | 22.6% |
| EU    | 15.0% |

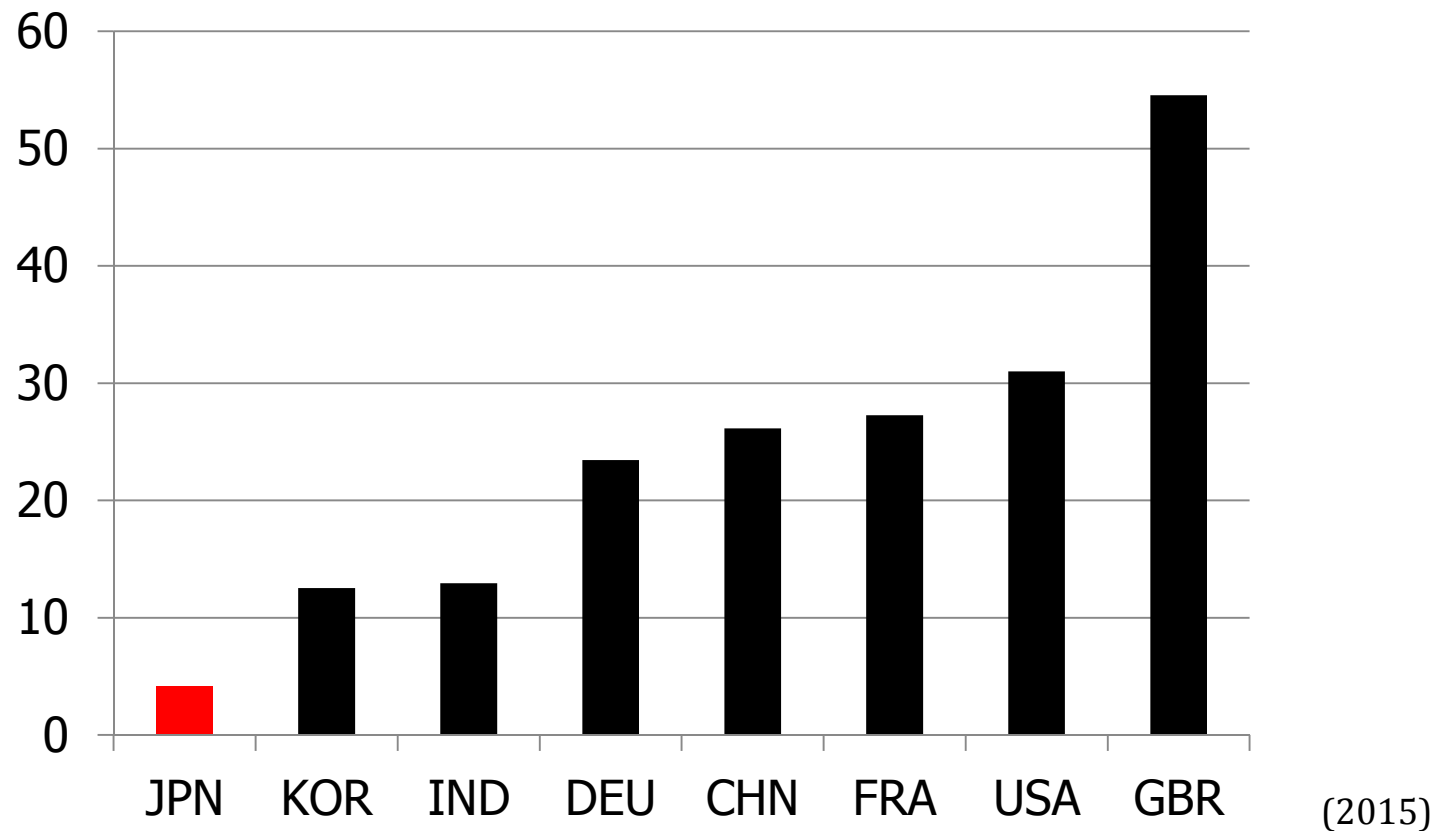
(2012)

\*Target: TOPIX 500 Companies, S&P500 Companies, and Bloomberg European 500 Companies excluding finance and real-estate industries.

Source: Masaki Asset (using Bloomberg Data)

# Levels of M&A and Foreign Investment Remain Low in Japan

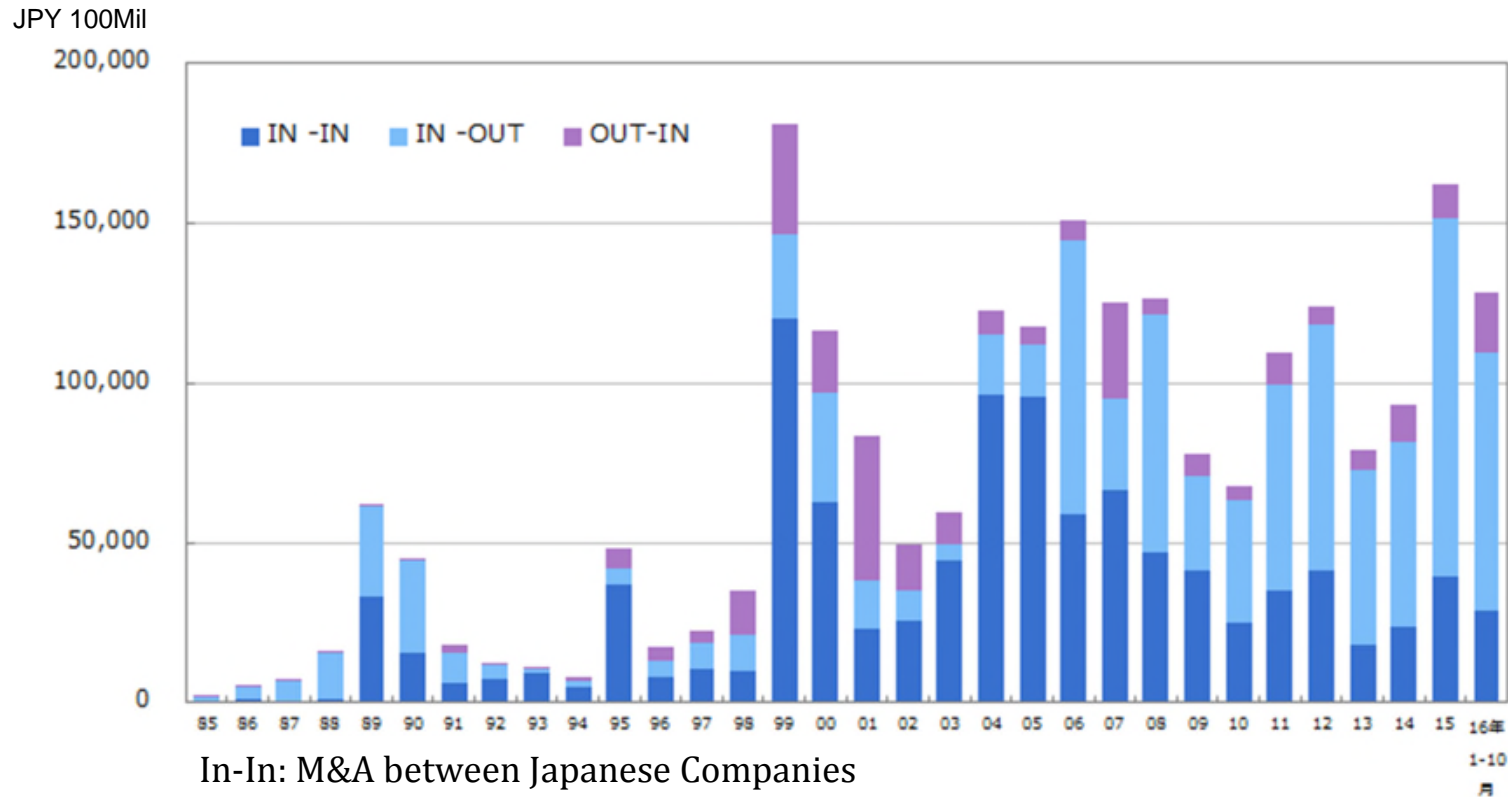
FDI Stock as % of GDP



Source: OECD International Direct Investment Statistics

# Levels of M&A and Foreign Investment Remain Low in Japan

## Japan M&A (Deal Value)



In-In: M&A between Japanese Companies

In-Out: M&A targeting Foreign Companies by Japanese Companies

Out-In: M&A targeting Japanese Companies by Foreign Companies

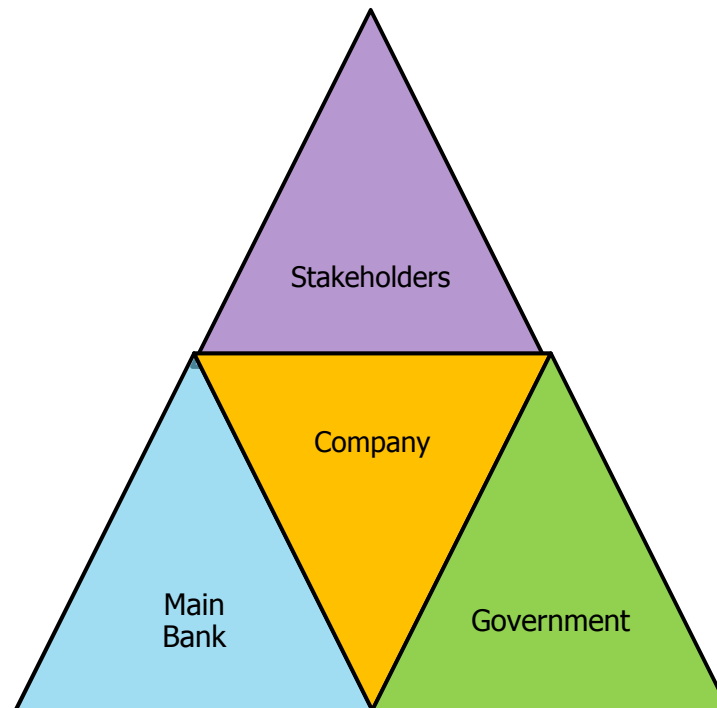
Source: MARR Online

# Corporate Scandals

- ✓ Corporate Scandals
  - Mitsubishi Motors in 2000/2004 (Defect/Recall)
  - Kanebo in 2005 (Accounting)
  - Daio Paper Corporation in 2011 (Family Co./Embezzlement)
  - Olympus in 2011 (Accounting/Whistleblower)
  - Toshiba in 2015 (Accounting/Whistleblower)
  - Takata in 2015 (Defect/Recall)
  - Mitsubishi Motors in 2016 (Test Data)
  
- ✓ Many Scandals Only Revealed After Years of Violations
  
- ✓ Little personal gain -- Protecting the Company
  
- ✓ “Tip of the Iceberg?”

# Traditional Governance: Corporate Iron Triangle

- ✓ Japan was known for old “Iron Triangle” of Big Business (keiretsu), Bureaucrat & Politician Rule
- ✓ CORPORATE IRON TRIANGLE?: Stakeholders, Main Bank & Government
  - Stakeholders: Vendors, Suppliers, Employees and Management
  - Cross-shareholding with group
  - Directors largely life-long managers
  - Xenophobia: Protect the Corporate Family/Status Quo
  - Worked well





# Corporate Reforms: Abenomics

- ✓ **Stewardship Code & Corporate Governance Code**
  - Improve corporate value and growth of Japanese companies
  - Facilitate discussion between investors and listed companies
    - Engagement by institutional investors
    - Disclosure by listed companies
  - “Principles Based” approach (Not “Rules Based” approach)
  - “Comply or Explain”
  - FSA & TSE lead the reform
  - NIKKEI Index 400
  
- ✓ **Amendment of Japanese Companies Act**
  - Introduce alternative governance structure: Board with independent audit committee
  - Listed companies must explain reason for not having an outside director
  - Earlier amendment (2003) for US style board with separate committees
    - Only 71 of 3500+ listed companies have adopted

# Objectives

- ✓ Improve corporate governance to satisfy global investors/criticism
- ✓ Increase long term/stable foreign shareholders and FDI
- ✓ Increase transparency of company management
- ✓ Improve Japanese corporate performance
- ✓ Good governance is NOT a corporate goal in itself/It's Government Policy

# Successes

- ✓ Increased ROE
  - Increased to 8.2% (Oct-Dec, 2015) from 5.7% (Oct-Dec, 2012)
- ✓ Increase in outside directors
  - 97.1% of listed companies have outside directors in 2016 (61.4% in 2014)
  - 79.7% of listed companies have more than one in 2016 (21.5% in 2014)
- ✓ Share buybacks
  - Nearly \$53 Billion of share buybacks in 2015 (a historic high)
- ✓ Cross-shareholding decline
  - Japanese mega banks plan to reduce 1.9 trillion Yen of cross-shareholdings
- ✓ New BOD with audit committee structure
  - Over 700 of 3500 listed companies have adopted
- ✓ Corporate leadership attitude change

# Issues/Concerns

- ✓ **Weak enforcement of Rules and Codes**
  - Corporate Governance Code and Stewardship Code are “soft law”
  - Companies may choose their governance structure (BOD with audit committee is optional)
- ✓ **Weak shareholders’ rights**
  - Only 209 shareholder proposals at 44 listed companies in 2015 (of over 3500 listed)
  - Only 7 shareholder proposals at 3 companies were approved in 2015
  - Shareholder proposal process takes nearly 9 months. Proxies cumbersome
- ✓ **No “hostile” takeovers/fundamental restructuring difficult**
- ✓ **Antipathy towards shareholder activism**
  - Reported negatively: Steel Partners, Cerberus, Ex-Murakami fund investors
  - Positive news coverage: Third Point, Taiyo Fund, others
- ✓ **New Development — BOJ / GPIF: Japanese Government as major “silent” shareholder**
  - BOJ/GPIF largest shareholder in 400 TSE listed companies (1/4 of TSE total)
  - BOJ owns ten trillion Yen in Japanese ETFs.
  - Back to Traditional Iron Triangle of Government “Guidance”?

# Shareholder Activism in Japan

- ✓ Disliked
  - Necessary evil for restructuring, increase in productivity?
  - Disturbs harmony (complacency?) – messy, public and confrontational
  - Tension: Foreign fund demands for immediate monetary results
  
- ✓ Some successes – Mostly Minor and not yet a “trend”
  
- ✓ Encouraging “dialogue” between management and investors
  - Investors leverage “public good” objectives of corporate governance code
  - Poor performance and decision-making increasingly difficult to disguise
  
- ✓ <An Aside> Headlines re major “family management” disputes (Otsuka Furniture, Idemitsu)
  
- ✓ True impact may take years to materialize

# Major Shareholder Activism in Japan

- ✓ Koito / T. Boone Pickens (1989-91)
- ✓ Shoei Co. / M&A Consultants (2000)
- ✓ Bull-Dog Sauce / Steel Partners (2007)
- ✓ J Power / The Children's Inv Fund (2007-08)
- ✓ Aderans / Steel Partners (2008-09)
- ✓ Seibu / Cerberus Capital (2013)
- ✓ Sony / Third Point (2013-14)
- ✓ FANUC / Third Point (2015)
- ✓ Seven & I / Third Point (2016)
- ✓ Number Quietly Increasing

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**Koito**

**SHOEI**



Bull-Dog

**J POWER**

**Aderans**

**Seibu Holdings**

**SONY**

**FANUC**



# U.S. Shareholder Activism

- ✓ Confrontational/State Court Case Law
- ✓ Growing Influence and Scale
- ✓ Activists and Institutional Investor Convergence
- ✓ The US not the activism model for Japan?

# The Future

- ✓ Challenge of Japanese Market/Population Shrinkage
- ✓ Future of increased Domestic M&A/Restructurings and Insolvencies?
- ✓ Need for foreign investment/capital---Will foreign takeovers/restructurings like Honghai/Sharp Increase?
- ✓ Japanese Corporations Forced to Change
  - How much?
  - How quickly?
  - Can shareholders help guide management in lieu of old corporate "iron triangle"?
  - Will better corporate governance really help growth?



# What Japanese Corporations Can Do

- ✓ Open up to shareholders – Can Japanese tradition of excellent “service” and “responsiveness” apply to shareholders?
- ✓ Improve messaging of corporate objectives
- ✓ Confront problematic shareholders but don’t clam up

# What Shareholder/Investors Can Do

- ✓ Be aggressive, but strategic and respectful
- ✓ Few practical legal tools – still a public pressure/media play
- ✓ Japanize your message (foreign investors)
- ✓ Watch out for hidden “tip of iceberg” problems--remnants of old Corporate Iron Triangle opaque management

# Corporate Governance Revolution

- ✓ NOT a Revolution, a Bloodless Evolution
- ✓ Businesses need to want to take the initiative, not rely on Government edicts
- ✓ Adjustment in CEO/Management attitudes and diligence
- ✓ Key foundation for Tidal Wave of Drastic Change facing Japanese Businesses

# THANK YOU

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Mr. Satoru Murase is a partner with Morgan, Lewis & Bockius LLP. He advises corporate clients on corporate governance as well as investor relations issues, and has been involved in some of the largest governance and shareholder activism matters in Japan. He advises global corporations and governmental entities regarding cross-border investments and disputes in the United States, Asia, Europe, and the Middle East.

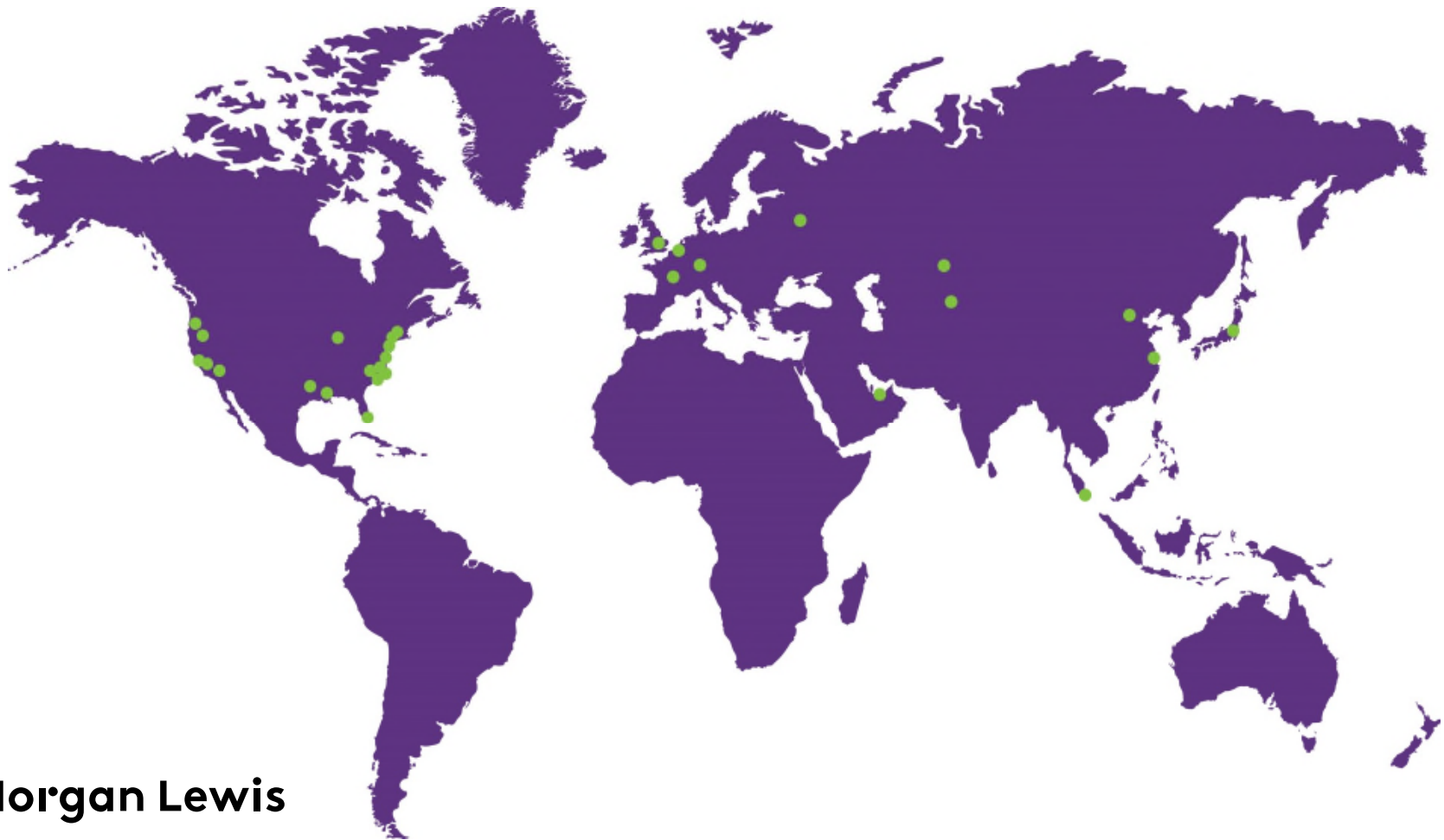
Satoru is listed in The Best Lawyers in America (2012-2016), The Best Lawyers in Japan (2012-2016), and as one of the 272 BTI Client Service All-Stars lawyers recognized nationally for their client service excellence.

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Latin America  
Middle East  
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