Governance lip service?

Japan's new Corporate Governance Code became effective last year. It is based on encouragement in the Japan Revitalisation Strategy to establish fundamental principles for 'self-motivated action' towards sustainable corporate growth and value creation over the medium to long term. It details expectations of board directors and preconditions for board effectiveness. The code, and the 'Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code' request that companies review governance issues in light of the aim and spirit of the principles, and take remedial action.

Japanese companies should discuss the required skills and knowledge for their boards and nominate appropriate directors. According to data from the Japan Exchange Group at this year's RI Asia conference in Tokyo in February, 94% of the Japanese companies listed in the first section of the Tokyo Stock Exchange had outside directors, 87% independent directors and 48% more than two independent directors. This is a major shift in Japan. However, some observers feel companies could do more. The introduction of independent directors is a means to an end. The goal is to create a wider strategic vision that contributes to long-term growth. One critical problem to date has been unclear nomination of board directors.

This includes:

➤ Ambiguous nomination process and small universe of board candidates

➤ Superficial explanation of nominations with boilerplate expressions such as "professional knowledge and abundant expertise"

➤ Inhibited development of independent board candidates and corporate reluctance to hire them.

This has led to lip service adherence to Principle 4.8 of the code to appoint two independent directors. Indeed, most Japanese companies had been reluctant to appoint independent directors until the Tokyo Stock Exchange revised its listing rules recommending at least one external director or auditor in February 2014.

Nonetheless, a report in February by Japan's Financial Services Agency and the Japan Exchange Group looking at how corporate boards were implementing the corporate governance changes found that more than 3,500 listed companies had explored the state of their corporate governance, and that more than 2,500 companies – some 70% of Japan's listed companies – had disclosed their responses to the new code.

The comply-or-explain code has already been integrated into the Tokyo Stock Exchange's listing rules, so companies must 'explain' if they do not comply with the principles or be delisted.

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