Barriers to Shareholder Activism in Japan: Transformation in the Face of International Investors?

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1. Background

Uneven character of capitalist development
- Institutional investors has transformed the power balance
- Questioning corporate governance system; greater shareholder value
  (Hawley and Williams, 2000; Clark et al., 2008; Clark and Wójcik, 2007; Dixon, 2010)

The case of Japan
- Some similarities in political-economic structures with Germany
  (Jackson, 2009)

Shareholder participation in corporate governance
- Shareholder initiated proxy proposals and voting
- a useful means of mitigating and monitoring managerial agency problems
  (Bebchuk 2005; Harris and Raviv 2008; Renneboog and Szilagyi 2009; Cziraki et al., 2010)
2. Research Questions

Despite of the significance of international financial forces, where do the barriers to a greater level of shareholder activism come from?

1. Is there any historical structural background that hinders shareholder activism in Japan?

2. Is it a result of the legal system and current limitation to shareholder rights?

3. What kind of transformation has occurred to Japanese corporate governance under the influence of international investors?
3. Historical Background

Similarities in Japan with Germany

- Banks have traditionally been powerful strong influence on the country’s corporate governance system
- Interlinked relationships among the main banks provided stable shareholding
- The stakeholder oriented corporate governance approach
  (Aoki, 1988; Cioffi, 2006; Jackson, 2009; Preu and Richardson, 2011)

Traditions

- Keiretsu (traditional corporate groupings) in Japan: Mitsubishi, Sumitomo etc.
- Mittelstand in Germany
- Number of listed companies: 1,100 in Germany vs 3,650 in Japan (2011)
3. Historical Background

- **Small SRI markets**
  - UNPRI signatories: 22 in Japan and 25 in Germany (vs 134 in the US)

- **Discouraged foreign investors**

- **Institutional investors’ risk-averse attitudes**

Answer to Q1: Historical structural background hinders shareholder activism
4. Shareholder Activism through Proxy Process

Several obstacles to exercising shareholder rights in Japan

- The regulatory framework hinders shareholder activism for minority shareholders.
  > e.g. the unit stock system in Japan (1982) vs German system

- The power of banks is reinforced through the exercise of proxy voting rights
  > e.g. the case of Olympus (2012)

- Increasing share by international investors
  - 24% in 2009 to 27% in 2011
  - 60% of them exercise their proxy voting
  - ISS’s policy change for proxy voting in Japan: stricter on CG issues
4. Shareholder Activism through Proxy Process

• Shareholder Proposals

Trends of shareholder proposals and submission by institutional investor in Japan 2007-2011

<table>
<thead>
<tr>
<th>Type of Shareholder Resolution</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environmental &amp; Social</td>
<td>53</td>
<td>0</td>
<td>60</td>
<td>0</td>
<td>59</td>
</tr>
<tr>
<td>Governance</td>
<td>43</td>
<td>23</td>
<td>38</td>
<td>16</td>
<td>10</td>
</tr>
<tr>
<td>Total</td>
<td>96</td>
<td>23</td>
<td>98</td>
<td>16</td>
<td>69</td>
</tr>
</tbody>
</table>

Source: Institutional Shareholder Services; SIF-Japan, 2009, 2011; The Sumitomo Trust & Banking, 2011
Notes: The figures in parentheses indicate the number of firms that received shareholder proposals.
The figures in bold and Italic represent the total number of shareholder proposals and among those submitted by institutional investors respectively.
4. Shareholder Activism through Proxy Process

- Proxy Voting

Proxy voting exercised as disagreement on management’s proposals in Japan 2007-2011

Source: Japan Securities Investment Advisers Association (2011)

Answer to Q2: There are legal barriers to shareholder rights among minority investors, and these restrict shareholder activism. Shareholders’ direct impact on corporate governance through the proxy process is limited.
5. Transformation in Japanese Corporate Governance

• Case of corporate governance in Germany
  a shift towards global standards among large companies

• Case of Japan?
  Independence of the board: The Corporate Code reform in 2001

The First Section of Tokyo Stock Exchange (1,675 companies, 2012)
1. Statutory auditors System without Independent Directors
   816 companies: 48.7%
2. Statutory auditors System with Independent Directors
   817 companies: 48.8% (vs 582 companies: 35% in 2005)
3. Committees System
   42 companies: 2.5% (Sony, Toshiba, Hitachi etc.)
# 5. Transformation in Japanese Corporate Governance

## Correlation between Ownership and Corporate Governance Characteristics of Listed Companies on the First Section of Tokyo Stock Exchange in 2012

<table>
<thead>
<tr>
<th></th>
<th>Consolidated Sales</th>
<th>Foreign Ownership</th>
<th>Existence of Parent Company</th>
<th>Major Shareownership</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Corporate Governance Indicators</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporate Governance Model 1</td>
<td>*0.12</td>
<td>*0.17</td>
<td>0.10</td>
<td>*0.07</td>
</tr>
<tr>
<td>Number of Board Members 2</td>
<td>*0.36</td>
<td>*0.19</td>
<td>*-0.04</td>
<td>-0.12</td>
</tr>
<tr>
<td>Outside Director 3</td>
<td>0.12</td>
<td>*0.21</td>
<td>*0.09</td>
<td>*0.10</td>
</tr>
<tr>
<td><strong>Ownership Indicators</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Major Shareownership 4</td>
<td>*-0.10</td>
<td>*-0.11</td>
<td>*0.72</td>
<td>-</td>
</tr>
<tr>
<td>Parent Company 5</td>
<td>*-0.01</td>
<td>*-0.06</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Foreign Ownership 6</td>
<td>0.41</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

*Data Source: Corporate Governance Information Service (in Japanese), Tokyo Stock Exchange, 2012; Nikkei Sales Ranking, 2011. Corporate governance data of listed companies on the first section of Tokyo Stock Exchange, n=1,675.*

*Notes:* * indicates significance at the 0.05 level.

1 Corporate Governance Model = if a company implemented committees system: 2, outside directors:1, otherwise:0.
2 Number of Board Members = number of board of directors
3 Outside Director Ratio = percentage of outside directors in the whole board members
4 Major Share Ownership Ratio = percentage of the ownership of largest shareholder
5 Parent Company = if the company has a parent company
6 Foreign Ownership = percentage of foreign shareholders
7 Consolidated Sales = consolidate sales level in 2011
## 5. Transformation in Japanese Corporate Governance

Characteristics of Japanese Listed Companies by Corporate Governance, Ownership, and Sales Classes in 2012

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Number of Companies and Percentage</th>
<th>Average Consolidated Sales (JPY million)</th>
<th>Foreign Ownership Level</th>
<th>Average % of Outside Directors</th>
<th>Average % of Major Shareownership</th>
<th>% of Companies with Committees</th>
</tr>
</thead>
<tbody>
<tr>
<td>All the listed companies</td>
<td>(1675) 100%</td>
<td>452,131</td>
<td>1.80</td>
<td>11.5%</td>
<td>17.8%</td>
<td>2.5%</td>
</tr>
<tr>
<td>With sales more than JPY 1 trillion</td>
<td>(117) 7.0%</td>
<td>3,063,129</td>
<td>2.87</td>
<td>15.4%</td>
<td>12.6%</td>
<td>5.1%</td>
</tr>
<tr>
<td>Without outsider directors</td>
<td>(816) 48.7%</td>
<td>311,118</td>
<td>1.65</td>
<td>-</td>
<td>17.1%</td>
<td>-</td>
</tr>
<tr>
<td>With outside directors</td>
<td>(817) 48.8%</td>
<td>542,358</td>
<td>1.92</td>
<td>21.0%</td>
<td>18.1%</td>
<td>-</td>
</tr>
<tr>
<td>With committees</td>
<td>(42) 2.5%</td>
<td>1,274,009</td>
<td>2.57</td>
<td>50.7%</td>
<td>26.3%</td>
<td>-</td>
</tr>
</tbody>
</table>


*Notes:* Corporate governance data of listed companies on the first section of Tokyo Stock Exchange, n=1,675.

Foreign Ownership Level = average of scores of each companies’ foreign ownership, namely, 0-10%; 1, 10-20%; 2, 20-30%; 3, more than 30%; 4.

**Answer to Q3:** Many of the large listed Japanese firms with higher foreign ownership have begun to voluntarily move towards a less traditional style of corporate governance.
6. Conclusion

• Changes can be seen, but the traditional Japanese characteristics of capitalism still remain.

• It is hard to expect that the corporate governance system among Japanese companies will converge to the Anglo-American style.

• Issues of corporate governance among Keiretsu will stay because of their global economic size.

• What underpins the legitimacy of Japanese corporations?
Q&A

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