



Bambi in the Boardroom

Discussions with corporates, regulators & recruitment agencies

4th February 2016

Mike Newman



Corporate Japan proactively avoids change

Corporate
Governance

Back in August 2015 we published a compendium in [English](#) & [Japanese](#) which described the landscape of the newly introduced Japanese corporate governance code and the importance of embracing it. The message to Japanese corporates was simple:

What
companies
should be
looking for

“Forget SOX as a prerequisite. A well-managed company should never feel threatened by the number of independent directors challenging consensus in the boardroom. Good governance is being open to constructive criticism. If a company has lacked strategic direction for years, a fresh perspective from independent minds is invaluable. [Japanese] companies must focus on qualitative aspects when hiring independent directors over quantitative parameters. Soft options to meet minimum regulatory requirements to protect the status quo is a recipe for failure. Independent directors should not be viewed as an ‘unavoidable cost’ but as a ‘wise investment’ for firms. Which company would rationally choose inferior staff for its operations? Would an airline actively seek unqualified pilots to fly its passengers?”

The reality

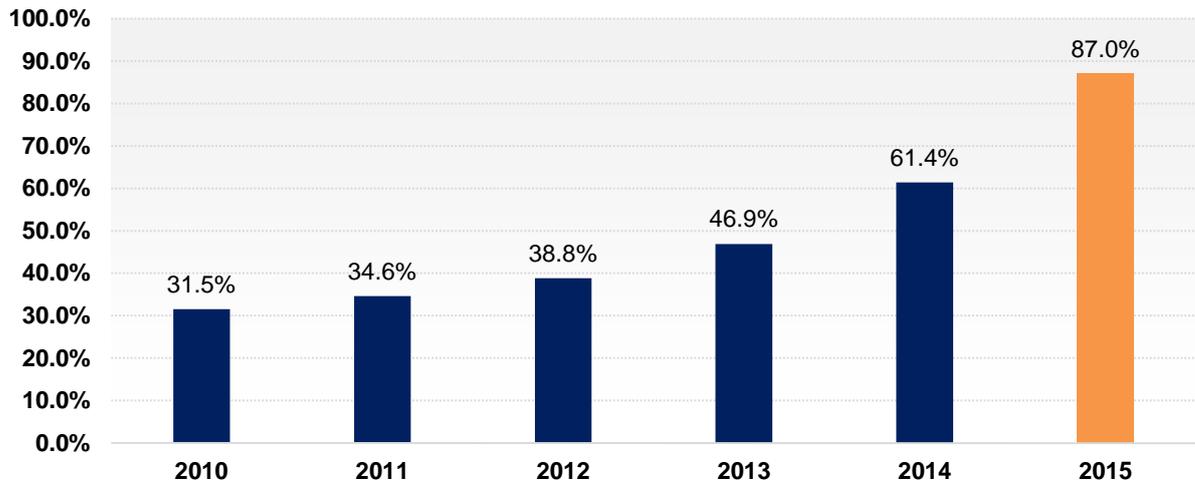
Sadly, in our discussions with the Financial Services Agency (FSA), the corporations themselves and recruitment agencies, the message is clear. Soft options are more often than not being taken.

JPX

The Japan Exchange Group (JPX) proudly states that 87% of Japanese TSE 1st Section companies have selected one or more independent directors. That number climbs to 94.3% when outside directors are also counted. It is an impressive leap in terms of that number being only one-third since 2005.



Ratio of TSE 1st Section Companies with Independent Directors



Source: TSE

Meeting with the FSA

In our meeting with the FSA they were pleased with the progress of companies complying with the new corporate governance code and believed the overwhelming majority of TSE1 listed companies understand its 'essence.' We argued that corporates would only be too eager to admit to a thorough understanding of the code, for failure to do so would only incite the wrath of the regulator to tangle them up into further training.

The new Japanese Corporate Governance Code makes it very clear that the boards should:

FSA has the right idea on the code

"...Endeavour to select independent director candidates who are expected to contribute to frank, active and constructive discussions at board meetings...independent directors should...aim to contribute to the sustainable growth of companies and increase corporate value over the mid to long term. Companies should appoint at least two independent directors that sufficiently have such qualities..."

While we believe that the FSA has gone about the details of the corporate governance code in the right way in seeking the opinions of investors (foreign and domestic), unfortunately that has been overshadowed by corporates not wanting to hire anyone that could cause them to alter behaviour.

Recruiters sending a negative message on corporate wishes

This was backed up by several recruitment firms (which for obvious reasons wish to remain unnamed) that said their mandates from Japanese corporates (including JASDAQ and TSE2 listed companies) were to paraphrase, 'hire as conservative as possible' so as avoid any risk of disruption. The recruiters were instructed not to put forward anyone that might be of a background that would make those companies uneasy.



Bambi in the boardroom

Unfortunately the downside is that if after their first terms, these 'softly spoken' independent directors will be deemed the 'right choice for' either extensions or the blueprint for further independent directors that are hired. Sadly, if this is the (not entirely unexpected) outcome is it any wonder why foreign investors are struggling to feel comforted at any real action. This is no time for Bambi in the boardroom.

Day-wage independent directors

Another recruitment agency said that the glut of applicants to do independent directorships (many above retirement age and looking to work somewhere more dignified than a convenience store) was running so high that they were giving companies looking to fill these slots the ability to appoint these directors on 'day wages' as opposed to fixed salaries. If companies are seriously thinking that hiring a 'day wage' independent director somehow constitutes a cost-saving victory, they only prove the old adage of 'you get what you pay for' and exhibit themselves as little more than modern day [corporate Yamato](#).

Some corporates suggest that swapping independent directors makes sense

The president of one corporate openly admitted to us that he had been on the phone to another CEO of another company (admittedly not a competitor) to plan for an independent director swap after their two-year contract period was up. That is to say the two corporates would exchange their independent directors, something that was more reminiscent of a Cold War prisoner exchange between rival powers at 2am in the middle of winter on the Glienicke Bridge in Berlin. I questioned the move by saying if you have hired a value added independent director why on earth would you think to give him or her up? Why not extend the contract further? If you plan to give them up they are the wrong hires in the first place. It is probably some of the finest evidence that Japanese corporates are not truly understanding the 'spirit' of the code and merely meeting bare minimum obligations.

Companies need to appoint crisis managers

As we wrote in ['Appointing crisis managers in a shame culture'](#) on February 1st, 2016, Toshiba was a perfect example of the failure of not appointing independent directors that would drive the necessary restructuring pill down the throat of the giant.

"Toshiba may have changed the command post but there seem to be few signs that the orders from its conning tower are going to be effective in tackling its way out. In Toshiba President & CEO Muromachi's appeal to investors to regain trust lost to the accounting irregularities, he cited, "In an environment where the only certainty is change at an ever faster pace, we must overcome many complex problems... we will focus on three main business domains, Energy, Storage and Healthcare..."

Problem: Acknowledged.

Solution: Largely unchanged"



As we wrote in detail in our 5th January 2016 report, ["Toshiba ended below ¥1 trillion mkt cap in 2015"](#) drastic change will be required.

"In short, the rumoured restructuring plans of the PC business replicate those of the failed attempt in mobile phones. Despite a majority independent led board, there seems to be little sign of understanding of the crisis it faces. Furthermore, Nidec's plans to recruit many of its best engineers as an assistance measure will only squeeze much needed human capital out. The medical business at this stage seems the only asset that can attract a bidder and at 6% of the group it is worth keeping an eye on."

*Saying
versus doing*

It is such a shame. There can be no question that Japanese corporates could be so successful were they to embrace the future. I'll never forget a presentation with Gibson Inc., the guitar company, 60% owner of TEAC (6803), the record company. After the Gibson CEO presented on the 'power of the brand' and how TEAC's market leading product suite would complement its growth strategy, the TEAC CEO followed up saying *"we have the best products and engineers in the entire market...we just suck at marketing!"* It was an epiphany. Here was a company that was coming to terms with its fundamental weaknesses. It was a watershed moment from the perspective of 'acknowledging' the elephant in the room. None-the-less acknowledgment is only the first step. Execution is all that matters in the end.

Summary

What is going on in Japanese boardrooms reminds me of the 'Ship of Fools' by World Party. The lyrics sum up perfectly why much of the good work of the corporate governance code will be wasted by (deliberate) ignorance to protect the status quo.

*Drowning in the oceans of history
Travellin' the world, you're in search of no good
But I'm sure you'll build your Sodom like I knew you would
Using all the good people for your galley slaves
As your little boat struggles through the warning waves
But you will pay, you will pay tomorrow
You're gonna pay tomorrow*

Japan Inc. may think that meeting volumetric independent director levels to show the world of getting with the program will somehow fool the overseas investment community to thinking they have changed. We are not fooled. As much as we don't think Usain Bolt will win the 100m final at the next Olympics wearing Wellington boots. Corporate Japan is acting with the softness of the journalism of an inflight magazine. There is no substance and celebrating mediocrity is going to be seen through.



Important Disclosures:

This material was prepared for you and is for your information and use only. This material should only be distributed to other members of that organization on a need to know basis and should not be distributed or disseminated to any other person or entity.

This material is for information purposes only and it should not be regarded as an offer to sell or as a solicitation of an offer to buy the securities or other instruments mentioned in it. This material is based on current public information that Custom Products Group Limited ("Custom Products") considers reliable, but we make no representation that it is accurate or complete, and it should not be relied on as such. No investment opinion or advice is provided, intended, or solicited. Custom Products offers no warranty, either expressed or implied, regarding the veracity of data or interpretations of data included in this report. This material is provided with the understanding that Custom Products is not acting in a fiduciary capacity. Opinions expressed herein reflect the opinion of Custom Products and are subject to change without notice.

The products mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors. The value of and the income produced by products may fluctuate, so that an investor may get back less than they invested. Value and income may be adversely affected by exchange rates, interest rates, or other factors. Past performance is not necessarily indicative of future results. If a product is income producing, part of the capital invested may be used to pay that income. © 2015 Custom Products Group Limited. All rights reserved.

Contacts

Hong Kong

Simon Rigney

☎ +852-3958-2394 (HK)

☎ +81-3-5786-3712 (Tokyo)

✉ simon.rigney@custprd.com

Salt Lake City

Patrick Hansen

☎ +852-8191-6925 (HK)

☎ +1-801-230-4796 (SLC)

✉ patrick.hansen@custprd.com

Tokyo

Robert Rowland

☎ +81-3-5786-3711

✉ robert.rowland@custprd.com

Michael Newman

☎ +81-3-5786-3713

✉ michael.newman@custprd.com

Office Locations

Hong Kong

15/F Langham Place
8 Argyle Street
Mong Kok, Kowloon
Hong Kong S.A.R.

Tokyo

17/F Roppongi Hills North Tower
6-2-31 Roppongi,
Minato-ku, Tokyo
Japan 106-0032

Salt Lake City

299 South Main Street
Suite 1300
Salt Lake City, UT
United States, 84111