Asian Corporate Governance Association (ACGA)

"Global Japanese Companies: What Foreign Investors Expect"

Presentation by:
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Governance of Global Japanese Firms

In general, foreign investors expect Japanese firms investing abroad to:

1. Understand international and national regulatory and governance norms, and adapt accordingly;
2. Board composition that reflects and supports the degree of internationalisation of the group;
3. A high degree of transparency in financial, CG and ESG/sustainability reporting—benchmarked against corporate global best practice, not local rules in Japan;
4. An approach to risk management that is relevant to challenges faced in overseas markets.

Successful Governance – Criteria

1. A culture of accountability within the company;
2. Leadership that sees governance as a continuously improving process, not a compliance game;
3. A sufficiently diverse board that undergoes regular evaluation and rejuvenation;
4. A high level of skill, competence and diligence among each individual director, with ongoing learning;
5. A robust audit committee, with strong oversight of financial reporting, external accounting auditor, and internal controls and risk factors;
6. A proper system of internal audit, reporting to the audit committee;
7. A nomination committee with real nomination powers;
8. Openness to dialogue with shareholders/stakeholders, sense of humility.

M&A Governance – The Missing Link

- One feature often overlooked for firms expanding overseas is the quality of their "M&A governance".
- It is striking that many overseas investments do not generate corporate value—and statistics today are not much different from 20 years ago.
- This suggests that something is wrong with the way in which many firms undertake M&A and manage the associated risks

A global problem

According to Vincent Poizat, Senior Manager, Risk Advisory, Deloitte Touche Tohmatsu, Tokyo:

- Twenty years ago, the success rate (value creation for the acquirer) was about 30%. Reality is even worse if we take into account deals that failed to close.

- Much progress has been made since then: strategy, valuation, due diligence, integration planning. All acquirers worldwide have access to such M&A tools.

- Yet success rate remains unchanged:
  - While some “serial acquirers” have learnt and developed their own M&A governance, many new entrants (e.g. many Asian companies) have not;
  - The landscape is littered with impairment losses, rushed exits and damaged reputations;
  - M&A tools add most value if in the context of well governed M&A processes

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What is failure in M&A transactions?

Vincent Poizat outlines the following process weaknesses that destroy value:

Failure to originate	•Inadequate M&A strategy or investment criteria leads to long periods of inaction •Inability to focus and make timely decisions consumes resources, hurts reputation and credibility, and generates fruitless chaos •When corporate strategy dictates that a deal be closed within a certain period, inefficiencies lead to rushed and desperate deals
Failure to close	•Lack of well-established and efficient processes with clear responsibilities results in missed deadlines and unpredictability – a cardinal sin especially in auctions •Poor execution processes resulting in overly disruptive, repetitive and long due diligence investigations and too much "back and forth" create deal fatigue and may lead to failure •Cultural clashes, especially in negotiations, can quickly derail deals and hurt reputation
Over-paying	•<u>Not knowing what you are buying:</u> unfocused and "tick-box" due diligence (often ignoring sensitive areas such as cultural fit), disconnected negotiation and post-transaction process •<u>Paying high premiums:</u> moral hazard of access to money, "long-term strategic" considerations that hide lack of economic appeal, personal agendas, over optimistic projections, lack of integrated pricing strategy, having to compensate for perceived lack of credibility or speed •<u>Not capturing value:</u> inadequate integration or involvement of integration team, no specific value targeted in the short (more tangible) term, cultural clashes

Does Japan lack accountants and auditors? Yes & No.

	# CAs/CPAs (per local industry body)	# Practising CAs/CPAs (have audit signing power)	# audit firms/ practices	# firms auditing listed comps	# listed companies ("issuer")	CA/CPA per issuer	Practising CA/CPA per issuer
China	235,398	104,913	7,461	71	3,425	68.7	30.6
HK	41,700	4,682	2,500	61	2,069	20.2	2.3
India	82,012*	66,061*	66,916	n/a	5,828	14.2	11.3
Japan	30,128	5,981	223	126	3,548	**8.5**	**1.7**
Korea	19,174	11,985	174	174	2,175	8.8	5.5
Malaysia	33,886	1,626	1,442	49	920	36.8	1.8
Singapore	24,243	1,105	706	16	749	32.4	1.5
Taiwan	7,178*	3,827	2,107	72	1,921	3.7	2
Thailand	9,546	6,368	1,071	27	663	14.4	9.6

Sources: ACGA research based on the following sources: **China**: CICPA, China Accounting.cn; **Hong Kong:** HKICPA; **India:** ICAI, personal contacts; **Indonesia:** **Japan:** Nomura Research Institute, JICPA; **Korea:** KICPA; **Malaysia:** MIA, MICPA, Audit Oversight Board; **Singapore:** ISCA, ACRA; **Taiwan:** Financial Supervisory Commission; **Thailand:** SEC, FAP.

(* = 2016)

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