

# Japanese Boards: **Wide Disparities in Quality, Substance**

## Quality of committees

At 56% of firms, the “nominations” committee met  $\leq 3$  times per yr; 41%,  $\leq 2$  times per yr. Vast majority of 3C firm nom committees met 5 or more times per year

Biggest problem for committees is the lack of information to evaluate qualifications of executives

Even many comm members do not consider “involvement in nom/comp decisions” to be their priority

## Impact, and engagement with shareholders

40% of outside directors have never succeeded in changing a board resolution or having it reconsidered as a result of their comments. 60% have had such an experience

Only 4.7% of outside directors have ever met with a shareholder on a one-on-one basis, even though “engagement” with shareholders is a duty under the CGC

Even so, 76% “would be willing to engage with shareholders if asked”, and 10% are actually doing something in that regard, vs. 14% who “see no need for engagement”

60-70% of companies with market cap > 1 Trillion Yen “fully comply” with the CGC . This percentage comes down rapidly to 45%, 20% or much lower for smaller market cap categories

Results are from various surveys by METI in recent years.

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## Strategy and Planning is the Major Challenge

The top issue/challenge for outside directors, as revealed in board self-evaluations, is “setting the long-term strategy”

49% of outside directors think that divestment of noncore businesses is going well, but 24-27% of believe there are problems that need addressing (unclear criteria or process, or not enough debate)

34% think that there is not enough time allotted to discussion about the business portfolio, 24% believe that discussion is not leading to concrete results, and 10% say there is no debate at all

At 36% of firms, there is no discussion by the board about the mid-term plan

19% of outside directors feel it is hard to make comments or ask questions because there are too many items on the agenda

About half of all outside directors think that it would help: a) to have informal forums for discussion, and b) to streamline board agendas so that there is more time to discuss strategy

## Many outside directors are inexperienced and untrained

31% of outside directors have less than 3 years of experience as an outside director at any firm. 84% of outside directors have less than 5 years of experience in their present position

Only about 20% of firms are actually doing something to train or update outside directors.

The majority of outside directors are not offered training by the company

Results are from various surveys by METI in recent years.

“Stakeholder” Global Shift Allows Firms to Defocus on “G”?

However, CG is still improving at **quality** Japanese firms.

**The challenge is how to identify those companies.**

- 1) Wide disparities: CG practice, quality of directors, board discussion, analysis of alternatives, true inclusiveness, etc.
- 2) Old behavior patterns on boards hard to change
  - Pre-scripted boards. Directors “look to the CEO” (want to be re-nominated)
  - Japanese directors unused to free debate, new ideas, financial analysis
  - Diversity, global experience needed. Director training needed, esp. in finance
- 3) Need more directors knowing a) finance; b) same industry  
More foreigners, women on boards needed: **stir it up!**
- 4) Investor voices can have big impact! → IF raised, in writing, or via activism, which continues to increase

# Ways to Identify “Quality” and “Substance”

- Quality of public disclosure, not just integrated report. Depth, clarity? Or cut/paste from last year? Compare w/ past years. Improvement trend? English?
- Ask to meet with an outside director. Try approaching that director first yourself, directly. The company may not tell him/her, or may make excuses
- Robust compensation policy, with enough truly long-term, stock-related compensation? Claw-back? Do the directors own substantial stock?
- Write down the governance practices you would like all portfolio companies to adopt over time, and meet after sending
- Ask specific questions and requests in writing and get answers. [See next page.](#)

# To Identify “Quality”, Ask the Right Questions

- What exactly did you DO last year about [diversity] [financial skills]
- Exactly what sort of director and pre-director training did you do last year?  
For how long (time); what topics; who took it; given by whom?
- How long is an average board meeting? Committee meetings?
- How many times did the [nominations] committee meet last year?
- Did you use an executive recruitment firm to find independent directors?
- Your “independent” directors do not meet all of the TSE criteria. What exactly are those “relationships” that noted as the reasons? Please explain
- Why do you have no outside directors w experience in your industry?
- The TSE rule for stock trading units is “< 5,000 Yen”. Your stock is at 15,000 yen. Why do you not do a stock split? Has that been discussed by board?
- Why does the CEO have to chair the nominations committee? How do you manage discuss his own performance right in front of him?
- How many “advisors” do you have who formerly were directors?

# But Attitudinal Shifts ARE Underway

- Most outside directors still invited via **personal networks**: “people we can trust to not rock the boat too much”
- Largely, the same old group of mainly Japanese men
- **BUT** on many boards now there is more discussion (all is relative); directors are feeling that more is expected of them
- More interest in being outside directors, and receiving director training, from hopeful “first-timers”
- Executive recruiters, consultants about governance being hired more
- “Numbers effects” lead to competition between outside directors
- **Interest in ESG is exploding in Japan**. This has both pros and cons, but it **leads to more discussion about strategy**