

Hermes Corporate Governance Principles - Japan



Introduction

We welcome the gradual improvement in the corporate governance environment in Japan in recent years. However, certain aspects of the underlying structure continue to make it difficult for investors to engage with the companies in which they invest with the objective of ensuring their long-term success. Hermes is committed to encourage further changes in Japan's corporate governance framework to facilitate a valuable dialogue between responsible owners and managers of companies.

Pension funds and long-term value creation

This dialogue is of particular importance to Hermes because we work on behalf of some of the largest pension schemes in the world to ensure that companies are run in a sustainable way that ensures the creation of long-term value. These pension funds are the classic long-term investors: they will be around for decades, and have a close interest in the wealth-creating capacity of the companies and economies in which they invest. They represent millions of individuals who depend on the pension schemes for their long-term financial well-being. On behalf of these long-term investors, Hermes votes at shareholder meetings of companies around the world and engages with the boards of those companies to add or preserve value.

The White Paper on Corporate Governance in Japan

There are a number of areas in the Japanese corporate governance system in which we and other investors consider reform to be necessary. As such, in May 2008, we joined with a group of other major international institutions in endorsing the White Paper on Corporate Governance in Japan issued by the Asian Corporate Governance Association (ACGA) (for more information on the ACGA, please visit: www.acga-asia.org). Although Hermes was involved in the development of the White Paper, we would note that it neither covers all of the issues which we consider to be important, nor does it necessarily exactly reflect the specific voting policies of Hermes or the other signatory organisations. Rather, the White Paper summarises the consensus view of the some major foreign investors regarding problems with the governance system in Japan and what might be done to improve it.

Ownership and voting policies

With regard to the exercise of our clients' ownership rights, including voting, we always seek to understand fully the specific circumstances of a company and apply our voting policies pragmatically. As such, we will engage with companies and decide how to vote on resolutions on a pragmatic case-by-case basis. Whenever possible we communicate reasons for voting against or abstaining on resolutions to the company, where practicable in advance of the relevant shareholder meeting. Throughout the year, we are available for a discussion of our ownership and voting policies with regulators, other market participants and Japanese companies.

The following extract from the White Paper on Corporate Governance in Japan summarises our views on the current state of the corporate governance system in Japan and the general nature of the reforms which we believe to be necessary over time. We acknowledge that the process of reform is likely to take some time. As such, we and the other signatories encourage companies to consider the recommendations and where appropriate implement them over the next few years. During this period, new issues may come to the fore. We will continue to be an active participant in the corporate governance debates and to communicate our views on emerging issues. We look forward to an ongoing and constructive dialogue with regulators, other market participants and companies in Japan.

White Paper on Corporate Governance in Japan
Available at: www.acga-asia.org

White Paper on Corporate Governance in Japan



Executive Summary

We believe that sound corporate governance is essential to the creation of a more internationally competitive corporate sector in Japan and to the longer-term growth of the Japanese economy and its capital markets. While a number of leading companies in Japan have made strides in corporate governance in recent years, we submit that the system of governance in most listed companies is not meeting the needs of stakeholders or the nation at large in three ways:

- By not providing for adequate supervision of corporate strategy;
- By protecting management from the discipline of the market, thus rendering the development of a healthy and efficient market in corporate control all but impossible;
- By failing to provide the returns that are vitally necessary to protect Japan's social safety net—its pension system.

This White Paper focuses on, and makes recommendations with regard to, six key corporate governance issues:

1: Shareholders as Owners:

The portrayal of the Japanese system as “stakeholder capitalism” is outdated and fundamentally inaccurate. The rights of shareholders as owners of listed companies need to be better recognised and protected. The interests of shareholders and other stakeholders can best be aligned through an enlightened adherence to the rules and conventions of international capital markets.

We believe that the fair treatment of shareholders can and should be aligned with the fair treatment of other stakeholders.

2: Utilising Capital Efficiently:

Demographic and social change will increase the pressure on listed companies in Japan to generate income for pension funds. Improved shareholder value will be vital in order to achieve positive social outcomes.

Managers should strive to maximise long-term corporate value by implementing rigorous financial and business disciplines.

There is strong evidence that, over the medium to long term, the total shareholder returns of Japanese companies that pay higher dividends outperform those that pay lower dividends.

3: Independent Supervision of Management:

There should be a transparent process of independent, external supervision of management on behalf of all shareholders. We recommend that all companies, even those with traditional board structures, make a commitment to appoint a minimum of three independent external directors as soon as practicable. Over the medium term, such directors should ideally comprise a third of the board. Over the longer term, we recommend that they comprise one half of the board.

These ratios are based upon practical experience in other developed markets regarding the minimum number of independent directors required for the effective functioning of boards.

4: Pre-emption Rights:

Pre-emption rights should be introduced for shareholders, so that they have adequate protection against dilution from the issuance of new shares or convertible securities to third parties or a small number of select shareholders.

5: Poison Pills and Takeover Defences:

The adoption of poison pills that have been structured to protect management and to stop takeover bids from succeeding is in the interest neither of shareholders nor the company (and companies should consider revoking these). “Shareholder rights plans” offer a workable and fair alternative.

6: Shareholder Meetings and Voting:

The timing of shareholder meetings and the process of shareholder voting should be accessible, fair and transparent. New and unpredictable cross-shareholding structures are distorting the voting results at shareholder meetings, particularly EGMs. Votes should be conducted by poll for all resolutions at the AGM and any other shareholder meeting. We recommend that full voting results be published as soon as possible, ideally the following day or no later than five calendar days after the meeting.