

# Foreign Investor Voice in Japan: An Overview

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# Outline

- 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?

# I. Introduction

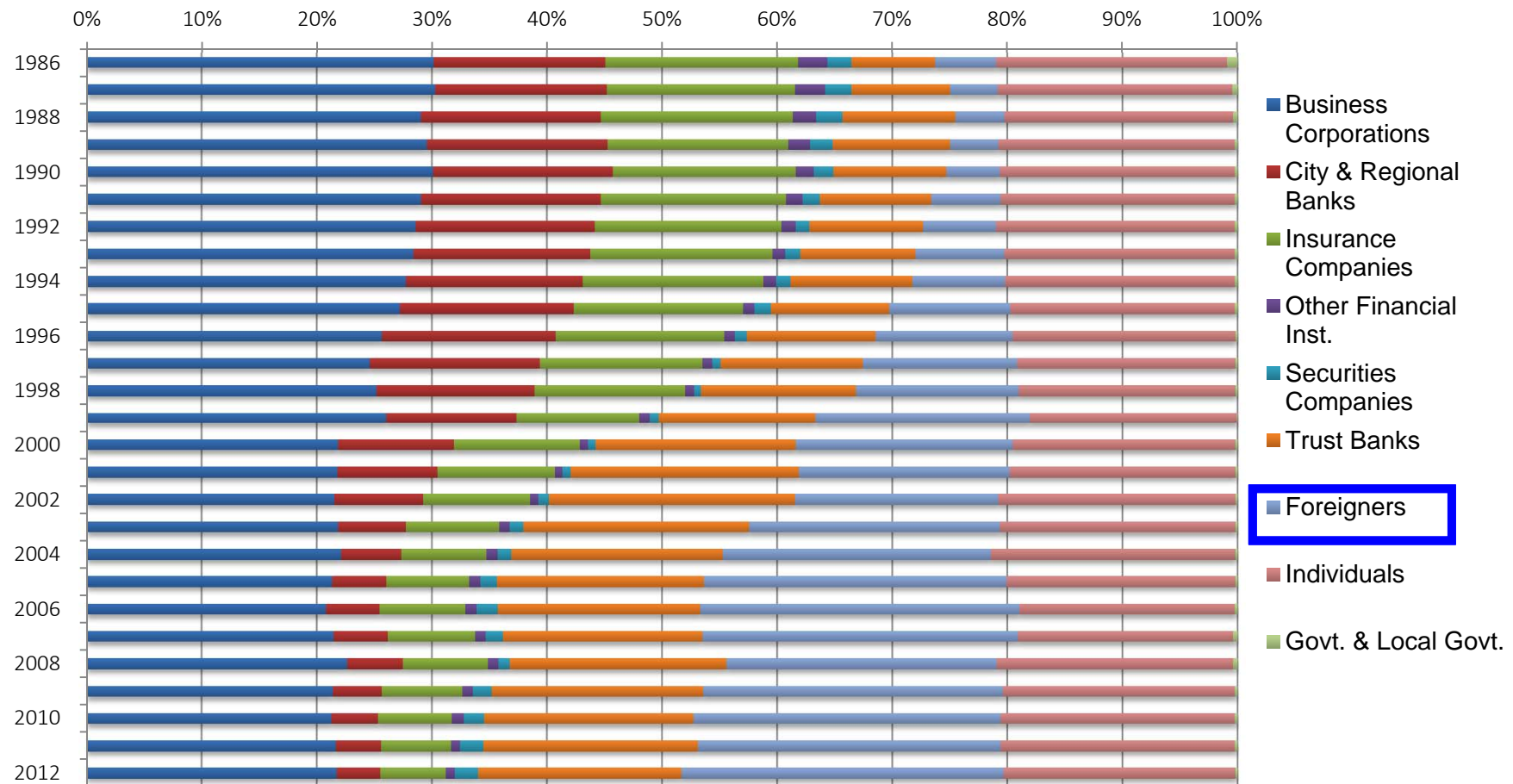
## ■ Traditionally, investor voice was weak in Japan

- 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

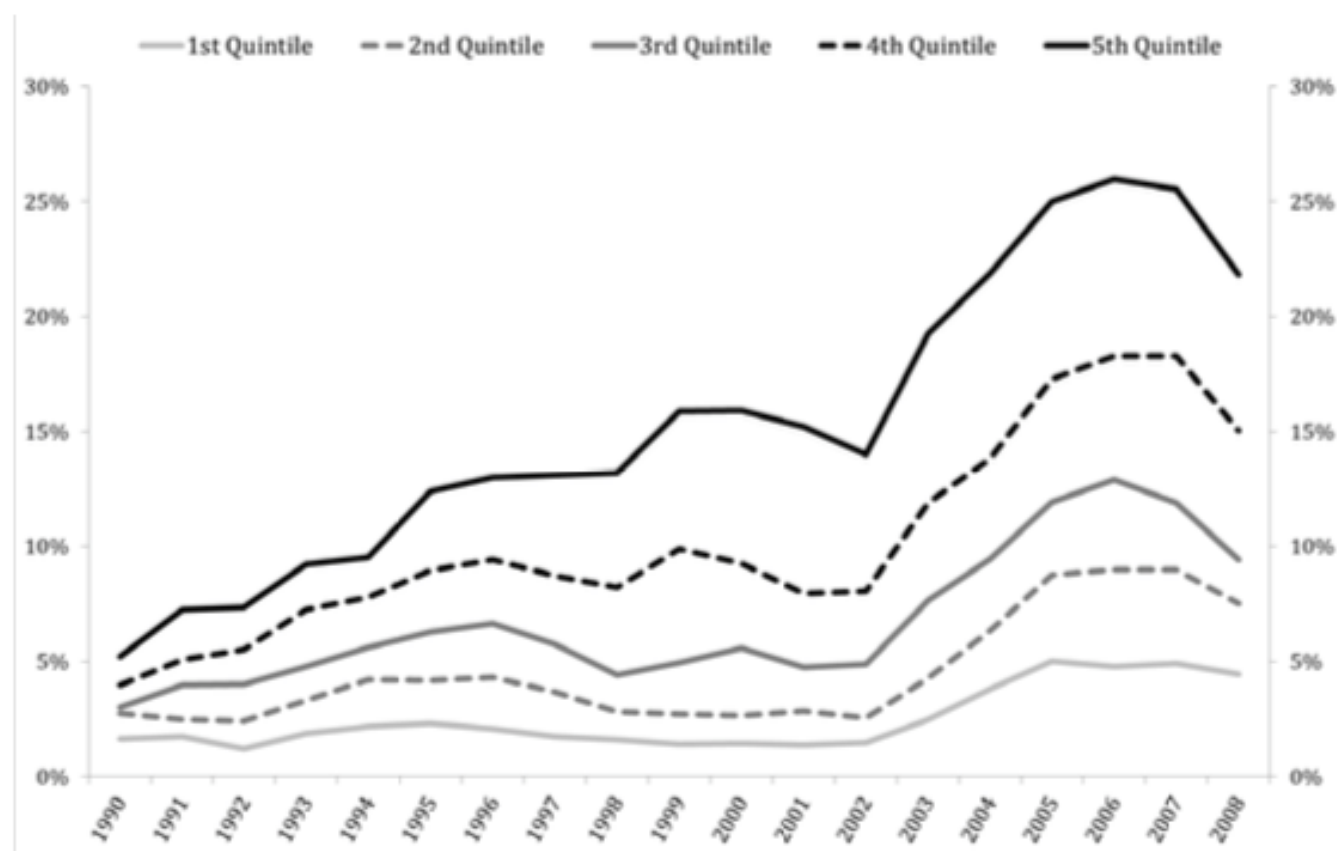
Transition in Share Holding Ratio at Market Value by Investor Category

# 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 (5<sup>th</sup> 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
- Stewardship Code (2014, 2017)
- 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

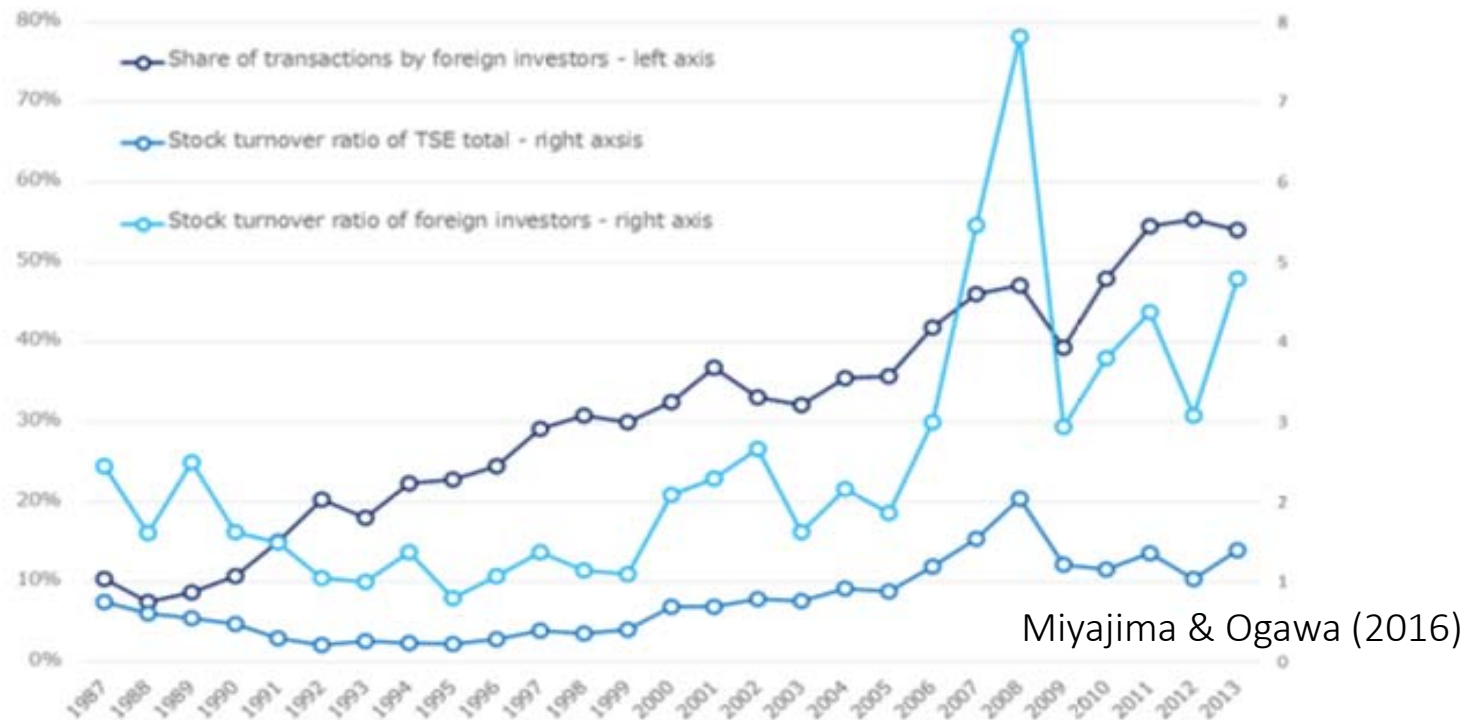
- The government apparently responded to foreign investors' request on corporate governance
- Why does the government care about foreign investors?
  - The ruling LDP traditionally sided with the industry
- Because they agreed on the substance?
  - Japanese companies in 2006-2012 fare poorly in ROA, 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



- Whichever the reason is, foreign investors' voice may become stronger

# IV. Two Competing Views on F-Investors

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))

## IV. Miyajima et al. (2015)

- 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))

# IV. How Does It Work?

## ■ 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. 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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