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Opinion at the 29th Meeting of Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code

Efforts by the FSA and the TSE to improve corporate governance, including the PBR issue, are steadily producing outcomes. In terms of corporate performance, Japanese companies with "ambidexterity" are steadily increasing. They are entering a virtuous cycle of profit and growth, in which they increase profitability by concentrating on business areas where they can leverage their fundamental strengths at the organizational capability level, while at the same time reducing business areas where they no longer have such strengths, and using the cash generated from these to invest in exploration of new business opportunities and innovation.

The Japan Association of Corporate Directors' annual Corporate Governance Award use sustainable growth potential, profitability, and governance adequacy as its basic criteria for selection. In recent years, Japan's leading traditional manufacturing companies have won the Grand Prize, indicating that corporate governance reforms are becoming more substantial. This trend must not be stopped, and the reforms should be accelerated further in the current direction.

On the stewardship side, in contrast, the hollowing-out of engagement is becoming a serious problem.

In the governance structure under the Japan's Companies Act, which adopts the "capital democracy parliamentary system," the more companies make efforts on corporate governance respecting the principles of the system, the more constructive dialogue and engagement between the side of shareholders and institutional investors, who have the right to vote in the election of directors, and companies will be an important requirement for the sound functioning of the governance structure.

However, the percentage of index funds and passive funds among institutional investors is expected to increase further due to the introduction of the new NISA, and there is a concern that the presence of active funds, which have the motivation to actively engage, will decline. Therefore, the role of so-called activist funds is attracting attention. Even if their claims are aimed at sustainable corporate value enhancement, there is an unavoidable bias to focus on undervalued stocks in order to aim for high investment performance, and their engagement coverage will inevitably be limited.

That is why collective/collaborative engagement is discussed. It is true that formalistic engagement, such as filling out a checklist, is not effective in improving corporate value. The hollowing out of engagement cannot be stopped unless a specific mechanism is created in which first class professionals with high expertise, knowledge, and experience in both finance and business become the bearers of engagement. Not only the slogan but also such effective efforts should be studied jointly by the public and private sectors.

It is true that the importance of "corporate culture" is emphasized in the discussion on sustainability, but it should be noted that the Japanese word for "culture" has a very soft nuance like an art term. The term "culture" used in English in context of management theory, as implied by the fact it is derived from "cult", refers to a mode of thinking and behavior that is deeply ingrained in people and cannot be explained by superficial rationality alone. It can be described as an intrinsic motivation mechanism. We should be careful not to misunderstand the nuance.

Finally, although it is out of the scope of issue at this meeting, I believe that the time has come to reconsider the institutional design of the Board of Directors, which is at the node of corporate governance and stewardship, and in particular, the ideal form of a "Company with a Nominating Committee, etc." in light of the fact that 20 years have passed since the system was launched (almost 10 years have passed since the intermediate form of institutionalizing a "Company with an Audit and Supervisory Committee" was institutionalized) and that the number of independent directors has increased dramatically since then. In the capital democracy parliamentary system, there is a big doubt about the system in which the Nominating Committee can skip the Board of Directors, which is the highest organ of corporate governance, and directly submit a proposal for the election of directors, which is an important agenda item, to the general shareholders meeting. In the case of a Board of Directors with a majority of independent directors, there is little rationality and necessity of such an irregular system. On the contrary, there is a concern about the runaway risk of the Nominating Committee, in which only a part of the directors participate. Although it is a matter of the Companies Act and relevant to the Ministry of Justice, now that the governance reform has finally advanced to the practical stage, the institutional design of the Board of Directors should advance to that of a "Company with a Nominating committee, etc."

harmonized with global standard.