

## **METI-RIETI Symposium**

“Corporate Governance Reform in Japan: Lessons  
from the United Kingdom”

Handout

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<http://www.rieti.go.jp/jp/index.html>

# Corporate Governance Reform in Japan: Lessons from the UK, US and Elsewhere

Colin Mayer

# Outline

- Traditional view of corporate governance
- Global experience
- The UK experience
- The European experience
- The US experience
- Recent developments in Japan
- Conclusions and lessons for Japan

## Main Conclusions

- Corporate governance is critical for corporate performance
- Corporate governance is much more than just corporate boards
- It is about ownership, commitment and control
- Excessive regulation can adversely affect these
- There has been a marked increase in outside, international institutional shareholding in Japan over the last two decades
- This has had a positive effect on company performance
- Japan should seek to maintain stable shareholdings and promote outside ownership by defining board responsibilities

# Traditional View of Corporate Governance

- Enhancing shareholder value
- Protecting shareholder interests
- Frequently reflected in policy recommendations, for example on corporate governance rules, stewardship codes, stock market listing rules and takeover codes

# Part 1

## The Global Experience

# 17 Years Ago We Had the Asian Crisis

- Recommendations of IMF and Alan Greenspan were end crony capitalism
- Asian countries should end their relationship systems
- They should adopt dispersed ownership

# 13 Years Ago We Had the Tech Com Crisis

- Corporate governance standards need to be strengthened
- Interests of management and shareholders need to be better aligned
- Accounting measures of performance need to be improved

## 6 Years Ago We Had the Financial Crisis

- The worst performing financial institutions during the crisis were those with the best corporate governance standards
- The banks that took the greatest risks were those that had the highest powered incentive arrangements
- Fundamental problem to identify correct purpose of corporate governance

# What Should We Be Trying To Do?

- Enhance economic prosperity, entrepreneurship, innovation, growth and value creation
- Corporate governance is critical to this

# Corporate Governance Proposals

Related to:

- Independent directors and chairmen
- Induction, servicing, rotation of boards
- Audit and risk management committees
- Executive compensation
- Investor relations
- Shareholder activism and engagement

## Examples of Policies

- Better legal systems and contractual rights
- Stronger investor protection
- More say on pay
- More shareholder resolutions
- More restrictions on related party transactions

## Examples of Policies

- Better legal systems and contractual rights
- Stronger investor protection
- More say on pay
- More shareholder resolutions
- More restrictions on related party transactions
- But corporate governance is more than this
- It is about ownership, commitment and control

# Part 2

## The UK Experience

## UK Model

- Cadbury Committee – comply or explain, independent directors, audit, remuneration, risk committees
- Corporate Governance Code – leadership, boards, accountability, remuneration, shareholder relations
- Stewardship Code – stewardship policy, conflicts of interest, monitoring, intervention, collective action, voting, reporting
- Listing Rules - premium listed companies cannot issue dual class shares on London Stock Exchange
- Takeover Code - prevents companies from introducing takeover defences during takeovers

# Corporate Governance Code

Leadership – division of responsibilities, role of chairman, non-executives

Boards – skills, appointment, time commitment, induction, information, evaluation, reelection

Accountability – assessments, risk management, reporting

Remuneration – transparency, process, relation to performance

Shareholder relations – communication, general meetings

# Stewardship Code

- Stewardship policy - monitoring and engagement
- Conflicts of interest – policy for managing conflicts
- Monitoring – performance, leadership, board
- Intervention – meeting with management, the board, shareholder resolutions
- Collective action – willingness to work with other institutions
- Voting – voting record, proxy voting
- Reporting – discharging of stewardship duties

# The Disappearing Listed Firm

- Highly dispersed shareholding with few concentrations of holdings
- Number of listed firms on main market of LSE:
  - April 1999: 2194
  - April 2014: 932
- 'The number of public corporations has dropped dramatically in the Anglo Saxon world- by 38% since 1997 in America and by 48% in Britain's main markets.'  
Economist, May 2012

# The Changing Face of UK Ownership

- Pension funds have pulled out
- Foreign institutions have moved in
- Hedge funds have filled the vacuum
- Private equity replaced public equity

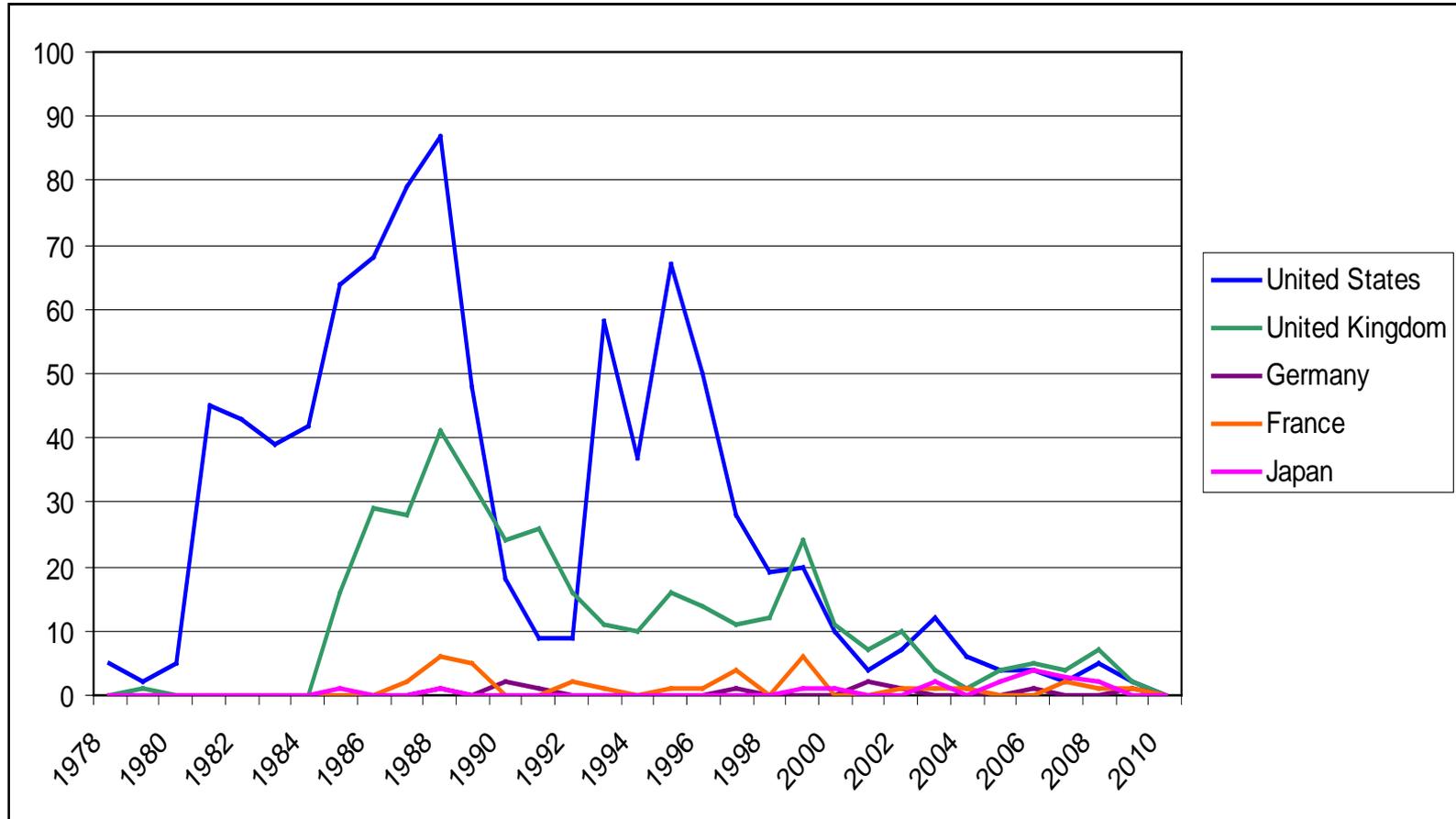
# The Changing Face of UK Ownership

%	1989	1993	1997	2001	2004	2008	2010
Individuals	20.6	17.7	16.5	14.8	12.8	10.2	11.5
Ins. Cos.	18.6	20.0	23.6	20.0	17.2	13.4	8.6
Pens. Funds	30.6	31.7	22.1	16.1	15.7	12.8	5.1
Other Fin. Inst.	1.1	0.6	1.3	7.2	8.2	10.0	16.0
Rest of World	12.8	16.3	28.0	35.7	36.3	41.5	41.2

Source: Paul Davies (2014)

# The Disappearing Market for Corporate Control

## Number of Hostile Takeovers, 1978- 2010



Source: SDC Platinum

# The Market for Corporate Control Illusion

- “New scandals will continue until we bring back the most powerful market mechanism for displacing bad managers: hostile takeovers.” Henry Manne
- “Our results provide a picture of the market for corporate control in the U.K. that is more consistent with dissatisfaction over the bid terms and the redeployment of assets after the takeover than a disciplinary role” Julian Franks and Colin Mayer

# The Market Response

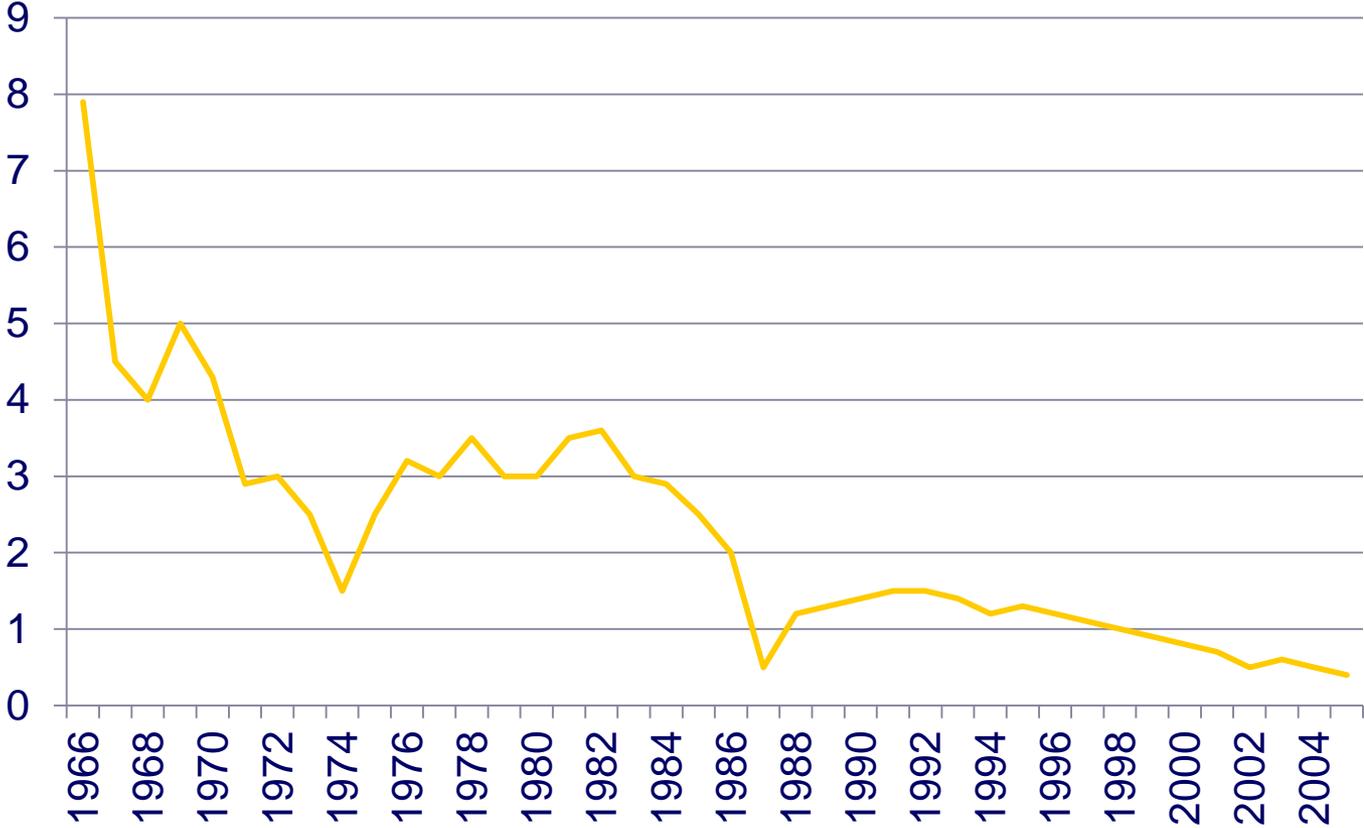
- Traditional Activists
  - Pension funds
  - Insurance companies
  - Mutual funds
- New Activists
  - Hedge funds
  - Vulture funds
  - Private equity funds

## And What They Do

- Focus on as few as 5 to 15 stocks at any one time
- Employ highly incentivized managers
- Create substantial benefits for minority shareholders
- But short-term investors

# The Shortening Holding of Shares

UK - Years



# Short-Termism

- 30-40% of trades are high frequency
- Declining holding periods of shares from average of 8 years 70 years ago, to 4 years 30 years ago to less than a year now
- Failure of commitment

# Cause of Eclipse of Public Corporation

- Excessive investor protection
- Prevents controlling shareholders from exercising control
- Results in ownerless economy
- No shareholder is providing effective corporate governance
- No anchor shareholder providing stable control of company

# Part 3

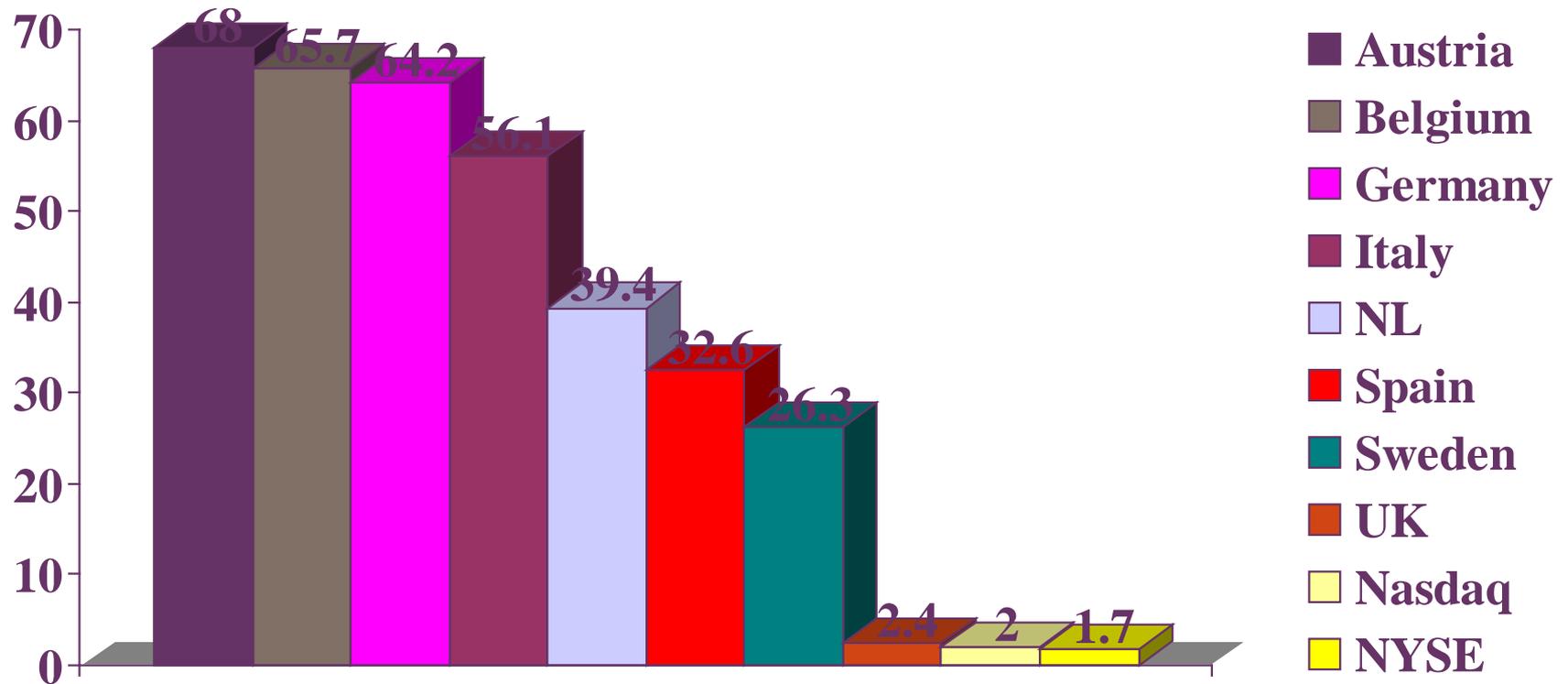
## The European Experience

# In Most Countries Listed Firms Small Proportion of Largest Firms

## Frequency of Listed Firms among Largest 1,000

	Germany	France	U.K.	Italy
Listed firms, % all firms	14.5	13.6	27.8	8.4

# In Most Countries Ownership Is Concentrated



Source : country chapters in Barca and Becht (2001)

# In Most European Countries Family Ownership is Dominant

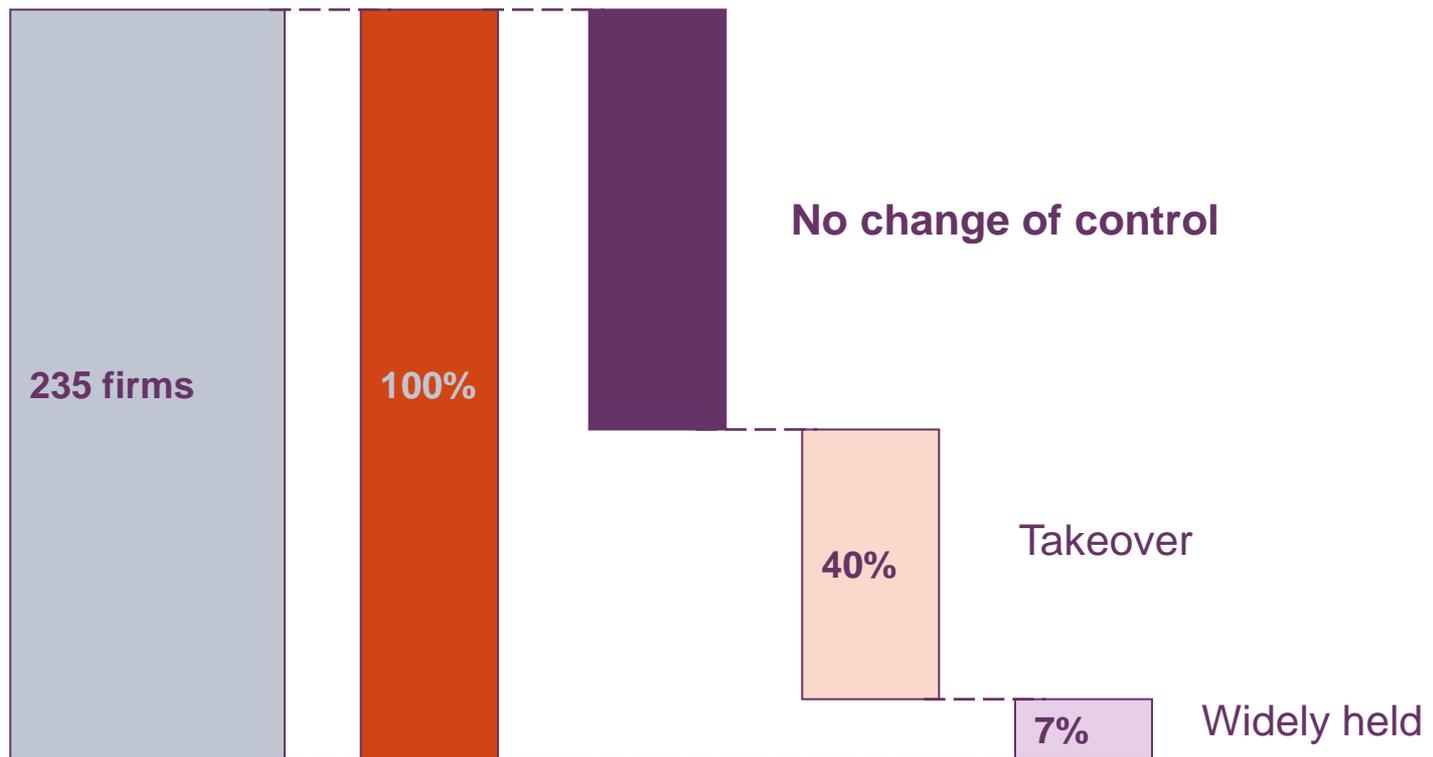
## Top 1000 (private & listed) companies in each country

	Germany	France	UK	Italy
Ownership Type				
Family	33.3	38.2	12.0	46.8
State	9.7	8.2	3.8	13.3
Widely Held	49.5	49.2	70.2	38.0

Franks, Mayer and Wagner (2012)

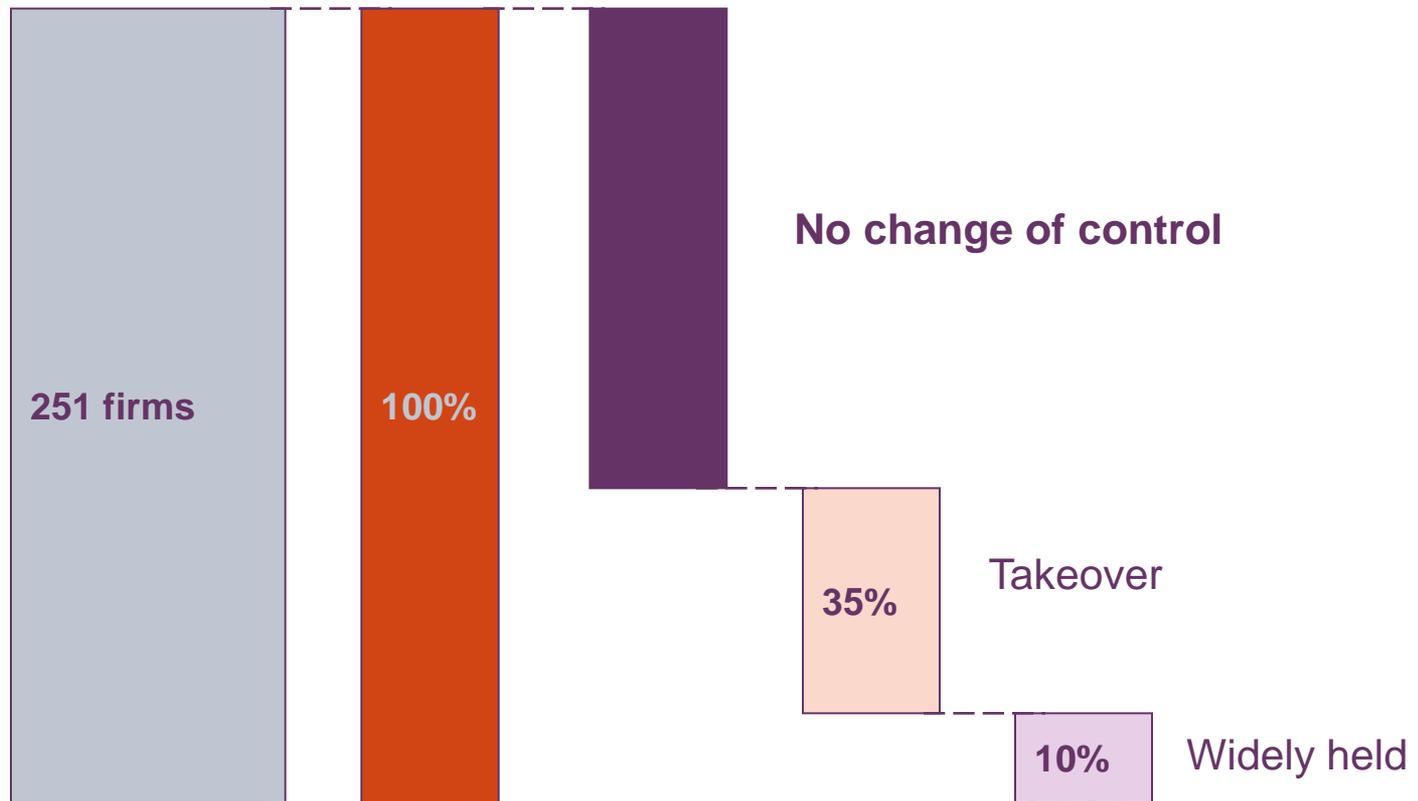
# In Most Countries Ownership is Stable (1996-2006)

## Germany

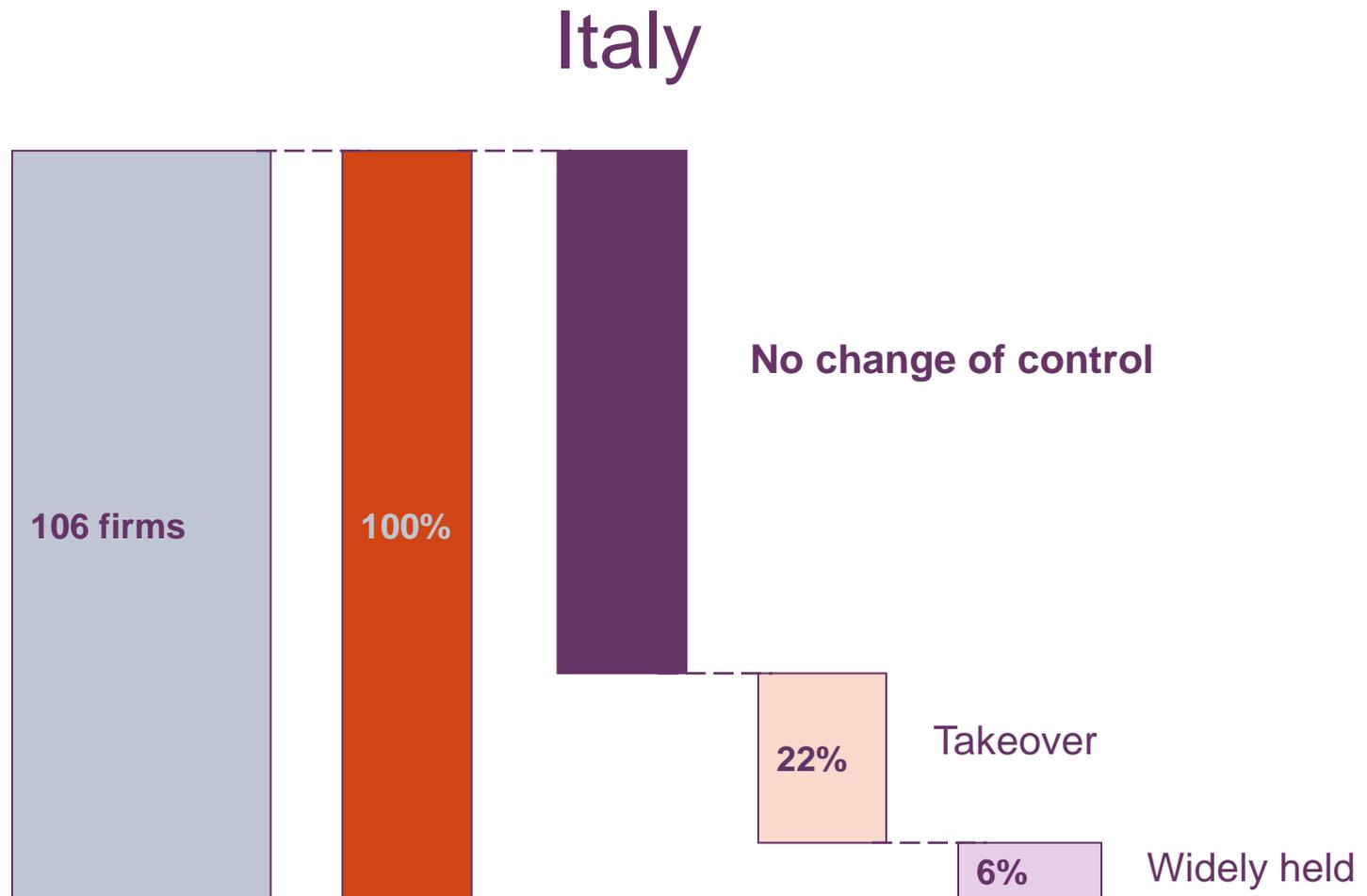


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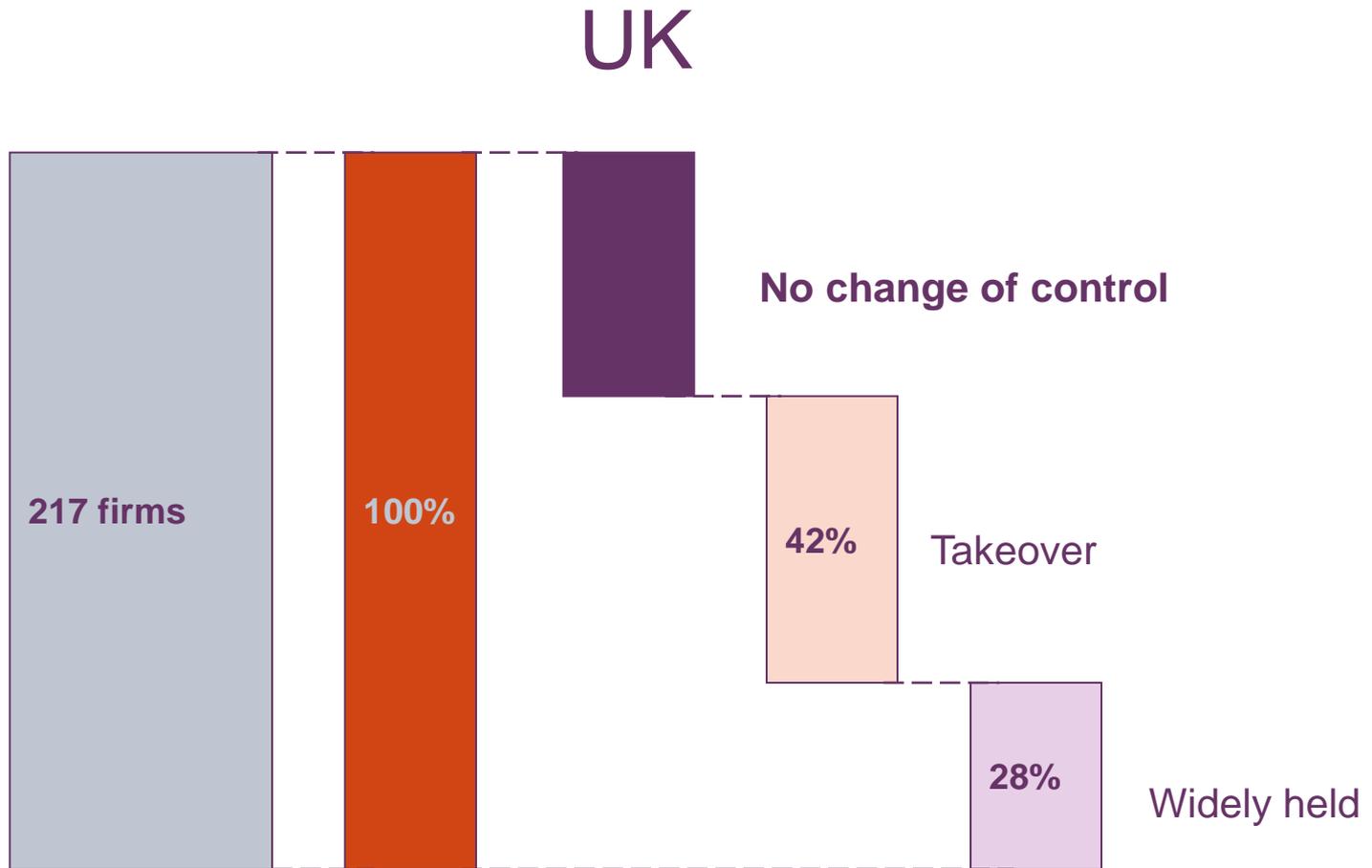
## France



# In Most Countries Ownership is Stable (1996-2006)



# But Not in the UK

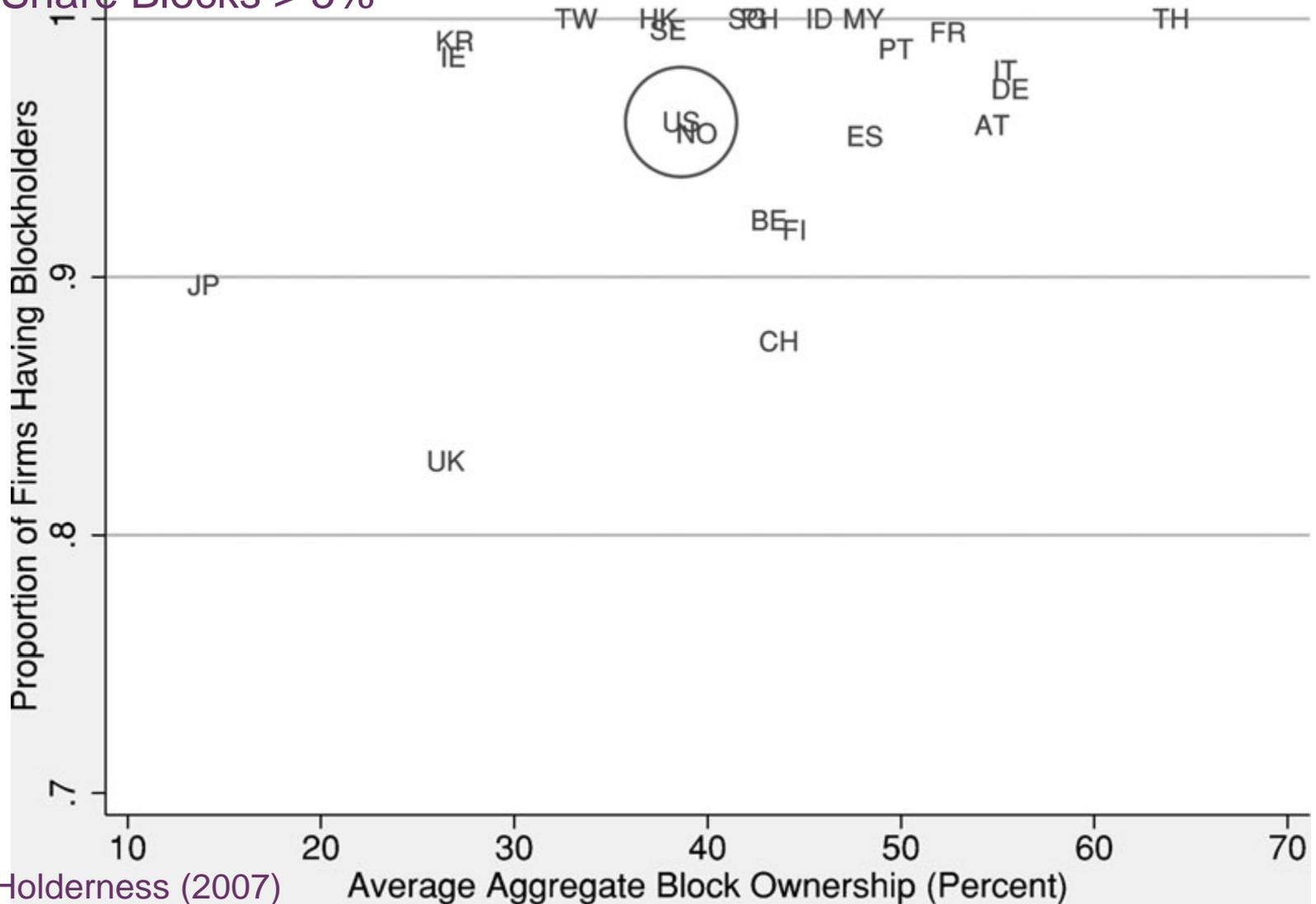


# Part 4

## The US Experience

# Anglo Exceptionalism

Share Blocks > 5%



# American Acceptance

Industry	Anti-Takeover Provisions	Dual-Class Shares
Apparel	18%	10%
Communication	17%	38%
Industrial Services	24%	10%
Metal, Plastics	34%	15%
Average All IPOs	22%	5%

Laura Field (1999)

# Some Examples

- Google: Class A common stock one vote per share
  - Class B 10 votes per share
  - Larry Page, Sergey Brin and Eric Schmidt  
37.6% of votes; executive and directors 61.4%
- LinkedIn: Class A common stock one vote per share
  - Class B 10 votes per share
  - Class B shareholders give to all pre-IPO investors
  - Reid Hoffman 21.7% increasing over time
- Alibaba, Facebook, New York Times company, Washington Post, Dow Jones, Berkshire Hathaway have similar structures

# Dual Class Shares: The Evidence

“Some of these studies document that firm value appears to fall due to dual class capitalization but at least an equal number of studies document that firm value appears to *increase* or remains the same.” (Renee Adam and Daniel Ferreira, Review of Finance, 2008)

# Takeover Defences: The Judgment

- “A board that in good faith believes that a hostile offer is inadequate may properly employ a poison pill as a proportionate defensive response to protect its stockholders from a “low ball” bid.” [Chancellor Chandler, *Air Products v. Airgas Inc*, Delaware Chancery 2011)

# Part 5

## The Lessons

# The Correct Focus of Corporate Governance

- Much more than just boards and institutional engagement
- About structuring firms – ownership, boards, remuneration
  - To achieve the right balance of commitment and control to attain the firm's objectives

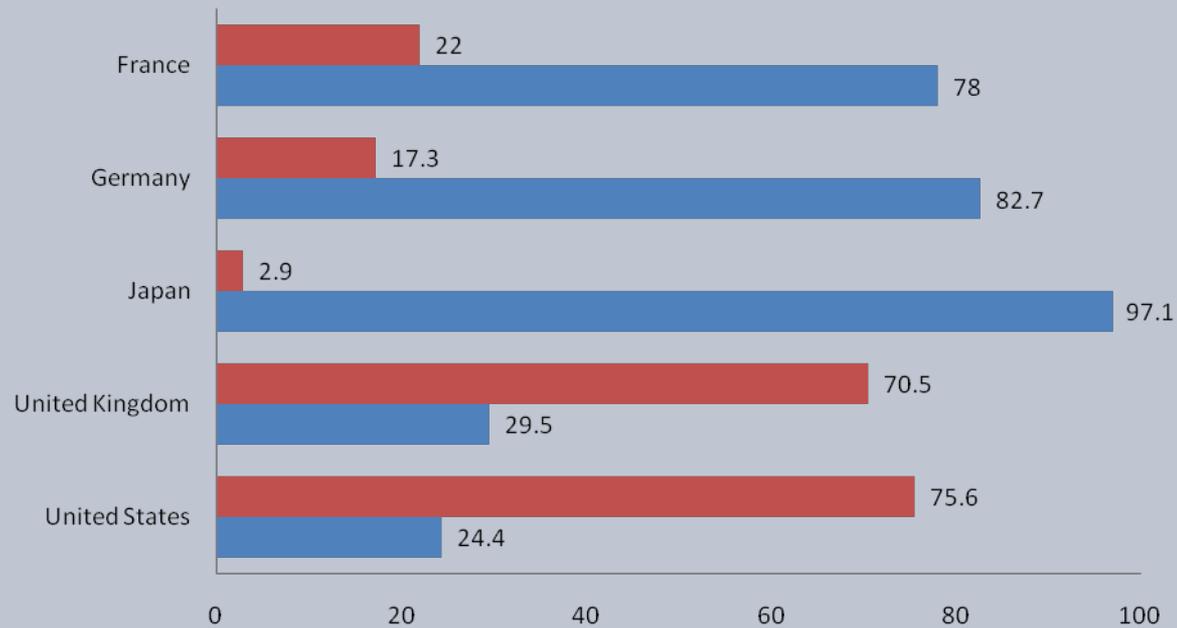
# Implication for Corporate Governance

- Ownership, shareholder control, board structure, incentives intimately related to corporate activities
- Corporate governance about design of ownership, control, board and incentive structure to promote entrepreneurship, innovation, investment and growth – corporate flourishing
- Unique to circumstances of particular companies

# Survey of Managerial Evidence

Which of the following best describes attitudes of senior executives in your company?

- The company exists just in the interest of its shareholders
- The company exists in the interests of all its stakeholders



■ For the shareholders(Shareholder interest should be given the first priority.)

■ For all stakeholders(A company exists for the interest of all stakeholders)

Number of firms surveyed: France, 50; Germany, 110; Japan, 68; United Kingdom, 78; United States, 82.

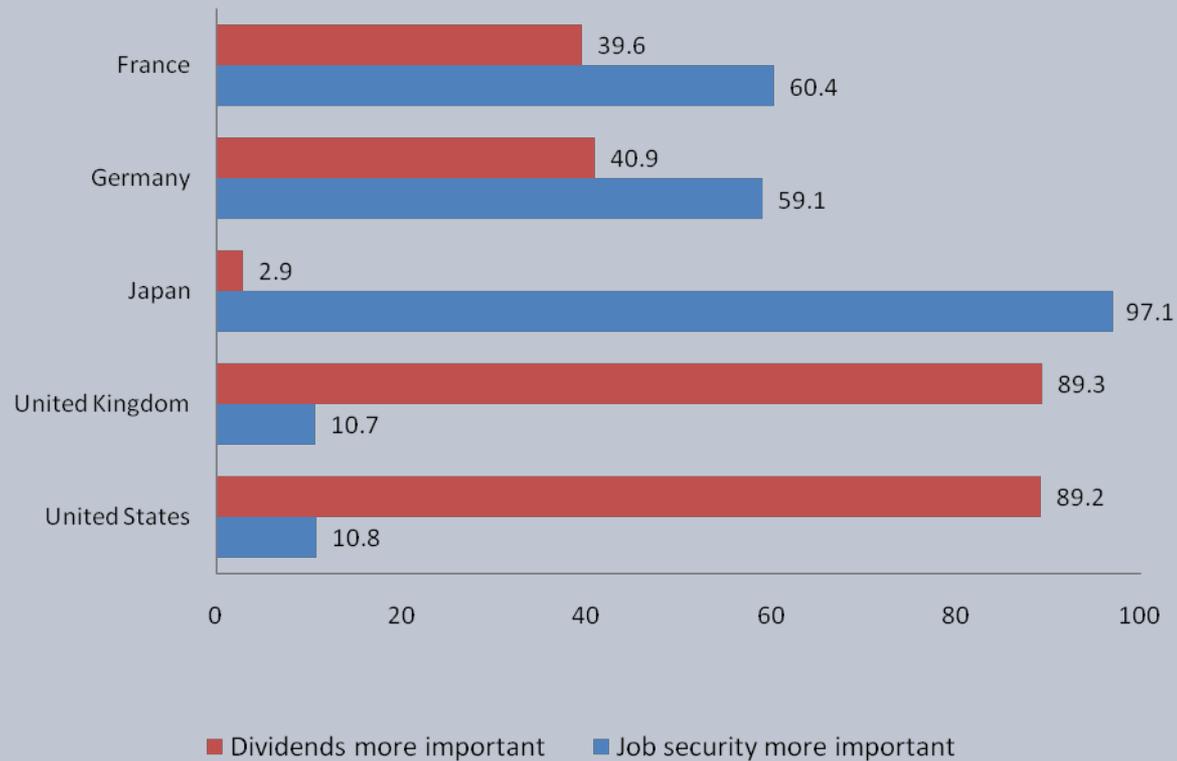
Source: Masaru Yoshimori, "Whose Company Is It? The Concept of the Corporation in Japan and the West." Long Range Planning, Vol. 28, No. 4, pp. 33-44, 1995

# Dividends Versus Employment

Which of the following best describes your firm?

In the event of a financial crisis in your firm senior executives would:

- Maintain dividends even at the expense of employment
- Maintain employment even if it involves cutting dividends



Number of firms surveyed: France, 68; Germany, 105; Japan, 68; ;United Kingdom, 75; United States, 83.

Source: Masaru Yoshimori, "Whose Company Is It? The Concept of the Corporation in Japan and the West." Long Range Planning, Vol. 28, No. 4, pp. 33-44, 1995

## Why Does This Matter?

- Determines degree of commitment to employees and shareholders
- Shareholder commitment high in UK and US and employee and commitments to other stakeholder (suppliers, customers) are low
- Employee and other stakeholder commitments are high in France, Germany and Japan and shareholder commitment is low

## What is the Effect?

- Elicits high employee, supplier and purchaser loyalty in France, Germany and Japan
- But leaves companies exposed to expropriation by stakeholders
- Elicits high shareholder investment in UK and US
- But leaves companies and stakeholders exposed to expropriation by shareholders
- Appropriate balance depends on nature of company, industry and economy

# Implication

What is suited for:

- One company is not for another
- One industry is not for another
- One country is not for another
- Diversity and contractual freedom are required
- Prescriptive regulation designed to enhance markets undermines this

# Part 6

## Recent Developments in Japan

# In Most Asian Countries Family or State Ownership Prevails

	China	Hong Kong	South Korea
<b>Number of Firms</b>	2063	330	345
<b>Widely Held %</b>	17	.6	14.3
<b>Family %</b>	2	64.7	67.9
<b>State %</b>	54	3.7	5.1

Source: Claessens et al. (2000), \*Tian and Estrin (2008).

## But Not in Japan

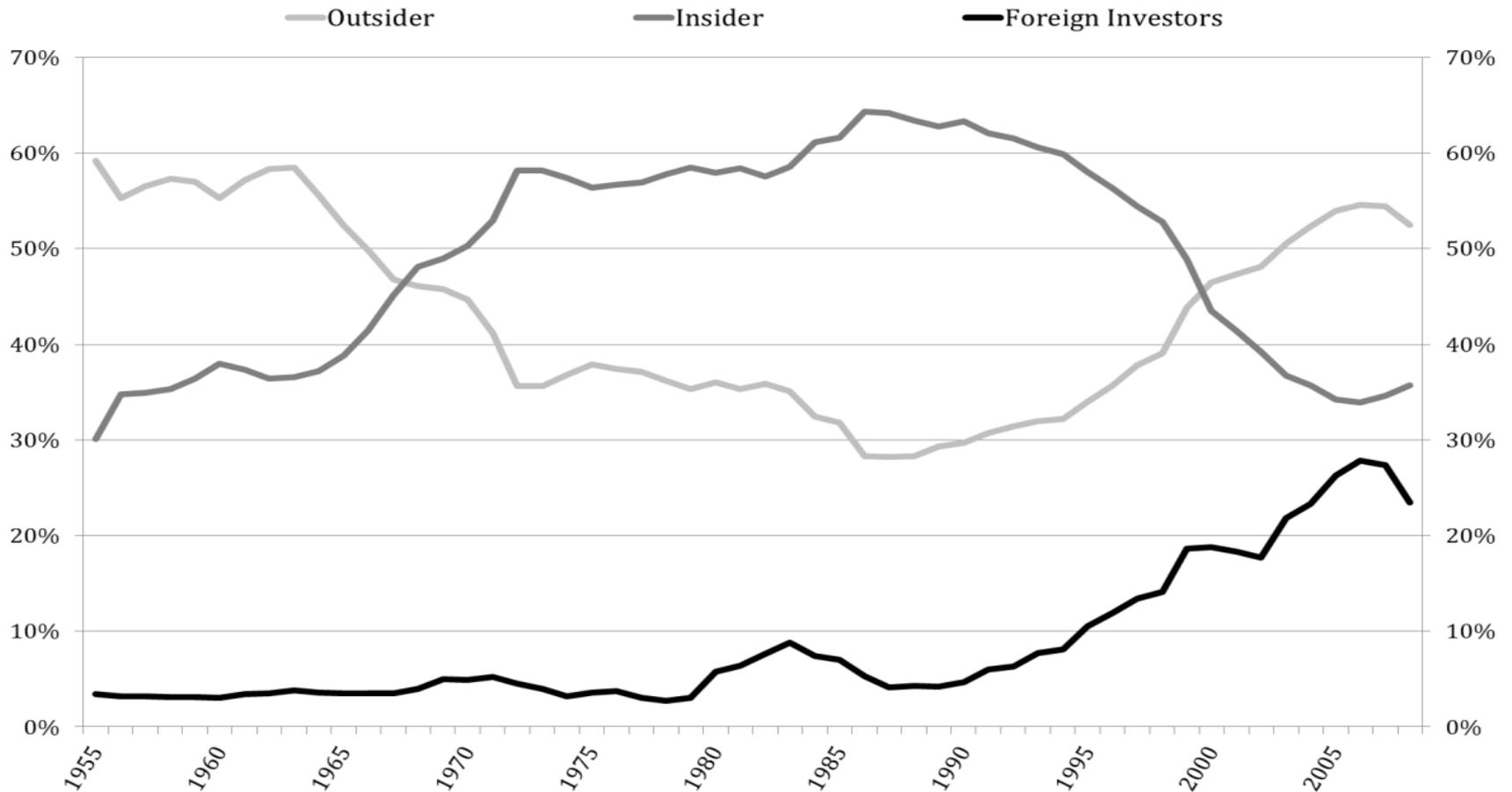
	China	Hong Kong	Japan	South Korea
<b>Number of Firms</b>	2063	330	240	345
<b>Widely Held %</b>	17	.6	42	14.3
<b>Family %</b>	2	64.7	13.1	67.9
<b>State %</b>	54	3.7	1.1	5.1

Source: Claessens et al. (2000), \*Tian and Estrin (2008).

## Japanese Experience Since Mid-1990s

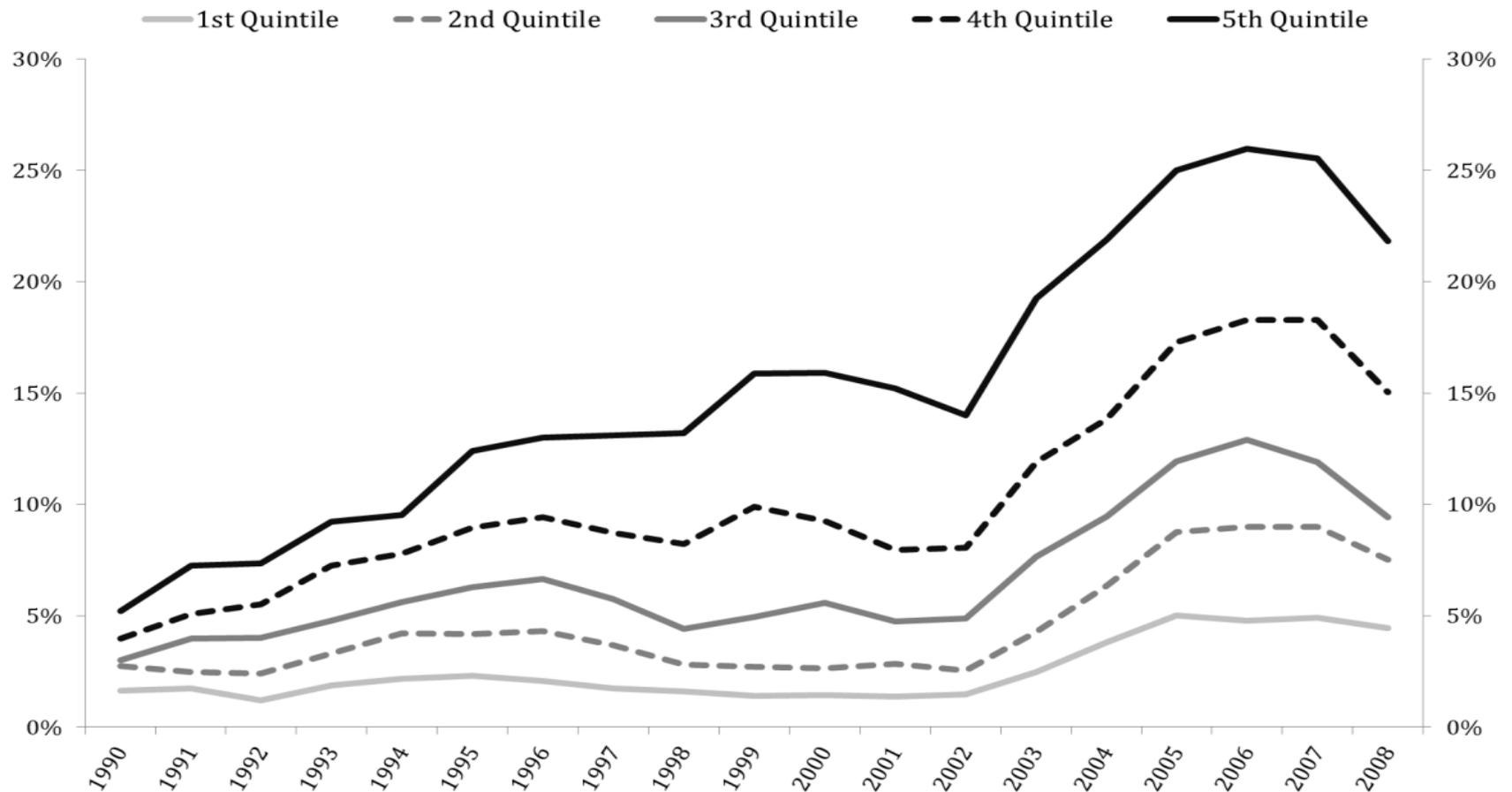
- Outside ownership by foreign and domestic institutional shareholders increased from 30 to over 50%
- Foreign ownership increased from 10 to over 20% - particularly pronounced in large companies
- Inside ownership by banks, insurance companies and other companies declined from 60 to less than 40%
- Some banks (Mitsubishi, Mizuho and SMFG) retain substantial shareholdings
- Cross-shareholdings by companies have not changed

# Ownership of Japanese Corporations



Source: Hideaki Miyajima, Takaaki Hoda and Ryo Ogawa (2014)

# Foreign Ownership by Size of Firm



Source: Hideaki Miyajima, Takaaki Hoda and Ryo Ogawa (2014)

# Ownership of Japanese Corporations

	1991 N=1223		1996 N=1198		2001 N=1404		2006 N=1616		2008 N=1599	
	Mean	Std. dev.								
Insider	46.6	13.5	44.9	13.2	41.8	15.0	37.4	16.2	38.3	16.4
Cross-shareholding	15.4	9.2	15.3	9.1	11.9	9.7	9.2	9.2	9.0	9.3
by financial institutions	10.8	6.3	10.7	6.2	7.2	5.9	4.6	4.9	4.1	4.7
by corporates	4.6	6.2	4.6	6.2	4.7	6.8	4.6	6.4	4.9	6.8
Other stable shareholding	22.5	16.7	22.0	16.6	18.5	17.7	14.9	17.7	15.5	18.0
ESOP	1.1	1.4	1.5	1.6	2.3	2.5	2.0	2.3	2.3	2.6
Directors	2.8	5.0	2.1	4.7	3.6	7.8	4.8	9.2	4.7	9.1
Family-controlled firms *	4.6	9.3	3.9	7.9	5.3	9.7	6.3	10.9	6.7	11.3
Outsider	31.0	10.5	35.8	10.8	43.3	13.0	48.5	14.1	47.8	14.8
Institutional investors	9.2	7.4	12.0	8.8	13.4	11.9	21.8	14.5	19.0	13.9
Foreign (FIO)	4.1	4.4	7.1	6.8	6.6	7.9	14.2	11.6	11.7	10.7
Domestic	5.1	4.1	4.9	3.3	6.8	5.6	7.6	5.6	7.3	5.8
Small individuals	21.2	8.9	23.1	10.6	29.0	14.0	26.0	13.8	28.2	14.7
Foreign corporates *	0.6	5.1	0.7	5.4	0.9	6.4	0.7	5.7	0.6	5.1

Source: Hideaki Miyajima, Takaaki Hoda and Ryo Ogawa (2014)

# Current Structure of Japanese Stock Market

- Number of listed companies on TSE unchanged
- Stable core shareholdings retained
- More outside in particular foreign ownership

## Relation with Performance

- Hideaki Miyajima, Takaaki Hoda and Ryo Ogawa (2014) report that:
- Foreign institutional investments are associated with firms with better corporate governance
- The presence of foreign institutional investors is associated with higher stock market values (Tobin's Q)

# Issues

- Can continuing outside in particular foreign ownership be encouraged?
- Can adequate protection be given to foreign owners while retaining stable core ownership?

## Three Possible Responses

- Strengthen investor protection – but already quite strong
- Boards play more of a monitoring role. Possibly introduce two tier board with representatives of both outside and inside shareholders on the board
- Companies specify the purpose of the corporation more clearly and boards are held accountable for upholding interests of different parties

# Advantages of This Proposal

- Retains long-term focus
- Continuity of life-time employment
- Outside shareholders provide governance function
- Outside shareholders provide equity capital
- Confers the benefits of private equity stability of ownership and close monitoring of management with access to external equity finance

## Conclusions and Lessons for Japan

- Corporate governance is about promotion of corporate growth, investment and efficiency
- Necessary to define appropriate balance between commitment and control
- Excessive investor protection regulation at expense of control and commitment of dominant shareholders
- Japan has moved to hybrid system of stable inside ownership with outside shareholders
- Diversity should be encouraged; companies free to choose
- Outside shareholdings should be protected by placing more responsibility on independent boards to uphold their interests