

# Active on governance issues in Japan

In April 2015, the RI (Responsible Investors) ASIA 2015 conference was held in Tokyo. On the agenda was the topic of Japanese corporate governance and the transformation it is experiencing at present. One of the invited participants was the Second AP Fund's General Counsel, Martin Jonasson.

Text: Lars Mattsson

"The Second AP Fund has substantial holdings in Japanese equities. This is why we should take a keen interest in these matters – both by networking and in direct dialogue with our portfolio companies, the Tokyo Stock Exchange and other policy makers," says Martin Jonasson.

Right now, the interest in governance issues in Japan is considerable.

"A 'stewardship code' and a corporate governance code have both been developed in a very short time. My impression is that many are surprised at the energy with which these codes have been implemented. As international investors, we must benefit from the momentum generated and employ it in an attempt to steer development in what we believe to be a desirable direction," notes Martin Jonasson.

## Initiative for growth

The background to these changes is the fact that the Japanese economy has been marking time for the past twenty years, even though the product portfolios of the country's extremely large multinationals generate a never-ending stream of export successes. The diagnosis reached by Prime Minister Shinzo Abe and his advisors highlights inadequate corporate governance as a fundamental weakness. The need to deal with the problem has been assigned top priority.

One example of the nature of these deficiencies in governance is the way the boards of Japanese companies are structured. There is a range of different models. Boards numbering close to 20 directors are not uncommon, featuring an internal distribution of responsibilities that can be difficult for an outsider to understand. Furthermore, external and independent directors are a rarity.

"One reason for this is the anxiety that the recruitment of board members from outside the company may be interpreted as a sign of weakness – that one's own organization lacks the necessary competence," comments Martin Jonasson.

This situation is slowly but steadily changing. The Second AP Fund is actively engaged in this issue, in dialogue with its portfolio companies.

## Dialogue for gradual change

"It is important to be respectful when conducting this dialogue, but it is also important to be concrete. We cannot expect to fly in from Sweden, attend a few meetings and then, we have a new governance model. Instead of demanding a radical transformation, we promote the idea that at least a third of the companies' boards should consist of independent directors. We also want to focus more on how control of the companies is structured. This means that the boards should devote more attention to strategic considerations and acting as a support to executive management," states Martin Jonasson.

Another weakness of Japanese governance is an historic aversion to distributing liquid assets to shareholders, which means that balance sheets grow or, in the worst-case scenario, that the money is used to keep faltering businesses viable. This has contributed to ensuring that companies' return on equity is low, when seen from an international perspective. Ultimately, this has an impact on the share price, which influences investors like the Second AP Fund. This is why it is so important to push for a change, according to Martin Jonasson.

"As well as helping protect the value of our investments, this dialogue enables us to see our own model in a more objective light. There is still plenty of room for improvement here in Sweden. Some of the proposals put forward in Japan could prove useful to us too," concludes Martin Jonasson.