

Strategic Capital, Inc. (“SC”) is pleased to announce the submission of its opinion to the International Corporate Governance Network (“ICGN”) on January 22 as additions to ICGN’s commentary:

The definition of “Cash” - SC would like to expand the definition of “Cash” to include not only cash and other liquid assets but all securities (with the exception of subsidiaries) and real estate for leasing. SC regards such assets as “Cash” because much like actual cash the returns are below the cost of capital.

Approach to capital allocation - If the capital allocation policy impacts the balance sheet significantly, companies should explain the rationale behind the decision. This will help ensure management is not irrationally using the cash such as rebuilding new office buildings etc.

The rationale of Cross shareholding - SC emphasises the facts as following:

- ◆ Cross-shareholdings weaken management discipline because such shareholders will unconditionally support management decisions (often referred to as “stable shareholders”).)
- ◆ One of the purposes of cross shareholdings is to help preserve managements’ positions as directors. Using shareholders’ assets for such a purpose is highly inappropriate.
- ◆ As unrealised gain / loss of cross shareholdings is accounted for as a part of equity capital, the return on equity will experience, exhibit undue fluctuations as a result of the market price movement of the cross shareholdings. In addition, during periods of extreme stock-markets drawdowns, the declining value of cross shareholdings potentially hit the P&L as an extraordinary loss a.k.a. mark down. As a result, both the denominator and numerator can suffer from unfavourable effects of holding cross shareholdings. SC cannot ignore the fact that shareholders are exposed to such market risk.

The disclosure of Cross shareholding - Companies should not try to ‘hide’ cross shareholdings in the pure investment category, which would also increase the weight in the revised TOPIX index. Therefore, SC recommends where the purpose of cross shareholding is changed to pure investment, the shares must be sold in one year.

Strategic Capital, Inc.
President & CEO
Tsuyoshi Maruki