

Opinion Statement for the Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code (for the 16th meeting)

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1. Overall Comments

As I will be absent from today's meeting of the Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code, I'd like to express my opinions.

In response to this year's revision of the Corporate Governance Code, an increasing number of listed companies have seriously worked on interpreting the intents and purposes of the revision, and autonomously implementing the revised Code as the corporate imperative; and I feel the Code has embedded in Japanese companies. Looking at institutional investors, it seems that engagement activities have taken root in the investment management industry.

Nevertheless, with respect to both companies and institutional investors, there are some cases where the reality does not conform to the intent of the Code as follows:

2. Cross-divisional efforts within a company Removal of the internal functional barriers

The Corporate Governance Reform advocated by the Code is not just about establishing governance structures and arrangements, but it also is the management reform, aiming at sustainable growth of corporate value over the mid- to long-term. Even within a company, different divisions, including corporate planning, finance, IR, general administration, and legal divisions may have different goals and objectives. Although business units are the driving forces of corporate value creation, it is not sufficiently stated in company disclosures, such as Securities Reports, Corporate Governance Reports, Integrated Reports, how they are incorporated in the process of creating the value over the mid- to long-term.

For instance, in their Corporate Governance Reports, many companies do not sufficient explain cross-shareholdings, considerations of the capital cost at management decision makings, and appointment/dismissal of CEO. Concerning these issues, there tends to be two opposing approaches within a company: while some consider that the company should proactively take necessary actions by understanding views of shareholders/investors and policymakers, others take a conservative approach, considering that it is safer to refrain from making active disclosures or standing out. In some companies, the general administration division takes a leading role, assigns necessary tasks to prepare for disclosures to relevant divisions, and compiles disclosure documents. If companies take such an approach, their disclosures tend to show mere acceptance of status quo. Even if they had serious internal discussions, their external communications are general and abstract, so it sometimes is impossible for shareholders or stakeholders to understand their specific efforts. When companies have fundamental discussions on their future corporate governance, such discussions naturally cover such matters as companies' purposes, business strategies, and value creation. Accordingly, I believe that a "control center" (e.g. corporate planning division), which directly reports to the top management, needs to lead cross-divisional discussions to remove the internal functional barriers, and make proactive information disclosures in a way to emphasize company-specific characteristics.

3. Cross-shareholdings

As proved by results of the empirical analysis, in response to the Corporate Governance Code, we have seen a reduction in cross-shareholdings. However some companies still request the other parties to acquire more of their shares as cross-shareholdings and it is concerned that such a behaviour would be deemed as an alternative to an anti-takeover measure. In order to discourage/suppress such a move, in case companies newly or additionally hold shares as cross-shareholdings, they should be required to make enhanced disclosures, including individual stocks and purpose of shareholdings. That would be beyond the new requirements of Security Reports, which is intended to enhance disclosures and now under public consultation.

Furthermore, under the current rules of Securities Reports, disclosures by companies whose shares are held as cross-shareholdings are not sufficient. Since it is difficult for shareholders and stakeholders to understand the actual situation, the sufficient disclosure provided is the basic premise of dialogue or engagement with them. The existence of cross-shareholders may hinder substantial dialogues, therefore disclosure of detailed information on cross-shareholders is required.

4. Quality of engagement

Looking at engagement between companies and institutional investors in Japan and the UK, I often wonder if they have discussions to promote the corporate value. While Japan's Corporate Governance Code aims at creating sustainable corporate value over the mid- to long-term, such dialogue topics as a company's strategies and business portfolio are the core issues of corporate management and are also likely to generate a conflict of opinions between the management and shareholders.

Unfortunately, in many cases, dialogues focus on such views innocuous topics as ESG-related issues and the improvement of disclosures, which is usually shared by everyone and easy to discuss.

In their Integrated Reports and CSR Reports, listed companies use many tables and photographs, and communicate sustainability-related activities in an easy-to-understand manner. However, sometimes the ways how such activities are related to corporate value are not described clearly. Not a few investors question how a company increases its corporate value over the mid- to long-term, while ensuring co-existence with the society.

Among institutional investors, there are not unusual that the time horizon of the active investment, the ESG investment and engagement are not inconsistent. Even in some cases, the ESG investment and engagement activities are addressed to promote the commercial purpose for asset owners and beneficiaries. Therefore, there are different views within an asset manager, thus causing a confusion for a company. It should be integrated ESG factors and outcomes of engagement into the investment process.

Regarding the proxy voting by institutional investors, after establishing the Stewardship Code, disclosures are notably improved. Many investors disclose their voting policy, and voting records for each investee company on an individual agenda basis. To promote effective dialogues with companies, institutional investors are expected to make wider disclosures, including voting policy and detailed criteria, and reasons for voting "against". Accordingly, I support to enhance more disclosures on "the list of institutional investors which accepted the Stewardship Code" on the FSA's website.

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