Foreign Investor Voice in Japan: An Overview

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I. Introduction

II. Two effects of foreign investor voice in Japan

III. Effect on corporate governance reforms

IV. Effect on individual corporations

V. How about domestic investors?
Traditionally, investor voice was weak in Japan

- Strong shareholder rights in the black letter law (Goto (2014))
  - E.g. No staggered board, proxy access granted, shareholder proposal on dividends possible
- No controlling shareholders after the World War II
- Web of management-friendly shareholders (cross-shareholding)
  - Cf. “keiretsu”
- Employee-oriented stakeholder model
  - “Life-time employment”
- State-contingent monitoring by the “main bank”
I. Changes of Share-ownership Structure

- Decline of banks and insurance companies in late 90s
- Rise of foreigners and trust banks (pension/mutual funds)

Made from Tokyo Stock Exchange, 2012 Share-ownership Survey
Transition in Share Holding Ratio at Market Value by Investor Category
I. F-Investors’ Presence by Company Size

Figure 2  Trend of foreign investors ownership by company size

The figure shows time series mean of foreign investors ownership ratio by company size brackets. The sample consists of all non-financial firms listed on the First Section of the Tokyo Stock Exchange. Company size brackets (quintile) is based on market capitalization of each year (5th quintile the largest).

Miyajima & Ogawa (2016)
I. Recent Governance Reforms

Recent CG reforms by Abe administration

- Companies Act Reform (2014)
  - Comply or explain on appointment of 1 outside director
- Corporate Governance Code (2015)
  - Comply or explain on appointment of 2 independent directors, disclosure of policy on cross-shareholdings
- Ito Review (2014)

May lead to stronger investor/shareholder voice

Are there any effects?
II. Two Effects of Foreign Investors

- **Effect on the Japanese market in general**
  - Foreign investors pushed for corporate governance reforms
    - CalPERS in 1990s (Jacoby (2007))
    - ACGA (2008)

- **Effect on individual corporations**
  - Activist hedge funds
  - Non-activist institutional investors
    - Passive / active
    - Long-term / short-term
    - Tokyo-based / overseas-based
III. Effect on CG Reforms

- The government apparently responded to foreign investors’ request on corporate governance

- Why does the government care about foreign investors?
  - The ruling LDP traditionally sided with the industry

- Because they agreed on the substance?
  - Japanese companies in 2006-2012 fare poorly in ROA, ROE & Tobin’s q compared to those in other countries (Arikawa et al. (2016))
  - “Growth-oriented or aggressive governance” as means to “revitalize Japanese economy”
  - How does having more independent directors help? (Goto (2017))
III. Effect on CG Reforms

- Because they just care about Nikkei 225, which correlates to the approval rating?

  Foreign investors’ share of transactions & turnover ratio in Tokyo market

  Miyajima & Ogawa (2016)

- Whichever the reason is, foreign investors’ voice may become stronger
1. Positive effect on governance and performance
   - More independent from the management and have higher monitoring capability (Bena et al. (2017))

2. No effect or negative effect
   - Suffer from informational asymmetry and “home bias” (Kang & Stulz (1997))
   - Myopia of short-term foreign investors (Bushee (1998))
Japanese non-financial listed firms in 1990-2008

Foreign investors do have home bias

- Firms with higher overseas sales and included in MSCI Index have more foreign investors

Still, high foreign investor ownership improves Tobin’s q and ROA and increases capital expenditure

- Reverse causality allegedly taken care of by simultaneous equation model (3SLS)
- Bena et al. (2016) find similar result on long-term investment, using inclusion to MSCI as instrumental variable
- Also, the higher foreign ownership is, the higher investment, leverage and payout are (Miyajima & Ogawa (2016))
Explanation by Miyajima et al. (2015)

- Not by voice
  - Each foreign institutional investor has only a small block
  - Only few hedge fund activism in Japan, rarely succeeds
  - Independent directors are still too few
- Rather by exit
  - The management cares about negative impact of exit by foreign investors on stock price
    - In order to maintain their reputation and support from the insiders, not because of fear for hostile takeovers or their stock options
  - But, why do insiders care about stock price?

IV. How Does It Work?
IV. Other Possible Explanations?

- Engagement?
  - Does not fit business models of some types of investors

- Voting against the management’s proposal?
  - Foreign investors tend to vote in line with proxy advisors’ recommendation (e.g. ISS since 2015: vote against CEO when 5-year average ROE is below 5%)
  - Anecdotal evidence suggests that the management cares about their approval rate at shareholders’ meeting on reappointment
    - But why?

- Supporting activists’ proposal?
  - Foreign investors may be more open to support activists
    - Is shareholder activism a real threat in Japan?
IV. Return of Activist HF to Japan?

- Partial success before 2008 (Buchanan et al.)
  - Steel Partners, TCI, M&A Consulting (aka “Murakami Fund”)
- Almost gone after the Global Financial Crisis
- A few came back recently, in some cases less confrontational than pre-2008 activists
  - Third Point: Sony (2013), Fanuc (2015), Seven & i (2016)
  - Oasis Management: Nintendo (2014), Panasonic/Panahome (2017)
  - Former Murakami Fund managers
    - Effissimo Capital: relies on lawsuits against smaller caps
    - C&I Holdings/Reno: Kuroda Electric (2017)
V. How about Domestic Investors?

- **Stewardship Code introduced in 2014**
  - 214 signatories as of Dec 2016, agreed to “comply or explain”

- **Would the attitude of domestic institutional investors change?**

- **Some take it seriously, others seemingly do not**
  - Could be a result of their business models
  - But could be also a result of conflict of interests

- **May 2017 Revision**
  - Emphasizes the role of asset owners, mitigation of conflict of interests, disclosure of voting results for individual agenda
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