Dealreporter
An Acuris company

PROPRIETARY

Japan's new Meti guidelines aim to curb unfettered behavior by controlling shareholders

24 July 2019 | 10:24 BST

- Independent directors should hold at least 1/3 of subsidiary board seats
- Independent directors need to act on behalf of minority shareholders
- Abundance of listed subsidiaries a result of many partial tender offers

Guidelines introduced in Japan last month to improve corporate governance of listed subsidiaries are expected to help contain the freewheeling behavior of parent companies and controlling shareholders, but fundamental legal issues remain unresolved, lawyers say.

The non-binding "group governance" guidelines, unveiled by the Ministry of Economy, Trade and Industry (Meti) on 28 June, acknowledge that conflicts of interest exist between a controlling parent shareholder and minority shareholders of the listed subsidiary.

For instance, parent entities can take advantage of their position by forcing their listed subsidiaries to supply goods and services to the parent on favorable terms. Also, when a parent company acquires its listed subsidiary, merger terms are often set at a disadvantage for minority shareholders of the subsidiary, the Meti said in its report.

There have been numerous such buyouts and group restructurings in recent years, and more are expected to follow. The Meti’s tougher group governance guidelines come as conglomerates like **Hitachi** [TYO:6501], **Sony** [TYO:6758], **NTT** (Nippon Telegraph & Telephone) [TYO:9432] and **Nomura Holdings** [TYO:8604] are set to consolidate their respective sectors either though buyouts or by selling off their hundreds of listed subsidiaries, this news service observes.

A key feature of the new guidelines is urging listed subsidiaries to fill a majority, or at the very least more than a third, of their board seats with truly independent directors. Anyone who has had a connection with a related company in the past 10 years should not be elected as an independent director. Listed subsidiaries should also install a mechanism whereby important conflicts of interest situations should be thoroughly discussed at a committee mainly composed of independent directors.

However, some lawyers argued that the guidelines may not go far enough in ensuring independent directors are indeed independent from the parent company.

“For the guidelines to be more effective, there should be a mechanism to reinforce the independence of directors of listed subsidiaries, for example, by changing the definition and introducing a rule to prevent the controlling shareholder from unilaterally exerting power over the director candidate slate,” said Ken Kiyohara, a Tokyo-based M&A and corporate governance lawyer.

Another fundamental legal issue not fully addressed, according to Kiyohara, is fiduciary duties. Under Japanese law, controlling shareholders do not owe fiduciary duties to listed subsidiaries or their shareholders, and therefore, minority shareholders of listed subsidiaries do not have effective means to hold the controlling shareholders directly responsible, Kiyohara said.

Truly independent directors

As per the new guidelines, independent directors of listed subsidiaries should “play a ‘key’ role in preventing minority/general shareholders of the listed subsidiaries from being abused [by the controlling shareholder],” Hideki Kanda, a Gakushuin University professor, said at a corporate governance seminar arranged by International Corporate Governance Network (ICGN) in Tokyo last week.

“The important thing is independent directors should be ‘independent’ from the controlling shareholder. They should be able to act sincerely on behalf of minority shareholders of listed subsidiaries to manage conflicts of interest between the controlling shareholder and general shareholders,” said Kanda, who chaired the Meti’s study group on the guidelines.

Hiroyuki Horii, chief stewardship officer of **Sumitomo Mitsui Trust Asset Management**, speaking at the same seminar, claimed the existence of “zillions of listed subsidiaries” in this country is a “uniquely Japanese phenomenon”.

Listed subsidiaries with a controlling parent that holds more than 50% accounted for 6.1% (238 companies) of all listed companies in Japan at the end of 2018, while that percentage in the US and the UK is 0.5% (28 firms) and zero, respectively, Horii said, citing the Meti report.

The number of subsidiaries listed on the Tokyo Stock Exchange (TSE) totaled 628 as of December 2018, representing 17.2% of all companies listed on the exchange, according to TSE data.

Listed subsidiaries do exist overseas, but they exist only as a transitional measure, and their parent companies eventually buy them out or sell them off. In Japan, listed subsidiaries continue to stay, the Meti said in its report.

Listed subsidiaries as post-retirement landing spots?

Quite often when you look at corporate governance failings, they have occurred at the subsidiary level or the subsidiary’s subsidiary level, Yoshimitsu Kobayashi, chairman of **Mitsubishi Chemical Holdings** [TYO: 4188], said at the ICGN seminar.

A key reason for the many listed subsidiaries in Japan is that companies are allowed by law to acquire other companies through partial tender offers. A bidder is required to purchase all tendered shares only if the shareholding ratio at the target company is expected to be two-thirds or more of the total voting rights following the tender offer, said Kiyohara.

“I don’t think the guidelines have touched on the real issue,” said Tsuyoshi Maruki, head of Tokyo-based activist Strategic Capital. “Why do we have many listed subsidiaries in Japan? Because they exist for the sake of their own happiness: i.e. to create post-retirement “amakudari” landing spots for their senior officials – not for improving corporate value.”

In a survey of 90 companies by the Meti, 54% of the companies said maintaining the motivation of employees of listed subsidiaries is the biggest reason for listing a subsidiary, while 40% said the objective is to maintain a brand status of listed companies. None of the surveyed companies cited improvement in corporate value of the listed subsidiaries as the major reason for listing.

According to Prime Minister Shinzo Abe’s “growth strategy”, approved by the cabinet on 21 June, the Tokyo Stock Exchange is expected to formulate additional measures aimed at enhancing the independence of listed subsidiaries from controlling shareholders by reviewing its own independence criteria in line with the Meti’s group governance guidelines.

Abe’s corporate governance reform plan is currently facing an acid test in the case of office supply provider **ASKUL** [TYO: 2678], whose controlling shareholder **Yahoo Japan** [TYO:4689] is threatening to oust ASKUL’s president, Shoichiro Iwata, at a shareholder meeting set for 2 August.

by Norie Hata in Tokyo

Grade: Strong evidence

Value (GBP m): 1086.4976

Market cap of ASKUL

TARGETS

ASKUL Corporation

BIDDERS

Yahoo Japan Corporation

VENDORS

PLUS Corporation

Japan

Internet / ecommerce

Topics: Other, Mergers and Acquisitions, Antitrust/Regulatory

Intelligence ID: prime-2876152