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Action Program for Accelerating Corporate Governance Reform : From Form to Substance

The Council of Experts Concerning the Follow-up of Japan's Stewardship Code
and Japan's Corporate Governance Code
Opinion Statement No. 6

I. Introduction

In Japan, corporate governance reform has been underway. The Stewardship Code and the Corporate Governance Code were made in 2014 and 2015; and were revised in 2017 and 2020, and in 2018 and 2021, respectively from the perspectives of both "growth-oriented governance" and "defensive governance." The reform is to support the growth of listed companies and the increase of corporate value over the mid- to long-term. Through these initiatives and constructive dialogues between companies and investors, corporate governance reform has made progress in recent years, where the interests of stakeholders, including shareholders, employees, customers, business partners, creditors, and local communities, were taken into account.

Specifically, many listed companies have made progress in appointing independent directors and establishing nomination committees and remuneration committees. Today, companies and institutional investors are becoming more aware of sustainability issues that are closely related to the interests of various stakeholders.

We have examined the effects of corporate governance reform in past years, taking into account our own interim review of corporate governance reform measures after the second revision of the Corporate Governance Code in 2021, as well as the views of stakeholders, including investors from outside Japan, which were obtained through the Japan Corporate Governance Forum. These examinations showed that not a lot of empirical research on the effects of the reform measures has been conducted as yet and the effect of corporate governance reform measures on corporate performance remains to be seen. However, some point out that many companies have shared the view that the function of the board is crucial for increasing of corporate value through corporate governance reform, and corporate governance reform is moving in a positive direction even if it does not immediately show positive corporate performance.

On the other hand, others point out that the speed of corporate governance reform has been slow in certain areas, and issues remain to be resolved.

II. Current Issues

Specifically the following issues have been pointed out:

- (i) Management issues, such as encouraging the management with an awareness of profit-making and growth based on the cost of capital and promoting initiatives

- relating to sustainability, including investment in human capital;
- (ii) Issues related to the effectiveness of independent directors, such as improving the effectiveness of the board, the nomination committee and the remuneration committee, and improving the quality of independent directors; and
 - (iii) Issues related to dialogues between companies and investors, such as enhancement of information disclosure as well as dealing with legal issues, and market environment issues.

In light of the objective of corporate governance reform, namely, boosting the growth of listed companies and the increase of corporate value over the mid- to long-term, it is vital to resolve the management issues mentioned in (i) above. At the same time, from the perspective of promoting efforts to resolve these issues, it is also important for independent directors to fully perform their functions so as to support the company's risk-taking and conduct effective oversight, as mentioned in (ii) above. In addition, it is also useful to enhance the self-motivated efforts of companies through constructive dialogues between companies and investors, as mentioned in (iii) above. The issues mentioned in (i) to (iii) above must be addressed and dealt with simultaneously.

III. Approach to Future Initiative

It is vital to move the focus of reform from form to substance in resolving the above issues. Sufficient results cannot be expected only by satisfying form. Substance matters. Furthermore, it has been pointed out that further detailed requirements, if introduced, may undermine the original purpose of the "comply or explain" approach and may cause corporate governance reform in practice to lose its substance.

Thus, it is desirable that effective solutions to individual companies' corporate governance problems be considered in the context of reality, by identifying individual issues through constructive dialogues between companies and investors. It is also important for self-motivated changes to take place in the mindsets of companies and investors. To this end, it is necessary to create an environment that promotes such changes, as well as to make the dialogues between companies and investors more productive and more effective.

In order to seek sustainable corporate growth and increased corporate value over the mid- to long-term, it is appropriate to deal with the above issues through various measures, such as the enhancement of information disclosure of companies and investors. In addition, it is appropriate to examine the timing of the revision of each Code in a timely manner based on the progress status from the viewpoint of the effective implementation of corporate governance reform, not necessarily following the review cycle in the past years.

IV. Specific Measures

Based on the above, the Council recommends that the following measures and considerations be implemented in order to make corporate governance reform have more substance, and the Council will review the implementation status from time to time and consider whether additional measures are needed.

1. Issues for promoting sustainable corporate growth and increased corporate value over the mid- to long-term	
Item	Details of measures and considerations
A) Encouraging the management with an awareness of profit-making and growth	<ul style="list-style-type: none"> ● Encourage the management with an awareness of profit-making and growth based on the cost of capital (such as the proper allocation of management resources toward risk-taking, including a business portfolio review and investments in human capital, intellectual property and R&D). [Implementation from spring 2023]
B) Encouraging the management with an awareness of sustainability issues	<ul style="list-style-type: none"> ● Encourage companies to take actions on sustainability issues through the statutory disclosure framework of sustainability information, including human capital, intellectual property and diversity, which was newly established in the Annual Securities Report (including the publication of companies' good disclosure practices). [Implementation from 2023 to 2025] ● Actively participate in the international discussion for the formulation of sustainability disclosure standards, and as a part of that, promote "human capital" to be included in the agenda priority of international sustainability disclosure standards. [Implementation from 2023] ● Consider whether additional measures are needed to improve the diversity of the board and core human resources, such as increasing the percentage of female executives (target of 30% or more by 2030), depending on the evaluation of the achievement.
C) Improving the effectiveness of independent directors (improvement of the effectiveness of the board, nomination committee and remuneration committee)	<ul style="list-style-type: none"> ● In light of the enhanced disclosure of information on the activities of the board, the nomination committee, and the remuneration committee in Annual Securities Reports, investigate, compile and publish the actual status and examples thereof and, through these initiatives, promote the establishment of a "PDCA" cycle based on the evaluation of the effectiveness of the board and strive to further demonstrate its functions. [Fall 2023] ● Conduct educational activities, including skill development through training, to promote understanding of the roles expected of independent directors. [Spring 2023]

2. Issues related to dialogues between companies and investors	
Item	Details of measures and considerations
A) Effective implementation of stewardship activities	<ul style="list-style-type: none"> ● Promote the efforts of asset managers and asset owners to deal with the issues involved in the effective implementation of stewardship activities (including allocating sufficient resources at asset managers, devising engagement methods, providing incentives for stewardship activities, establishing governance structures of asset owners such as pensions). [Implementation from spring 2023]
B) Enhancing the quality of disclosure as a basis for dialogue	<ul style="list-style-type: none"> ● Request companies listed in the Prime Market to disclose the status of dialogues with their investors and the content of such dialogues. [Spring 2023] ● Re-emphasize the purpose of the “Comply or Explain” principle and make clear sufficient and insufficient cases of “Explain.” [Spring 2023] ● Continue to consider measures to provide investors with the information they need prior to general shareholders meetings in an effective and efficient manner, including enhancing the efficiency of disclosure of duplicate information in Annual Securities Report required by the Financial Instruments and Exchange Act and Business Report required by the Companies Act. ● Consider measures to enhance timely disclosure of information that can serve as a basis for dialogues between companies and investors.
C) Promoting dialogues with global investors	<ul style="list-style-type: none"> ● Promote dialogues between companies and investors by "visualizing" companies that willingly and actively respond to the expectations of global investors (such as the ratio of independent directors, diversity, and disclosure in English). [Implementation from summer 2023] ● In particular, expand the coverage of English disclosure practices, including making English disclosure of relevant documents of the companies listed in the Prime Market mandatory. [Fall 2023]

2. Issues related to dialogues between companies and investors	
Item	Details of measures and considerations
D) Resolving legal issues	<ul style="list-style-type: none"> ● Clarification of "act of making important suggestions" and "joint holders" under the large shareholding reporting rule. ● Consider what beneficial shareholders transparency should be. ● Consider how to protect minority shareholders in the case of a partial takeover bid.
E) Resolving market environment issues	<ul style="list-style-type: none"> ● Continue to consider the disclosure and corporate governance issues with regard to quasi-controlled listed companies. ● With regard to the reduction of cross-shareholdings, continue to follow up on the progress made in light of the strengthening of disclosure rules in Annual Securities Reports, the change of continued listing criteria due to the reorganization of market segments by Tokyo Stock Exchange, and transitional measures therefor, and consider whether further measures are called for. [Implementation from 2023 to 2025]

(End)