Related Party Transactions: Board and Shareholder Approvals

Japan case

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FOLLOWING THE SECOND WORLD WAR, JAPAN’S ECONOMY GREW DRAMATICALLY THROUGH 1990, AND HAS RECENTLY RECOVERED FROM A DECADE-LONG RECESSION

JPY Trillions
DETERIORATING PERFORMANCE HAS BECOME A KEY DRIVER IN TRANSFORMING CEO MINDSETS TOWARD CORPORATE GOVERNANCE

Percent

Profit/sales

Average profit margin

Sales volume increase  No increase

1960s  4.8
70s  3.9
80s  3.1
90s  2.5
2000-07  2.92
07: 3.9%
NEW PARADIGM: OWNERSHIP, MANAGEMENT, AND EXECUTION ARE UNDERGOING FUNCTIONAL AND PSYCHOLOGICAL DIVISIONS

**Value Based Management**

- **Board**
  - Appropriate funding
  - Stakeholder value maximization
  - Introduction of independent directors
  - Evaluation of management

- **Corporate**
  - Oversight and advice
  - Transparency
  - Operating officer system
  - Division of corporate and business units

- **Business unit**
  - Resource allocation
  - ROI maximization
  - Responsible for performance and profit maximization
  - Respect for employees and value delivery

**Capital market** to **Product market**

- **Stakeholder value maximization**
- **Appropriate funding**
- **Oversight and advice**
- **Transparency**
- **Resource allocation**
- **ROI maximization**
- **Responsible for performance and profit maximization**
- **Respect for employees and value delivery**
**CORPORATE GOVERNANCE IS BEING ADAPTED, BUT FACING MANY CHALLENGES WITH THE JAPANESE CORPORATE CONTEXT**

<table>
<thead>
<tr>
<th>Corporate governance challenges</th>
<th>Common perspectives</th>
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<tbody>
<tr>
<td><strong>Traditional system</strong></td>
<td>CEOs believe independent directors lack company-specific knowledge and are, therefore, useless</td>
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<td>Strong <em>keiretsu</em> (company group) and main bank systems</td>
<td>Independent directors are not “independent,” as mutual shareholding is still commonplace</td>
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<td>Mutual shareholding</td>
<td>Independent directors are often referred to as “outside” directors</td>
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<td>Seniority-based lifetime employment</td>
<td>Homogeneity and affinity in companies is quite strong, and diversity is rarely considered</td>
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<td>Board membership as final objective of lifetime employment</td>
<td>The most important owners of a company are often thought to be the employees, not the shareholders</td>
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<td>Boards of over 50 members</td>
<td>The “old boys club” continues to be influential</td>
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<td>Auditors in charge of monitoring &amp; controlling function</td>
<td>The CEO appoints auditors who are junior to him</td>
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BY NOW, MANY COMPANIES ARE INTRODUCING INDEPENDENT DIRECTORS, BUT PARENT-SUBSIDIARY RELATIONSHIPS AND MUTUAL SHARE-HOLDINGS ARE A BOTTLENECK, AND THE IMPORTANCE OF DIVERSITY ON BOARDS IS NOT RECOGNIZED YET

Note: In Japan, parent companies and subsidiaries can be separately listed
Source: Nikkei

Number of companies to introduce independent directors

<table>
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<tr>
<th>Year</th>
<th>Number of Companies</th>
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<tr>
<td>2004</td>
<td>780</td>
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<tr>
<td>2005</td>
<td>1,200</td>
</tr>
<tr>
<td>2006</td>
<td>1,419</td>
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<tr>
<td>2007</td>
<td>1,545</td>
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39% of listed companies

- Number of directors: 31,500
- Number of independent directors: 3,000
- Number of directors who serve at more than two companies (including parents and subsidiaries): 3,270
- Female ratio
  - directors: US17.5%, Japan1.2%
  - managers: US42.5%, Germany 37.3%, Japan 10.1%
RECENT DISCUSSIONS SEEM TO CENTER ON DEVELOPING A DECISION-MAKING SYSTEM FOR BOARDS THAT FUNCTIONS PROPERLY . . .

Recent benchmark of highly functional board

**Independence**
- Only CEO (or CEO/COO) can become an operating officer, and the board has more than two independent directors

**Information**
- Directors receive meeting materials well before the meeting
- Meeting materials are informative
- Sufficient time is allocated for discussing all agenda items

**Authority**
- Directors can postpone decisions on topics which cannot be discussed thoroughly at one meeting

**Resources**
- Directors (especially independent directors) are directly involved in their companies for a substantial amount of time