Corporate Governance Reform in Japan

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1. Introduction

Thank you very much for your kind introduction. It is a great honor to have an opportunity to explain the Corporate Governance Reform, CG reform, in Japan, to the distinguished participants in this room.

Prime Minister Abe has particularly highlighted CG reform as a top agenda of his growth strategy. We formulated the Stewardship Code in 2014 and the CG Code last year. Today, I would like to outline, first, how they are steadily improving and implemented, and, second, how we are facilitating their further progress.

2. Background to the Two codes

Let me begin with the background to Japan's two codes to show their consistency with global standards.

Japan has formulated its CG Code along with the new G20/OECD Principles of CG, which was revised last year and is regarded as the global standard of this field including for the World Bank and FSB, by inviting a top CG expert from OECD to advise our formulating process, while we were actively involved in the discussion of the OECD CG Committee as a Vice Chair.

Therefore, Japan's codes and the OECD's principles are mutually coordinated, and Japan's codes are completely consistent with global standards.

More specifically, Japanese CG codes incorporate all critical elements of the OECD's Principles, such as the rights and equitable treatment of shareholders, role of stakeholders, disclosure and transparency, and responsibility of the board.

The Stewardship Code corresponds with the new chapter of the OECD's Principle, "Institutional investors, stock markets, and other intermediaries."

Having pointed out the consistency, on the other hand, Japanese codes include three additional unique principles.

First, "Dialogue with Shareholders". This aims to encourage companies to engage in constructive dialogue with shareholders even beyond general shareholders meetings.

Second, the combined effects of the CG code and stewardship code. They are expected to work together to create a virtuous cycle of sustainable corporate growth and higher returns for investors.

Third, Japan's codes place strong emphasis on corporate growth and increased corporate value.

Next, I'll show the overview of the two codes.

Japan's Stewardship Code provides principles of actions for institutional investors, stipulating their responsibilities for ultimate providers of funds. Institutional investors are required to enhance the mid-to long-term investment return by improving the invested companies' corporate value through constructive engagement.

On the other hand, the CG Code provides principles of actions for companies, stipulating their responsibilities for shareholders and other stakeholders. In the Code, 'corporate governance' means a structure for transparent, fair, timely and decisive decision-making by companies, with due attention to the perspectives of shareholders and also customers, employees and local communities.

It is expected to ensure growth-oriented governance, increase the corporate value through appropriate cooperation with a wide range of stakeholders.

Japan's Stewardship Code and CG Code work together like two wheels on a cart and realize a virtuous economic cycle through constructive dialogue between institutional investors and companies, and ultimately lead to the growth of the economy as a whole.

3. Improvement of governance framework in Japan

The initial results of introducing two codes are significant. I would like to touch upon four examples of how companies are improving their governance framework.

First, around 50% of the TSE First Section listed companies now have more than two independent directors, jumping from merely 10% in the past. Furthermore, over 10% of the companies have formed a board structure in which their independent directors constitute more than one-third of all board members.

Second, Japan's three major banking groups have unveiled their plans to unwind cross-shareholdings by around 30% within 3 to 5 years. This unwinding is steadily progressing, and other sectors have also started to follow suit.

Third, almost all major institutional investors in Japan have already accepted the Stewardship Code. In total, 201 domestic and foreign investors have expressed compliance with it.

Investors which accepted the code have complied with around 90% of Code's principles. In the past, most of Japanese institutional investors were generally regarded as 'silent shareholders', however they are now more actively engaged in constructive dialogue with companies.

Fourth, over 80% of all listed companies comply with over 90% of the principles contained in the CG Code, and when they do not meet any of the principles many of the companies have publicly explained why not.

4. Follow-up of Japan's two codes

While we witness significant progress in the acceptance of two Codes, this is not the goal itself; it is only a starting point. What is more important is that we should encourage more companies to develop a governance system in substance not just in form.

These two Codes must function like two wheels on a cart, to facilitate a sustainable increase in corporate value. In order to further improve CG, we established the follow-up council for the two Codes last August.

Meetings have been held on a monthly basis six times to date. At this council, we continue our discussion on the issues including cross-shareholdings, board of directors and institutional investors.

The council published an opinion statement at the last meeting, based on intensive discussion about boards of directors and CEOs. Let me introduce the main proposals.

Many Japanese companies are perceived as unable to effectively adapt to the challenging environment in the midst of globalization, technological innovation, rapid demographic change and environmental issues.

Here, the selection of the directors, especially the CEO, is critical for a company to achieve a sustainable increase in corporate value.

Regarding the function of the board of directors, they should fully exercise oversight functions and determine strategic directions.

Some council members expressed concerns on transparency in the CEO selection process, especially when existing CEOs unduly exercise their influence on the process like Toshiba. It is important to ensure objectivity, timeliness and transparency in the process.

Concerns are also expressed on the insufficiency of qualified CEO candidates. Japanese companies need to cultivate human resources from a long-term perspective through more involvement of the board of directors.

Some also argue that dismissal of CEOs is not properly conducted. The framework to dismiss CEOs based on a proper performance test needs to be in place.

Furthermore, with respect to the board of directors, I'd add the following three matters pointed out by the council.

First, the independence and objectivity of the membership of boards of directors are important. So, it is desirable not only to increase the number of independent directors but to appoint outside directors with diverse backgrounds to address various managerial challenges.

Second, in order to respond to rapid changes in the business environment, the board should focus on the strategic aspects of business decisions.

Third, the performance of the board should be regularly evaluated to identify challenges and problems of its effectiveness.

Since most shareholders' meetings are held in June and companies will start the selection process of their boards of directors shortly, I'd like to encourage all companies to make use of this statement and encourage all institutional investors to more actively engage in constructive dialogue with invested companies based on these proposals.

The follow-up council moves on to the agendas of effectiveness of dialogue between institutional investors and invested companies, highlighting the fiduciary duties of institutional investors. It intends to publish an opinion statement concerning enhanced engagement by institutional investors with companies.

As the council is inviting public comments on its website, your views would be highly appreciated.

5. Conclusion

It is crucial for each company to accelerate CG reforms for sustainable growth without hesitation. We also hope that institutional investors play a greater role in facilitating these reforms through active investment and engagement with invested companies.

These initiatives to bolster CG will boost Japanese companies' earning capacities and facilitate higher returns for shareholders, thereby helping to improve the functions of financial and capital markets in which growth capital is effectively intermediated.

The markets will then be able to play a more efficient role in supporting sustainable economic growth.

To conclude, Japan is moving in the right direction.

Thank you very much for your attention.