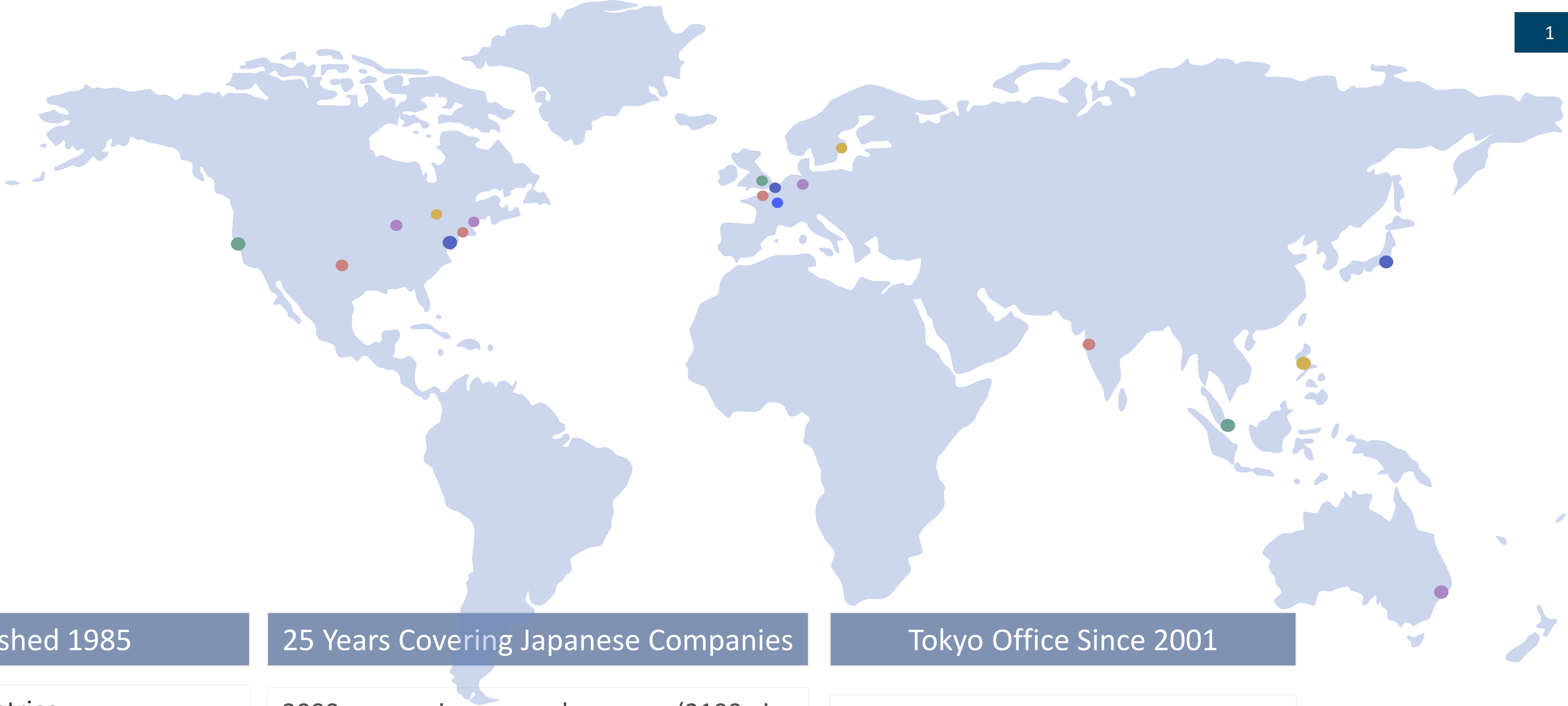

ISS Established 1985	25 Years Covering Japanese Companies	Tokyo Office Since 2001
› 19 offices; 13 countries › 1300 employees › 43,000 shareholder meetings in 132 markets › 10 million ballots voted in 2018; approx. 4 trillion shares › Proxy Research & Voting; Responsible Investment; Data & Analytics; Securities Class Action Services	3000 companies covered per year (2100+ in June)	› Benchmark research, custom research for Japanese and non-Japanese investors › Vote execution for domestic clients › Sales, client services

Corporate Governance in Japan

Where have we come from?

- **1990s**
  - “Stable shareholders” dominate – no pressure on managers. Cost of capital is a foreign concept.
  - Executive comp is all cash, seniority-based: Salary, semi-annual bonus, retirement allowance. No incentive to boost the share price.
  - Typical board of directors is 20-30 middle-aged-to-elderly Japanese men who are life-long employees of the company. Board committees are non-existent.
  - Shareholder proposals used by anti-nuclear activists and company labor unions
  - Managers’ greatest fear is the Sokaiya – so 90% of June shareholder meetings take place on the same day/time. Hard-copy proxies (in Japanese only) mailed out 15 days before the meeting.
  - Domestic investors return blank voting cards, voting with management on all items. Foreign investors own 5-10% of the market; are starting to vote but obstacles are huge. Companies do not disclose vote totals (just pass or fail).

Corporate Governance in Japan

Where are we now?

- **2018**
  - Managers are feeling pressure. Domestic pension funds and asset managers vote according to predetermined guidelines, as do foreign shareholders. Vote results are disclosed.
  - Governance Code and Stewardship Code are hard to ignore. Cost of capital is part of the Governance Code.
  - Executive comp has an equity component, often in place of cash retirement allowance. Performance cash and equity are becoming more prevalent.
  - Average board size (TSE1) is <10 people. Women and foreign nationals are common at large companies. Most companies have 2 or more outside directors.
  - Most shareholder meetings still take place on one of 3-4 peak days, but proxies are released electronically 3-4 weeks ahead of time.
  - Managers' greatest fear is shareholder activists

Corporate Governance in Japan

Why have things changed?

- **Demographics. Japan has:**
  - World's longest life expectancy
  - Birth rate below replacement
  - Negligible immigration
  - Declining ratio of working people to retirees
- **How can Japan support its retirees, in a zero interest rate environment? The only answer is to improve returns in the stock market. That means less tolerance for:**
  - Hoarding cash
  - Uneconomic investments
  - Resistance to M&A and steps to improve efficiency
- **These are enabled by poor governance:**
  - Insider-dominated boards
  - Low levels of performance-based pay
  - Takeover defenses, including cross-shareholdings
- **Regulators understand that improving governance is the key to improving returns, and that pressure from investors, through engagement and voting, is needed to bring that about.**

What does this mean for shareholder activism?

What's different today compared to mid-2000s?

- Typical activist goals (better capital management, higher shareholder returns) are endorsed by the government. Governance Code calls for "strategic shareholdings" to be reduced.
- Executives have to defend their plans and practices to their companies' own outside directors – not as easy to circle the wagons.
- Prevalence of poison pills is at a 12-year low.
- Institutional investors can't hide: vote disclosure means that if they vote against their own clients' interests, it will be apparent.
- At the same time, much low-hanging fruit has already been plucked. It's harder for activists to appeal to mainstream investors based on egregiously poor governance.

Notable recent examples of activism

Large-cap companies are not immune

- **Sony Corp. 2013-14:** Third Point urges partial flotation of entertainment unit to (1) generate capital for investment in electronics business and (2) compensate entertainment execs with equity in the unit they control. Sony rejects proposal, but only after hiring investment banks to evaluate it.

- **Fanuc Corp. 2015:** Third Point calls for increased returns to shareholders. Company doubles payout ratio from 30% to 60%.

- **PanaHome Corp. 2017:** Oasis Management makes counter-offer to TOB from parent Panasonic. Board recommends that shareholders tender to Panasonic despite the lower price.

- **Toshiba Corp. 2017-18:** Company forced to carry out private placement to raise funds due to negative net worth. Hedge funds including Effissimo, Elliott, Third Point and Oasis are major purchasers. Argyle Street Management raises concerns about the sale price of Toshiba Memory, arguing that Toshiba no longer desperately needed the cash and should have pushed for a higher sale price.