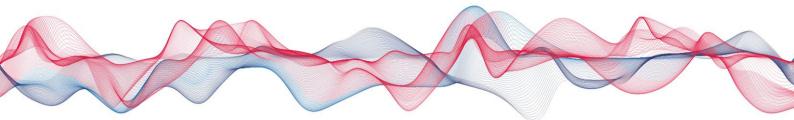


### IMPACT OF CORPORATE DYNAMISM Why Japan's corporate reforms matter so much



In 2024, Japan's equity markets hit highs last seen in 1989, breaching a symbolic threshold in the country's three-decade battle against stagnation.<sup>1</sup> In her opening at the BofA Global Research Japan Conference in September 2024,

Tamao Sasada, Bank of America's country executive for Japan, remarked:

#### "Corporate reforms have made progress and shareholder returns are improving."

It was that first element – reforms – that speaker after speaker cited when it came to explaining how Japan's economy has transformed to the hundreds of global investors and major Japanese companies who gathered in Tokyo for the event.

During a roundtable of chief investment officers (CIOs), decisionmakers from three large global institutional investors pinpointed three elements needed for successful corporate reform: a coordinated government desire for them, willingness on the part of corporations, and the public perception of the reforms as beneficial for everyone. Japan has managed to put all three ingredients in place, they added.

They noted that one of the key differences this time versus previous attempts at reform is the notable willingness of companies to participate, with early movers being rewarded by the market in terms of higher multiples and stock price performance.

And in a generational shift in culture, the CIOs observed that pressure is also coming from employees, particularly among discerning fresh graduates who are looking to benefit from their prospective employers' growth. Given Japan's labor shortage, companies are pressed to perform to attract and retain employees, the CIOs explained. That mindset shift, they added, also reflects the more positive view among younger investors in Japan about investing in the stock market than previous generations who experienced the market upheavals of the 1980s and 90s.

# Cash loses its luster in inflationary Japan

In a Q&A with Masashi Akutsu, Japan Chief Equity Strategist at BofA Global Research, Akutsu said Japan's labor shortage was contributing to reform momentum in another way.

#### "Holding unnecessary cash and surplus capital is no longer reasonable under the inflationary environment and rising borrowing scores," he argued.

"Especially when inflation is caused by a labor shortage, as it is now, companies have to keep raising wages to attract talent, and to do that, they have to fundamentally change their price strategy. To hike prices, they have to concentrate their business resource where they are strongest to improve their productivity."

Akutsu linked Japan's 2024 surge in share buybacks, which ran at a record 9 trillion yen (\$57 billion USD) between January and May,<sup>2</sup> both to this need to mobilize cash holdings and to meet the requirements of new reforms, after the Tokyo Stock

<sup>&</sup>lt;sup>1</sup> Associated Press: Japan's Nikkei stock index breaks its 1989 record and surges to an all-time high, February 2024

<sup>&</sup>lt;sup>2</sup> Nikkei Asia: Japan stock buybacks hit \$57bn, speeding toward annual record, June 2024

<sup>&</sup>lt;sup>3</sup> Nikkei Asia: Japan firms' share buybacks expanded to a record \$65bn in 2023, January 2024

Exchange called for listed firms to improve their capital efficiency.<sup>3</sup>

Likewise, the return to inflation has encouraged Japanese households to invest differently. Japanese households hold around half of their financial assets in cash, compared to just 13% in the U.S.<sup>4</sup> Here again, reforms are helping redeploy this capital.

In January 2024, the government vastly expanded the NISA savings accounts that allow investors to buy stocks tax-free, in an attempt to mobilize the equivalent of \$7.7 trillion that Japan's households hold in cash and deposits.<sup>5</sup> In the first three months of 2024, almost half the investments made through NISA went into Japanese stocks.<sup>6</sup>

Hiromi Yamaji, Group CEO of Japan Exchange Group, is a key advocate of Japan's reforms. He told the audience in Tokyo that many observers had expected the NISA flows to be more directed towards U.S. stocks or global funds. However, a few statistics have shown that a large part of the NISA investments had been directed to Japanese stocks. While he noted that a weak yen, low interest rates and a safe-haven reputation in periods of heightened geopolitical risk were all making Japanese markets more attractive, he highlighted corporate governance reforms as a key factor.

"Investors are seeing that progress in corporate governance reform is creating the possibility that the Japanese governance discount will be dismissed altogether, and that the Japanese company's full value will be realized." Yamaji told the audience.

# Comms, disclosure and transparency

Following the establishment of the Stewardship Code in 2014 and the Corporate Governance Code in 2015, the next challenge, he said, is to improve companies' governance in substance — culture and mindset — to align their perspective with market expectations, especially in terms of capital efficiency and share price (corporate value). Reporting and disclosure — including in English is also crucial to ensure transparency and accountability. "Companies need to clearly explain their business strategy, capital allocation and progress," Yamaji said. "But it is not just companies. Investors have the responsibility to lead the engagement and have a meaningful and impactful dialogue with a long-term perspective."

One distinctive feature of Japan's corporate landscape are cross-shareholdings, where listed companies hold stakes in each other. These are used to cement business relationships, but they have been criticized by minority shareholders for a variety of reasons.<sup>7</sup> Yamaji predicted that crossshareholdings would continue to decline, as regulatory pressure on banks and insurance companies mounts to unwind these arrangements.

Unlike other speakers at the BofA Global Research 2024 Japan Conference who saw the reforms at a midway point, Yamaji viewed them at an earlier stage expecting more room for improvement and growth.

Whichever is the case, Japan's shift towards a modern approach to corporate governance is clearly a work in progress. Yet the sense of optimism it has generated among investors both in Japan and further afield is already energizing markets, as shown by record attendance at the 2024 Japan Conference. Investors perceive a cultural sea change in the way Japan's biggest companies do business, one that will have far-reaching upside for their competitiveness and valuations.

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<sup>&</sup>lt;sup>4</sup> BofA Global Research, Must Read Research, 8 September 2024

<sup>&</sup>lt;sup>5</sup> Financial Times, Can Japan's legendary savers spark a stock market boom? December 2023

<sup>&</sup>lt;sup>6</sup> Japan Times, Half of new NISA investments went to Japanese stocks, May 2024

<sup>&</sup>lt;sup>7</sup> Asian Corporate Governance Association: ACGA Open Letter: Strategic Shareholdings in Corporate Japan, April 2024