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Regulatory Developments

Implications for Corporate Governance and Investment

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Corporate Governance

- “Corporate Governance provides an architecture of accountability – the structures & processes to ensure companies are managed in the interests of their owners. But architecture itself does not deliver good outcomes”

Derek Higgs, Combined Code of Corporate Governance

- Responsibilities to shareholders
- Engagement between board and shareholder

Independent Directors

- METI report reflects the challenges dealing with Keidanren
- Independence, Objectivity, Commitment
 - But not the solution to governance
 - Codes of conduct
 - Diversity
- Board & shareholders
 - Engagement is improving
 - Notable results when this happens

Disclosure

- Disclosure of institutional investors' voting
 - Fiduciary duty
 - Appropriate exercise of voting rights

- Disclosure by companies of votes cast at AGM
 - Clarifies shareholders' intentions
 - Restraining influence on management

- Consequences for Investors
 - Likely to make management more attentive to shareholders
 - Promotes engagement and better mutual understanding

Takeover Rules

➤ Shimada Report

“To contribute to the facilitation of M&A, which is an important means of FDI in Japan, wide-ranging studies should be advanced, and the further improvement of Japan’s M&A system should be accelerated”

➤ Investment implications

- Genuine M&A creates a market for corporate control
- External pressure
- Poison pills & cross holdings?

➤ M&A fever

- Available cash...
- Value creation?

Cross Holdings

- FSA
 - Banks' Shareholding Purchase Corporation
 - Stricter disclosure

- Changing business practices brought on by impairment charges
 - Reviews are taking place
 - Bond holdings more damaging to corporate value than equity holdings
 - On & off balance sheet exposure

- Maximising shareholder value
 - Generating cash flow from all assets
 - Present value of future cash flows

Capital Markets

➤ FSA

“Large-scale capital increases through third-party share issuance that entail a significant dilution of control or transfer of control have the potential to cause major problems, particularly in terms of investor protection.”

- Case for pre-emption rights
- Reliance on capital markets → attention to investors
 - Too many companies listed?

➤ Cost of capital

- Financial structures
- Treasury stock

Corporate Governance Implications

- Improvements to structures that promote engagement
 - Involvement of METI & FSA reinforces the trends
 - 'Robust discussion'
 - Governance is improving
 - Greater awareness of capital efficiency
 - Reduction in assets applied
 - Recognition that change is needed
- ➔ Acceleration in corporate value as companies emerge from recession

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