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Lessons From Koizumi-Era Financial Services Sector Reforms

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C O L U M B I A U N I V E R S I T Y I N T H E C I T Y O F N E W Y O R K



**Asia-Pacific
Economic Cooperation**

Advancing Free Trade
for Asia-Pacific **Prosperity**

Case Study: Financial Services Sector Reform in Japan

APEC Policy Support Unit
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Lessons From Koizumi-Era Financial Services Sector Reforms

Financial Services Sector Reform in Japan

Abstract

Japan's "lost decades of growth" owe to insufficient countermeasures to address (a) demographic changes and (b) belated and incomplete adaptation of the services sector in particular to globalisation. The combination of a strong bureaucracy, a high level of per-capita GDP at the outset and redistributive dynamics between industrial sectors have softened the impact of deflationary shocks but allowed policy immobilism to flourish. The Koizumi reform agenda was successful in resolving Japan's banking crisis, and endeavoured to capitalise on this success to go beyond financial services reform, and to implement capital market reform.

Why examine Koizumi's 2006 reforms?

Koizumi's reform agenda was part of a long (still ongoing) process of financial reform. The 2006 reforms were those most focused on the opening of capital markets and represented a far greater opportunity for much-needed structural reform than actually took place.

To understand the context of these reforms and gauge their degree of success or failure (thereby learning lessons in the process), it is necessary to have a working understanding of several things including:

- (1) Characteristics of Japan's postwar political economy.
- (2) The influence of these characteristics upon Japan's postwar history of financial reform
- (3) The overall economic context of Japan's "lost decades"

It is worth bearing in mind that while financial sector reform may have been an objective in its own right until the bursting of Japan's real estate and stock bubbles in 1990, the over-arching goal of structural reform thereafter became one of extricating Japan from its deflationary "lost decade" dynamics thereafter. The latter proved extremely difficult and lent to negative evaluations of structural reforms in the post-bubble era.

What were the reforms?

The 2006 reform package included:

- The Financial Instruments and Exchange Law
- New Companies Law
- Postal Privatisation

What did they intend to achieve?

- Market-opening (greater cross-border investment, particularly inward investment)
- Better corporate governance through capital market opening
- A move "from savings to investment" – diversification of household balance sheets

What was the outcome?

The 2006 market reforms were successful in overcoming a degree of policy immobilism but were ultimately incapable of resolving Japan's "lost decades" of growth, particularly given the 2008 Lehman shock.

There were some individual policy successes as well as valuable lessons learned from the 2006 Koizumi reforms. Limited progress on capital market reforms in various subsequent administrations after Koizumi tended to place disproportionate focus on the negative aspects of the reforms' outcome. Japan's relapse into "lost decade" dynamics alongside the global financial crisis only underscored the necessity to press ahead with structural reforms to achieve eventual sustainable economic recovery.

Ultimately, financial and capital market reforms represented advancements but not enough to solve the entire economy's problems.

Lessons for APEC

Lessons from the 2006 reforms as applicable to APEC include:

- The complementarity of capital market reforms to reforms in financial services
- Policy sequencing: economic expansion makes structural reform via income redistribution more palatable
- Benefits in expansion of new products may be sought to offset compliance costs associated with harmonisation to global regulatory standards in financial systems.
- Idiosyncratic application of the rule of law is a potential hurdle for cross-border M&A into Asian economies
- "Mandatory" corporate governance regimes might be more transparent than "enabling" regimes in the eyes of foreign investors
- Given the greater role of non-shareholding stakeholders in many Asian models of governance, there may be merit in collectively exploring alternative models to Anglo-saxon governance models.
- Strong and centralised political leadership may be a pre-requisite to achieve success when battling vested interests to enact reform
- Gradualist or piecemeal financial reform agendas run the risk of falling behind global trends - failing to achieve desired reform or even exacerbating crisis risks

1. The need for structural reform in Japan

As of 2001, Japan had experienced its first "lost decade" of growth. Although it was generally agreed that policy reforms were required, policymakers were divided on the substance of such reforms. Prior to the Koizumi administration, Japan's consensus-driven policymaking process did produce hard-won reforms at great cost, which amid frictions among stakeholder interests were implemented in stuttering, piecemeal fashion.

Koizumi's reformist credentials are not to be overlooked, even if in implementation his reforms failed to rescue Japan from its "lost decades". It is argued that, if not for the onset of the Global Financial Crisis (GFC) in 2007, the postal privatisation (PM Koizumi's

Timeline of Reforms under PM Koizumi

- April 2001: PM Koizumi comes to power
- June 2001: CEFPP under Koizumi & Takenaka compile first centralised economic and fiscal policy guidelines
- Sep 2001-Apr 2002: FSA inspections to reclassify non-performing loans at troubled institutions
- Jan 2002: Bank Shareholding Purchase Corporation established (Purchased 1.6trn yen of stocks by 2006)
- Oct 2002: PFR (Programme for Financial Revival) to accelerate bank loan restructuring.
- April 2003: IRCJ established
- April 2004: Economic expansion has begun
- September 2004: Takenaka is appointed Postal Reform Minister
- March 2005: Major banks form Minister of Finance
- October 2005: Postal reform legislation is enacted.
- May 2006: New Companies Act comes into force
- June 2006: FIEL is enacted
- September 2006: PM Koizumi steps down per LDP rules

crowning legislative victory) would have changed the face of Japan's financial system.¹ The New Companies Act represented the first major revision to corporate law since the early 20th century, striving to modernise Japanese laws surrounding corporate mergers and acquisitions (M&A) and therefore to fuel growth in cross-border investment. The Financial Instruments and Exchange Law (J-SOX, as commonly known in the US) was designed to comprehensively overhaul Japan's outdated Securities and Exchange Law taking into account regulatory changes in the

United States² and, by establishing a regulatory "level playing field" to encourage inward foreign direct investment (FDI).

As a result of the GFC, the Tohoku Tsunami in 2011 and their impact on the Japanese economy (Japan's relapse into deflation) these reforms have been widely dismissed as failures. Yet summary dismissal overlooks elements of progress in financial sector function and productivity.

A more nuanced assessment of the programme is necessary, starting with the political and economic contexts of the reforms.

1.1. Political economy of the Japanese financial sector:

The Japanese financial system displays structural idiosyncrasies whose roots lie in recent political and economic history. In evaluating the success of structural reform in Japan, it is insufficient simply to hold up isolated examples of policy reform to comparisons with the US or UK. Instead, it is necessary to take into account characteristics of Japan's model of stakeholder capitalism, in which suppliers, employees, business partners and financiers alongside shareholders are all viewed as important business stakeholders.

¹ (Vogel 2006)

² In the wake of Enron and WorldCom accounting scandals, US Congress enacted the Sarbanes-Oxley Act, passed on 30 July 2002, under the oversight of the Securities and Exchange Commission "to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes."
<https://www.sec.gov/about/laws/soa2002.pdf>

The Japanese model, born of an era of far less flexible financial policy, is not without its benefits – including stability throughout the supply chain and plentiful private-sector support for innovative R&D. However, among other rigidities, the shareholder's power to drive change is much blunted in comparison to the US shareholder. Existing stakeholders may see insufficient benefits to the US model to abandon the Japanese model wholesale. Thus protection of stakeholders' interests may remain a structural characteristic of the Japanese economic model that will not disappear. If so, it would be realistic for Japan to seek alternative models of structural reform than that of pure shareholder primacy.

In order to understand the motivations behind structural reform in Japan in the 2000's and the challenges reforms faced, it is useful to consider several key developments in the Japanese postwar financial system, including:

- Japan's rigid postwar financial system was characterized by a high degree of interventionism, which helped mobilise resources in Japan's high-growth era yet at a cost to the efficiency of decentralised market functions. As Japan's economy matured and global financial markets internationalised, domestic fiscal and monetary policy alone were inadequate in regulating liquidity flow and assuring productive asset allocation across sectors.
- The pains of adjustment to globalisation led to market-opening reforms in the 1980's that, in the absence of complementary regulatory and administrative reform, proved incomplete. The incomplete nature of market-opening reforms in the 1980's contributed to market failure.
- The necessity for comprehensive reform had become clear from the early 1990's, upon the bursting of Japan's real estate and stock market bubbles. Indeed, these market shocks led political and business leaders to question the existing Japanese economic model.
- In the mid to late 1990's "Big Bang" deregulatory reforms, intended as market-opening measures, were unable to resolve the main problems of loss of confidence in the Japanese financial sector, which was aggravated by the Asian Financial Crisis of 1997. Deregulation and structural reform proved to be two separate phenomena.
- Meanwhile, an aging demographic combined with regulatory forbearance³ prolonged Japan's financial crisis. Japanese productivity growth plummeted.

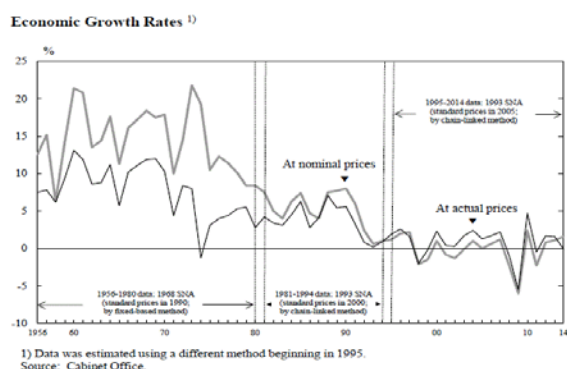


Figure 1: Japanese GDP growth (real vs nominal)
Source: Statistical Handbook of Japan 2016, p. 23

See Appendix 5 for a detailed account of Japan's postwar history of financial reform and Appendix 6 for a structural description of Japan's financial sector.

1.2. The economic problem

While financial sector reform may have been an objective in its own right until the bursting of Japan's real estate and stock bubbles in 1990, the over-arching goal of structural reform thereafter became

one of extricating Japan from its deflationary "lost decade" dynamics thereafter.

³ (Hoshi and Kashyap 2011)

By 2001, when PM Koizumi came to power, productivity had taken a large hit, particularly in the more domestic portions of industry (in the services sector, which comprises over 70% of Japanese GDP and jobs). Moreover, with the financial sector beset by problem loans, loose monetary and fiscal policies were having little impact in rescuing Japan from its deflationary spiral. Nor was export-oriented growth proving successful in extricating Japan from its economic malaise.

The source of the problem:

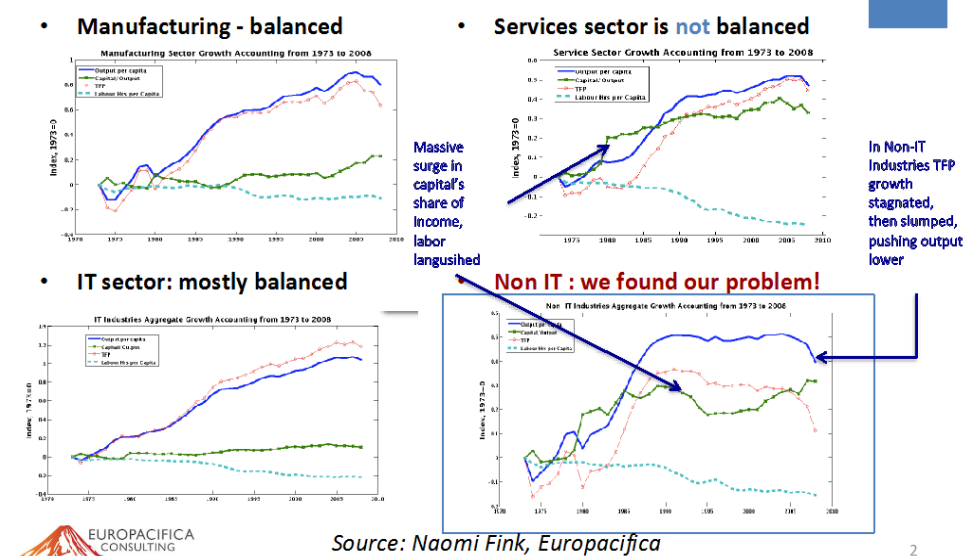


Figure 2: Heterogeneity in Japanese growth accounting, 1973-2008

Source: (Fink, 2015)

Industry-level decomposition of Japanese growth accounting is illustrative in pinpointing structural problems from an economic perspective.

The slump in Japanese productivity that occurred during the “lost decades” was accompanied by increased divergence between industrial sectors. Manufacturing displayed textbook characteristics of a “balanced growth path”, in contrast to services. Although it may seem counter-intuitive (given the trend toward offshoring production was greater in the manufacturing sector), labor’s share of income showed an unhealthy decline in services, where capital’s share surged.

Total factor productivity (TFP) growth in the (largely domestic) services sector substantially underperformed TFP in (more export-oriented, less regulated) manufacturing. But under-performance in the non-IT sector with respect to IT was greater still, suggesting that mercantilist export-led growth strategies were not the only explanation behind the failure of domestic demand to recover.

Further empirical research reveals the importance of technological investment in Japanese productivity growth. A simulation by Fink (2015) incorporating Investment-Specific Technology (IST) achieves an even better fit with actual data than the

Hayashi-Prescott “base case” model. Fink finds that IST explains roughly one-third of productivity growth since 1970.⁴

Meanwhile, for both IT and non-IT sectors, allocation to “innovative capital” matters for total factor productivity growth, above and beyond overall investment in capital, or even in intangibles. This is a result robust across a number of econometric studies (see Appendix 1). Separately, econometric analysis also reveals that increases in productivity are consistent with deregulation in the non-IT services sector in particular (Fink, 2016).

The combination of analytical findings support the argument that regulatory incentives should be designed not only as to boost allocations to innovative capital but also to reallocate capital away from non-innovative “dead weight” capital, which dulls productivity.⁵

With regard to the financial sector in particular, it is demonstrated (see Appendix 1) that between 2005 and 2008 (following a period of financial deregulation), the financial sector’s investments in intangibles as a proportion of gross value added (GVA) surged by almost 5%, with innovative capital accounting for a high proportion of intangibles, a mix consistent with improvements in total factor productivity (TFP).

In practical terms, empirical results underscore the importance of **strengthening corporate governance**. Where corporate governance influences the allocation of firm assets, improved governance, by way of improving asset allocation, ought to lead to higher productivity. Improving corporate governance is also consistent with deregulation of highly regulated industries, also empirically consistent with growth in services-sector TFP.

Appendix 1 presents empirical analysis on drivers of Japanese total factor productivity.

1.3. The structure of the Japanese financial sector

As of 2012, financial services represented roughly 3% of gross output and a similar percentage of compensation of Japanese employees. Examining input-output tables, the greatest immediate impact of changes in financial services outputs is greatest upon the following industries:

- Housing
- Activities not elsewhere classified
- Finance
- Real estate
- Railway
- Rental of office equipment and goods
- Wholesale
- Retail
- Other services for businesses

⁴ (Fink, 2015)

⁵ (Fink, 2016)

Input-output analysis of the financial sector however, has limitations in analysis of structural reforms' potential impact on the macro-economy. As of 2012, bank lending accounted for less than 30% of nonfinancial firms' financing, with capital markets providing most of the balance.

It is certain that there is a great discrepancy between access to capital markets among large and small firms, particularly within the services sector (see Appendix 6 for further details).

Figure 3: The Koizumi Reform Agenda

Key reforms

1. Financial system reform
2. Postal Privatization
3. Labor reform
4. Promotion of FTAs and agricultural reform
5. Deregulation through special zones
6. Local public finance reform ("Trinity" reform)

Source: (Hoshi and Kashyap, Why Did Japan Stop Growing? 2011)

However, small firms, many of them suppliers to large firms, are also more dependent on inter-business credit, which accounted for nearly 13.9% of nonfinancial firms' financing.

The role of Japan Post in Japan's financial system as a savings and investment institution

underscores the pivotal role of indirect financing for Japanese firms. Even though Japan Post Bank is not a corporate lending institution (remaining subject to the rigid segmentation of public financial institutions), it is Japan's largest savings institution and deposit taker, with over JPY200trn in assets as at March 2016. Over 40% of its assets are allocated to Japanese Government Bonds (JGB's), and over 20% are liabilities against the financial sector; 8% of its balance sheet is dedicated to local government and corporate bonds. Japan Postal Insurance holds an additional 81.5 trillion yen in assets. Privatisation of these institutions brings with it the prospects of greater diversification of their balance sheets away from JGB's and into risk assets, providing from private firms' perspective greater domestic supply of capital market financing.

This is one substantial limited factor, in our view, of input-output analysis of the financial sector. A Computable General Equilibrium (CGE) model may be superior in analytical power when measuring the instantaneous impact of financial services reform upon the economy.

But as we have argued above, narrow reform to financial services is insufficient on its own (in the absence of accompanying capital markets reform) to offer the optimal market solution in terms of financial intermediation. In the presence of capital market reforms however, it is important to capture interest rate dynamics, structural change in capital markets and interaction with monetary and fiscal policy. A Dynamic General Equilibrium (DGE) model might provide a more complete analysis of realised and potential benefits of comprehensive financial and capital markets reforms, including interactions with cyclical (monetary and fiscal) policies.

See Appendix 6: Current structure of the Japanese financial sector for further descriptive details on the structure of the Japanese financial services sectors.

2. The implementation of the Koizumi reform agenda:

Key points:

- The greatest strengths of Koizumi's reform credentials lay in the combination of institutional structure, ability to capitalize on its own successes, efficient use of prior reforms, and policy sequencing.
- Financial sector reforms of 2002-2004 under Koizumi and financial reform minister Heizo Takenaka were largely viewed to have resolved Japan's financial crisis, allowing some recovery in financial sector productivity.
- After building a track record with the resolution of the financial crisis and reflation the economy, the Koizumi-Takenaka team focused on a combination of reforms to capital markets and regulatory reforms necessary to re-invigorate the newly recovered financial sector with the aim of restoring its regional and global competitiveness.
- The radical aspect of Koizumi's reform program was the legislation of market-liberalising reforms (Postal Privatisation) that challenged not only bureaucratic power but also vested interests within the Liberal Democratic Party (LDP).
- Instrumental in Koizumi's reforms was its institutional structure. Notably, the Council on Economic and Fiscal Policy (CEFP) was a pivotal body in the drafting, successful legislation and implementation of reform measures.⁶
- Reflationary conditions not only made structural reforms more palatable, but they helped achieve other economic targets (such as fiscal reform).
- Despite his radical reform program, Koizumi stopped short of transforming Japan into a US-style liberal market economy. In the context of Japan's postwar history of financial reform, this is not surprising.

Successful elements of Koizumi reforms

The Koizumi reform agenda included several controversial items: cabinet appointments based on merit rather than seniority; breakup of the highway corporation and reductions of "wasteful" spending on public works; a cap on public borrowing; devolution of both power and responsibility from central to local governments, and resolution of non-performing loans in the banking sector.

The majority of these items were either overt or indirect challenges to MOF interests. Yet the truly radical component of the reform agenda was not its overt challenge to bureaucratic power, but its challenge to vested interests within PM Koizumi's own political party, the Liberal Democratic Party (LDP). This manifested most clearly in his plans for privatisation of Japan Post. Even the mandarins of the MOF had historically little say over this behemoth institution, whose regional offices were bastions of LDP political support. Koizumi's willingness to challenge not only

⁶ Established in 2001 by PM Yoshiro Mori to emulate the Council of Economic Advisors in the US, the CEFP served as a vehicle to devolve power from the Ministry of Finance (which previously held greater sway over the compilation of budgets) to the Prime Minister's office. The CEFP was chaired by the Prime Minister and included up to 11 members including the Minister of State for Economic and Fiscal Policy, the BOJ Governor and up to four independent private-sector experts. The CEFP served to consolidate the Prime Minister's control over economic and fiscal policy (Mulgan 2013).

bureaucratic but also political vested interests won him credibility abroad, amid expectations that he would introduce "globally standardized capitalism"⁷

Effectiveness of the CEFP under Koizumi and Takenaka

Koizumi's reforms did not arise in a vacuum. Rather, they were built on the foundation of reforms enacted by his predecessors, particularly PM Hashimoto's electoral and administrative reforms, legislated in 1994⁸ and PM Mori's establishment of the Council on Economic and Fiscal Policy (CEFP).

Indeed, much of Koizumi's success in giving rise to change owed to his efficient use of the CEFP, established in 2001. The CEFP was one of the four councils directly established by PM Mori under the Cabinet Office Establishment Law⁹, and was responsible for compilation of *Honebuto no Houshin* or "Big Boned Policy", central policy guidelines compiled annually to drive economic and fiscal policy priorities.

In the words of Peter von Staden, the body was pivotal to the transfer of power from *kanryo shudo* (bureaucratic leadership, axiomatic under the convoy system) to *kantei shudo* (leadership from the prime minister's residence).¹⁰ As a result, Koizumi's administration received the credit for "[breaking] down the old fashioned and well-entrenched system of administrative guidance that was a pillar of traditional Japan."¹¹

In a 2006 report, the APEC secretariat lauded the CEFP as: enhancing the "consistency and comprehensiveness of economic policymaking", enabling of "policy achievement evaluation and feedback to new policymaking" and as a driver of "transparency in the decision-making process" and finally for acting "as a driving force to promote the structural reforms of the Koizumi cabinet".¹²

Staffing was one of the greatest merits of the CEFP under Koizumi. Heizo Takenaka, appointed by Koizumi as Minister of State for Economic and Fiscal policy in 2001, who included private sector expertise in the formulation of policy. The CEFP coordinated its reform agenda with the FSA's "Program for Structural Reform of Securities Markets" in August 2001, in order to facilitate a "transition from preferential treatment of savings to preferential treatment of investment" (popularly known by the policy slogan "from savings to investment"). The Program provided the basis the 2006 Financial Instruments and Exchange Law.¹³

Capitalising on early successes (Resolution of the Banking Crisis)

The reform program that led to the resolution of Japan's banking crisis started in 2002, when Heizo Takenaka was appointed Financial Reform Minister and head of

⁷ (Sakai, Japan's Economy in the Post-Koizumi Era 2006)

⁸ (Shinoda 2013), p. 79

⁹ (Mulgan 2013), p. 76

¹⁰ (Hook 2010); Peter von Staden cites Estevez-Abe (2006) in pointing out that "Reform in favour of a 'Westminster system' was one of the most significant structural changes that Koizumi brought to political decision making and by extension, the business and government relationship," p. 169

¹¹ (Sakai, Japan's Economy in the Post-Koizumi Era 2006)

¹² (APEC Secretariat 2006)

¹³ (Summary of the "Front-Loaded Reform Program" 2001);

the Financial Services Agency.¹⁴ In his reform plan, Takenaka capitalised on prior reforms to compel disclosure of Non-Performing Loans (NPL's) on bank balance sheets¹⁵. In September 2001 the CEFP set up a plan for corporate restructuring, in cooperation with the Development Bank of Japan (DBJ), the Resolution and Collection Corporation (RCC), and the Deposit Insurance Corporation (DIC)¹⁶ which laid the ground for Takenaka's pivotal six point plan for NPL disposal.¹⁷

Under Takenaka's guidance, government capital injections softened the blow of select bank failures (formerly impossible under the convoy system). Troubled firms were encouraged to restructure via the Industrial Revitalisation Corporation of Japan (IRCJ). Financial institutions were consolidated as a less systemically damaging alternative to failure; 13 city banks that emerged in the early 1990's were merged to form 4 megabanks. Harmonisation with global standards progressed under the FSA's guidance on disclosure and capitalisation per BIS regulations. Securities firms were consolidated under the umbrella of large banks (both domestic and foreign), leaving Nomura as the only large independent player. The insurance industry consolidated.

Importantly, the plan met its two-year goal to halve Bank NPL's by 2004. In fact, major banks lowered their NPL ratio from 8.4% in March 2002 to 1.8% in March 2006. The achievement was lauded by APEC as an exemplary case of structural reform.¹⁸

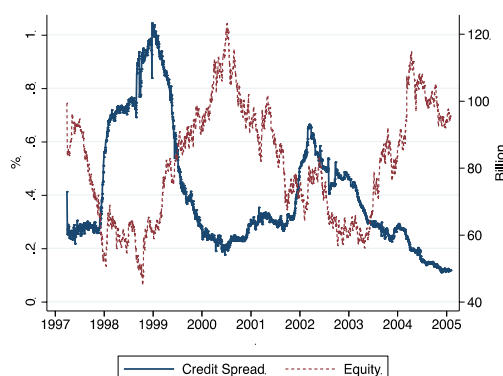


Figure 4: AA credit spreads decline as equities rebound

Source: Nakashima & Saito (2007)

Japanese history allowed Koizumi to achieve a number of his stated goals without great effort.

Koizumi's successes on manifold fronts after the end of the banking crisis taught a lesson on policy sequencing. The upturn in the economy had not only assuaged the

Building on reflation and early success of bank reform

By 2006, the stock market had troughed, and mild inflation had taken hold, prompting optimism among consumers and investors that Japan had left its lost decade behind. Slumping productivity growth that had hit the services sector particularly hard post-bubble, had begun to improve.¹⁹ Assisted by solid global expansion, the longest expansion in postwar

¹⁴ (Hoshi and Kashyap, Why Did Japan Stop Growing? 2011)

¹⁵ The NPL disclosure mandate had already been cemented in 1999 (see Big Bang reforms, above) alongside the establishment of the Financial Services Agency (FSA).

¹⁶ (Japan Cabinet Office 2001)

¹⁷ (Japan Cabinet Office 2002)

¹⁸ (APEC Secretariat 2006), section 2.2.3

¹⁹ (Fink, Heterogeneity in Japanese TFP, Part 1: Why Overcoming Deflation Alone is Not Enough 2015)

pains of reductions in public works spending and labor reforms, but had also boosted fiscal coffers beyond the MOF's initial targets, and in 2006 the government looked as if it were on track to achieve its goal of primary balance by 2010.²⁰

A significant reflationary cycle provided favourable conditions to put in place the less popular reforms of Koizumi's manifesto.

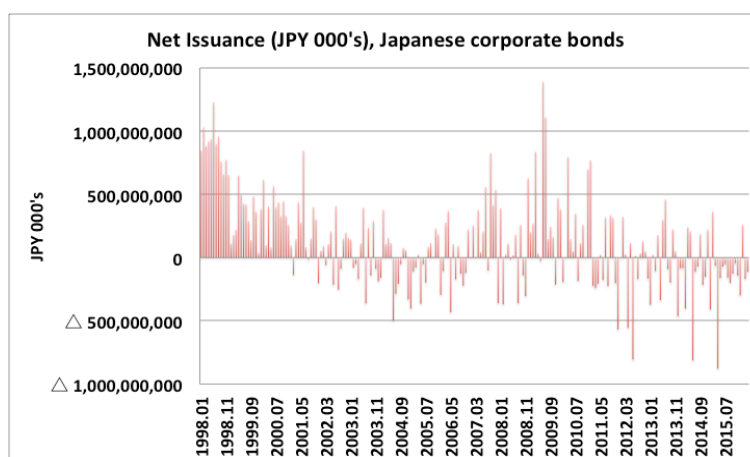


Figure 5: Corporate bond issuance remains stagnant

Source: JSDA

This was convenient, given the need for structural reforms remained ever-apparent. Despite the pick-up in lending growth after the resolution of the Japanese banking crisis, progress in capital market development had stagnated. Lacklustre foreign inward investment and risk-averse household balance sheets were ripe targets for growth-enhancing incentives by way of structural reform.

²⁰ (Yumoto 2003) The main contributor to the accelerated improvement in fiscal coffers was corporate taxes. Firms who had previously posted insufficient profits to pay corporation tax had started becoming profitable, thus going from a 0% to 40% tax rate. Importantly, banks (whose deferred tax assets had delayed their taxpaying status) were central among firms newly paying tax at this stage. Source: Discussions with Japan's Ministry of Finance, 2005 (Fink)

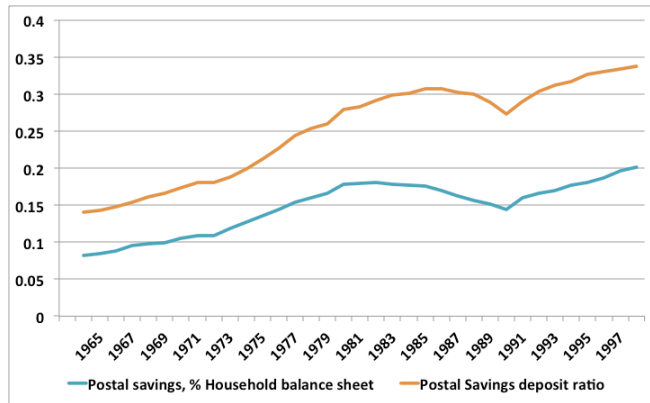


Figure 6: Historical ratio of Postal Savings in household balance sheets

Source: Japan Statistics Bureau, *Europacifica*

The postal privatisation referendum

As Koizumi's signature reform, privatisation of the Japanese Post Office was of both practical and symbolic value. Postal privatisation was the most radical and thus contentious reform proposed by PM Koizumi.

In form, postal privatisation backed both the administration's commitment to transfer economic activity from the public to the private sector and concretised its policy slogan "from savings to investment". *Yucho* (postal savings) balance sheets remained inflated by deposits and cash that had flowed in from households when Japan's "lost decade" was in full swing and sentiment was at its worst (see Figure 6: Historical ratio of Postal Savings in household balance sheets).

Japan's trading partners in the region also welcomed privatisation. The goal of ensuring "equal footing with the private sector" promised to dilute the existing predominance of Japan Post in the financial and insurance sectors, which previously conformed to APEC's description of "natural monopolies that are protected from strong competition by large start up costs" and "ineffective structures that allow anti-competitive behaviour [that] may act as a barrier for firms" (APEC Secretariat 2006).

In substance, postal privatisation was the most direct challenge to intra-party factions within the Liberal Democratic Party (*habatsu*). Japan's Post Office, since its birth at the time of the Meiji Restoration, was a powerful political lobby group, representing conservative interests in regional Japan.²¹ Its Postal Savings and Insurance arms are formidable publicly owned competitors and remain massive employers in financial services and insurance.

Over the course of Japan's modern history, Japan Post held direct policymaking influence in the form of *seisaku zoku* "policy tribes" or groups of Diet Members who specialised in specific policy affairs within the framework of the LDP's Policy Affairs Research Council. Even the MOF's powerful *gyōsei shido* guidance system had declined historically to interfere with interests controlled by LDP's policy tribes.

Postal reform and its inherent challenge to status quo occupied a priority position on the Koizumi agenda from the start; in the CEEP's first *Honebuto no houshin* in 2001, "Privatization/ Regulatory Reform-Maximizing Use of the Private Sector" occupied the top spot among his seven programs of structural reform following the resolution of the non-performing loans problem.

²¹ Japan Postal Savings was established in 1885, initially modeled on UK Postal Savings.

To drive the reform initiative, Koizumi appointed his reform czar Heizo Takenaka as Postal Reform Minister in September 2004. Takenaka's postal reform proposal (promulgated, incidentally, without the approval of the LDP) was to:

1. Divide Japan Post into four independent companies, each in charge of network services, postal services, savings and insurance
2. Divide Japan Post into regional companies
3. Establish a holding company
4. Establish a private corporate body to succeed the public company

Privatisation was to take place by end of fiscal 2006 (April 2007). Following privatisation, Takenaka proposed application of commercial laws to all new corporations, and establishment of an oversight body. Takenaka's plan was greeted with resistance at almost every stage, both from LDP *zoku*, opposition parties, the Ministry for Internal Affairs and Communications (headed by Taro Asō) and Japan Post itself (represented by Japan Post president Masaharu Ikuta).

The postal privatisation bill survived parliamentary boycotts to gain Lower House approval in July 2005 by a narrow margin of 233 to 228, but was defeated in the Upper House thanks to the rebellion (dissent or abstention) of thirty Diet Members. In a bold move, Koizumi called a snap election and dissolved the Lower House, strategically choosing high-profile candidates to run against thirty-seven dissenters within the LDP (popularly known as Koizumi's "assassins" campaign). On September 11, Koizumi won by a landslide, at once winning a mandate for postal reform systematically removing policy reform opponents from influential political posts, finally enacting the legislation on October 11th 2005.

In legislating postal privatisation, Koizumi successfully capitalised upon 1994 electoral reforms (promulgated in 1996) to consolidate legislative power²², finally turning the tables on vested interests, weakening their influence and instead pursuing a market-opening agenda.²³

The Japan Postal Services Holding Company was established in January 2006, which APEC aptly lauded as a "major achievement" (APEC Secretariat 2006). The 2006 postal privatization referendum should have changed the face of Japan's financial system. However, given in part the end of Koizumi's turn as Prime Minister, the longer-term fate of his signature reform would prove much less revolutionary than their legislation.

2.1. The New Companies Act, which came into force in May 2006 to replace the existing Commercial Code, found its roots in a series of reforms starting in 2001, spearheaded by the judiciary. These were the first major changes to the Commercial Code since the Meiji era (1868-1912) and focused upon:

1. Improving corporate governance
2. Updating the law to reflect technological developments (particularly in information technology)
3. Improving corporate fundraising availability and access.
4. Updating company law to reflect the internationalisation of corporate and

²² (Pekkanen, Nyblade and Krauss 2007)

²³ (Pekkanen, Nyblade and Krauss 2007), p. 21

financial activities

5. Modernising and streamlining corporate law²⁴

In form, the Act brought made available to enterprises previously unavailable financial structures, including the acquisition and sale of treasury stocks, stock exchange/transfer, corporate splits and takeover bids.²⁵

Points relevant to corporate governance standards and specifically to new regulations dealing with cross-border mergers and acquisitions (M&A) were most representative of the Koizumi agenda of market-liberalising reforms and harmonisation with global standards. With regard to corporate governance, the Act distinguished between large and small companies, with larger firms required to adopt a strict internal control system based on board resolutions.

The need for improved corporate governance had been made especially apparent by global investors, whose investment into Japanese capital markets surged from the deregulations of the 1990's onward. Cross-shareholdings, the dearth of independent directors and discouragement of shareholder derivative suits did little to protect minority shareholders.²⁶

It is remarkable to note that legislating these reforms did not require the same firebrand legislation as postal privatisation. MITI (the Ministry of International Trade and Industry, the predecessor to the current Ministry of Economy, Trade and Industry) had been calling for improvements to corporate governance (such as the appointment of external directors) since the mid-1990's. Notwithstanding, bureaucratic support for legislation targeting corporate governance did not necessarily make legislation friendlier to foreign investors. Rather, their participation diluted the substance of the reform.

Examining why this was, it is pertinent to note that the intended beneficiaries of corporate governance under the commercial code are not the shareholders first and foremost, but all stakeholders. Indeed, peppered throughout the legislation are references to the interests of the stakeholder²⁷, which at times are at odds with those of shareholders. On top of this, the legal framework in Japan (even after reforms to the outdated Commercial Code) leaves substantial room for interpretation. Putting these together, the Ministry of Justice is given substantial discretion to arbitrate these conflicts, without the underlying assumption of shareholder primacy.

A particularly contentious element of legislation was the “triangular merger” provision under which the Japanese subsidiary of a foreign firm can exchange shares of its foreign parent for control over a Japanese company. On one hand, the provision was the first official recognition of cross-border M&A in Japanese law, but on the other it was met with (and diluted by) a slew of anticipatory bureaucratic guidance, the “Guidelines for Defending Corporate Value”²⁸, released in 2005. These were, in the tradition of

²⁴ (Takahashi and Shimizu 2005)

²⁵ Takashi Ejiri, Asahi Koma Law Offices (2004)

²⁶ (Spedding 2009)

²⁷ 利害関係人 (*rigaikankein* or “interested parties”) in Japanese Law traditionally refers to stakeholders including business partners, employees, and suppliers, etc. as mentioned in section 2.1

²⁸ There was some confusion of triangular mergers with hostile takeovers (when in fact, the law precludes the use of triangular mergers for hostile takeovers without board approval from the target company).

bureaucratic guidance, extrajudicial standards, which were upheld by courts as if it were law.

In implementation, fear of hostile takeovers imposed a much less market-friendly solution than originally intended. Bureaucratic guidelines created a wedge between supply and demand in the market for corporate control. In the eyes of international participants in the market for listed shares, Japan fell short of instituting best corporate governance practices upheld by transparent rule of law. The result has proven a hurdle for inward foreign direct investment, which to this day remains muted. The linkage of the hostile takeover stigma with M&A regulation is illustrated below with the Livedoor and Bulldog Sauce case studies.

The Corporations Act of 2006 was a work in progress and springboard for ongoing reform, as manifold subsequent revisions showed. Its legislation was also complementary to the Financial Instruments and Exchange Law, enacted in June 2006.

2.2. The Financial Instruments and Exchange Law (FIEL)

The FIEL, legislated in 2006 and implemented in September 2007 was the final step in a series of market-opening reforms falling under the category of “from savings to investment” reforms.²⁹ This class of reforms built on the recent market-opening measures of the Big Bang reforms in the late 90’s, and in so doing focused on the improvement of sales channels and financial infrastructure and also sought to attract a diversity of investors (particularly cash-heavy households), with some success. A rise in the number and volume of complex financial products and transactions resulted.³⁰

The FIEL was, in form, an update to the existing Securities and Exchange Law, aimed at keeping up with developments in global financial markets, also protecting investors by means of adequate disclosure and stringent measures against unfair trading practices. Aspects of FIEL (commonly referred to as J-SOX in the US) attempted to harmonise regulation with international standards, notably with the recently-implemented Sarbanes-Oxley regulations in the US. The broader objective of these reforms was to establish an adequate regulatory environment to implement Koizumi’s market-opening reforms³¹ and was intended by the Financial Services Agency to promote Japan’s status as a “Financial Services Nation”.³²

The FIEL also sought to streamline regulation; outdated regulatory codes such as the Financial Futures Trading Act, the Act Concerning the Regulation of Investment Advisory Services Relating to Securities and the Act Concerning Foreign Securities Firms were supplanted by FIEL. Other codes, such as the Commodity Fund Act, were updated to reflect FIEL.

There were four key changes that came from FIEL³³:

²⁹ These reforms included the Basic Policies for Economic and Fiscal Management and Reform (June 2001); the Program for Structural Reform of Securities Markets (August 2001); and the Program for Promoting Securities Markets Reform (August 2002).

³⁰ (Japan Securities Research Institute 2014)

³¹ <http://www.fsa.go.jp/en/policy/fiel/>

³² <http://www.fsa.go.jp/news/newse/e20041224.pdf>

³³ (EVANOFF 2015)

1. Expansion of the range of regulated financial instruments, to include investment trusts and collective investment schemes; the scope of regulated “derivatives transactions” was broadened to include interest rate and currency swaps, weather derivatives and credit derivatives.
2. Establishment of more stringent regulations for broker/dealers of high-liquidity securities than low-liquidity securities, and for general investors versus professional investors.
3. The J-SOX component, which sought more stringent disclosure by issuers of listed equity and bonds as well as external auditor certification of the issuers’ internal controls on financial reporting.
4. Rules for bidders and target companies in tender offers, in form designed to ensure “fairness and transparency in market transactions”.

In substance, some aspects of FIEL facilitated financial activity and others acted as a restraint. Exemplifying the former, FIEL did away with the need for special authorisation to conduct business in the over-the-counter (OTC) derivatives market. Considerable compliance costs were also associated with FIEL, which on top of new regulations also imposed new reporting requirements – the Quarterly Reporting System, the Internal Control Reporting System and the Certification by Management System.

For a concrete example where FIEL presented an expanding financial sector with compliance costs, it is useful to examine the market for investment trusts. Distribution channels for investment trusts were on an expansion path after 2005, in anticipation of postal privatisation. Under FIEL however formerly exempt investment advisory firms were required to register under the provisions of the new law, increasing registration and reporting requirements, hence compliance costs. Nonetheless, the investment trust market ultimately benefited from the harmonising aspect of the new regulations, as may be seen in the case study on investment trusts, below.

Japan - Balance of Payments - Current accounts - Insurance and financial services (% of service exports, BoP) (%)

Insurance and financial services (% of service exports, BoP) cover various types of insurance provided to nonresidents by resident insurance enterprises and vice versa, and financial intermediary and auxiliary services.

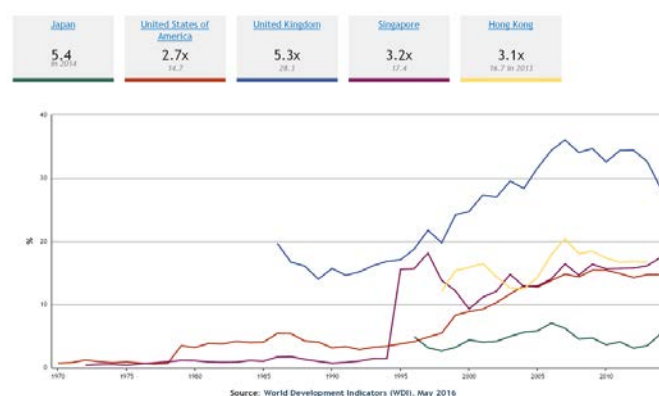


Figure 7: Financial and Insurance Services, % of total exports

Source: World Bank WDI, Knoema

The fourth key change introduced by FIEL (regarding disclosure in tender offers) was strongly influenced by the events surrounding the Livedoor debacle (examined below), and acted as one of several effective deterrents to hostile takeovers, which many foreign investors view as a failure in corporate governance and a wedge in the market for corporate control. The optimal role of hostile takeovers in the market for corporate

control remains hotly contested to this date (addressed in Appendix 2). This aspect of the FIEL, similarly to the “Guidelines for Defending Corporate Value” with regard to

Corporations Act reform, frustrated foreign investors who had eagerly anticipated the introduction of more Anglo Saxon style M&A practices.

Much like the New Companies Law, the FIEL has been updated frequently since inception. FIEL remains a work in progress and a springboard for future reform.

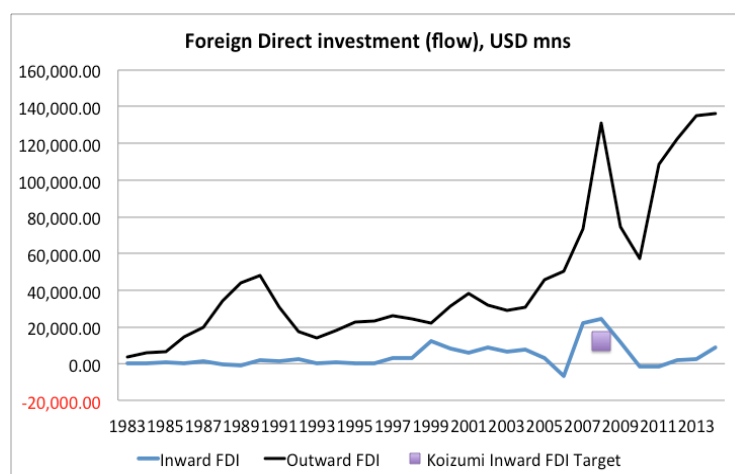


Figure 8: Japanese Foreign Direct Investment (USD mns)

Source: JETRO, Europacifica

3. Evaluation of the Koizumi reforms and lessons learned

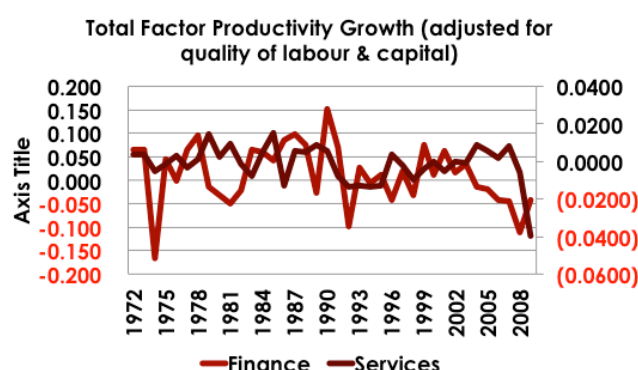


Figure 9: Financial services vs Services sector productivity

Source: Europacifica, RIETI

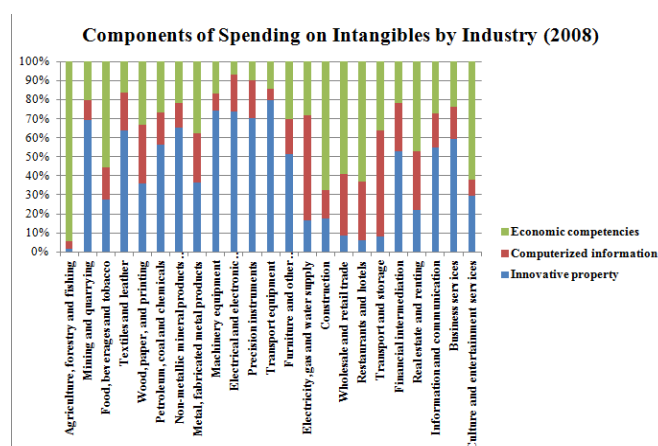


Figure 10: Spending on Intangibles by Major Industry

Source: (Fukao, Hisa and Miyagawa 2012)

malaise. From a global competitiveness standpoint, financial services lagged far behind the export-oriented IT or manufacturing sectors.

Comparing exports of financial services with those of other large global financial centres however yields a much more sombre verdict on the FSA's goal of promoting Japan as a "Financial Services Nation" (see Figure 7: Financial and Insurance Services, % of total exports).

The FIEL is not entirely to blame for this, however, nor does it invalidate other benefits of 2006 reforms. Incidentally, inward FDI did increase from 2006 onward (see Figure 8: Japanese Foreign Direct Investment (USD mns)), though failed to maintain its gains. Peaking at a meager USD24.5bn per annum, inward FDI failed to recover following the GFC; outward FDI meanwhile regained its peak of USD120bn post-GFC.

Conversely, a much more positive conclusion may be drawn when examining portfolio flows. In absolute terms, portfolio inflows dwarf foreign direct investment; as of calendar year 2013, net inward investment cleared JPY 20trn.

Admittedly, Koizumi's reforms do appear to have missed their mark by some metrics. Targets for drastically increasing inward Foreign Direct Investment were set³⁴, but only temporarily met.

Similarly, success in promoting Japan as a "Financial Services Nation" was only partially successful. On one hand within the services sector, financial services productivity is comparatively competitive. Total factor productivity in the sector hit an early trough following the GFC, and by our above framework of economic analysis, was assisted by not only deregulation but also positive asset allocation, as may be observed in the rising rate of intangible investment as well as allocation to innovative capital as a percentage of capital.

Anecdotally, we may also observe disposal of non-performing assets as supportive of financial sector productivity. Still, as mentioned above, there were limits to the ability of financial sector recovery to relieve Japan of its economic

³⁴ Koizumi announced targets to double FDI by 2008 in a 2003 speech (Wada 2005)

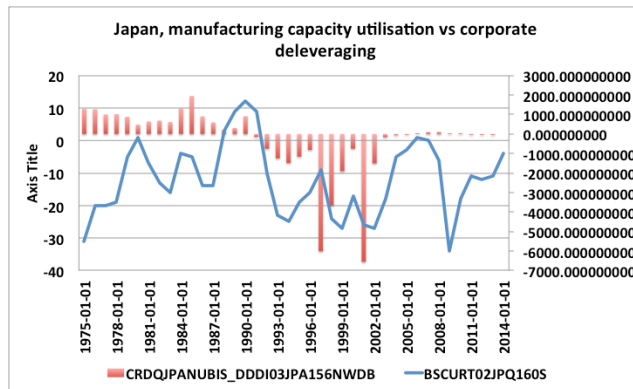


Figure 11: Japanese capacity utilisation vs corporate leverage

Source: FRED, Europacifica

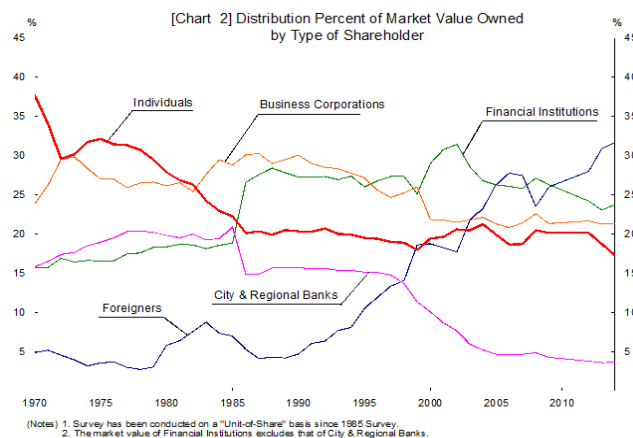


Figure 12: Japanese shareholdings, distribution by type of investor

Source: JPX

Although capacity under-utilisation temporarily resumed with the global financial crisis (GFC), it was quick to correct thereafter. Problematically however, corporate deleveraging appeared too successful in that it failed to give way to new risk-taking behaviour once the cycle turned, yet another signal that resolving the Japanese banking crisis was not enough to boost final demand. As a result, try as they might, foreign investment into Japanese stocks has been unable to propel Japanese stocks to new highs.

Foreign investors find it tough to avoid Japan's stock market altogether, given it is the world's second largest by market capitalisation. But their investments wax and wane with economic cycles and remain, on trend, barely sufficient to offset domestic reductions in risk-taking.

Foreign investors have become the largest investor class in the Japanese equity market since the time most recently eclipsing traditionally cross-shareholding financial institutions (see Figure 12: Japanese shareholdings, distribution by type of investor). This is a significant shift in the composition of share ownership that would not have happened without the Big Bang, and was further facilitated by reforms to the financial sector and changes to share transfer regulations under the New Companies Act.

Many credit the Koizumi administration for having enhanced the allure of Japanese corporates after having overcome the "three excesses" of excess debt, excess employment and excess capacity that beset Japanese corporates, by virtue of the conditions surrounding the resolution of the Japanese banking crisis.³⁵ Indeed, we may observe empirically that, during the Koizumi administration, chronic underutilization of manufacturing capacity resolved, as did corporate leverage.

³⁵ (Sakai, Japan's Economy in the Post-Koizumi Era 2006)

Inward foreign direct investment (FDI) on the other hand reflects the stunted market for corporate control. As mentioned above, inward FDI remains subdued even despite the surge in foreign share ownership. Responsible at least in part for lacklustre inward direct

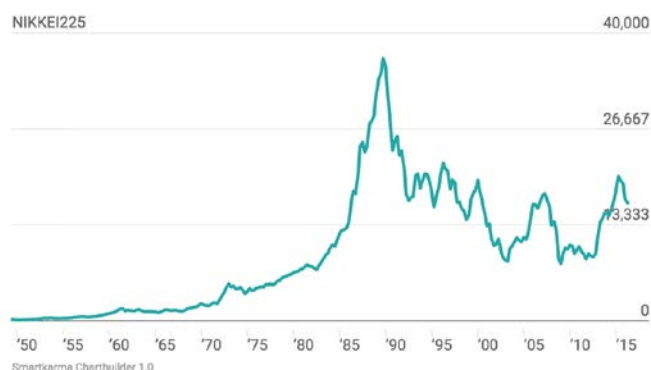


Figure 13: Nikkei 225

Source: FRED, Europacifica

investment are (a) perceived limitations to access to the Japanese market for corporate control and (b) perceived limitations to the ability of shareholders to influence governance.

The next logical step, it would appear, would be to bring governance up to global standards, enhancing the appeal of cleaned-up corporate Japan for good. Under Koizumi, this did not happen, and one major root of the perceived

failure of the reform programme.

Despite this considerable drawback however, there remain aspects of the programme that still contributed to the advancement of financial sector and capital market function.

A top-down LAISR Evaluation

Employing APEC's five-point LAISR framework³⁶ to evaluate the Koizumi structural reform program, we observe that:

- i. **Regulatory reform:** The implementation of FIEL covered significant ground in both updating Japanese regulations and harmonising them with global (American) precedents. Many new regulations were clearly modeled after Sarbanes-Oxley in the US. In some markets, regulation was effective in increasing market activity (e.g. the FX market and eventually the Investment Trust market). However, much as with Sarbanes-Oxley, associated compliance costs remain significant, which remains an oft-expressed concern for other regional regulatory authorities under pressure to implement US-style reforms. Japan continues to update regulations to adapt to changing market conditions. Recent updates to regulations concerning Investment Trusts in particular might prove amenable to the adoption of the Asia Regional Funds Passport (see Appendix 3).
- ii. **Competition policy:** although FIEL, the New Corporations Act and postal reform all attempted to break down barriers to regional competition in financial services, the delay of postal privatisation and its partial nature led to muted improvement in financial sector competition. Moreover, the perceived protection of cross-border acquisition targets decreased the market-opening effect of the New Corporations Act. As a result, growth in inward FDI has failed to sustain, even as outward FDI has rebounded.
- iii. **Public sector management:** The Koizumi reforms were bold in their consolidation of power under the Prime Minister's office and cabinet (via the CEFP) but envisioned a reduced role for central government in the financial sector, once the banking crisis

³⁶ (APEC Secretariat 2006)

had passed. The postal privatisation referendum was a major political coup. However, implementation of postal privatisation was much delayed. Separately, the dilution in practice of new laws governing cross-border investment became apparent in application. Some argue³⁷ that the shortfalls in overall macroeconomic policy, including ineffective fiscal stimulus, has created new problems for policy, including a massive debt overhang.

- iv. **Strengthening economic and legal infrastructure:** The combination of the New Companies Act and FIEL made substantial strides in updating Japanese legal and regulatory infrastructure, incorporating regulatory harmonisation and a legal framework for cross-border investment. Nonetheless, the application of the legal framework remains intransparent for many foreign investors. With regard to economic infrastructure, despite the availability of new financial products for Japanese households and the rise in popularity of vehicles such as Investment Trusts and Foreign Exchange, risk assets remain a very small part of the household balance sheet. By this measure, Koizumi's "from savings to investment" strategy has enjoyed only limited success (see Appendix 4).
- v. **Corporate governance:** one of the most contested points of Japanese structural reform to date, including those of the Koizumi era, is related to corporate governance. Underlying the debate are questions of the appropriateness and applicability of the model of shareholder primacy. The Corporations Act disappointed both domestic and foreign investor expectations for improved governance in 2006 (see TSE Saito's comment, above). As a result, growth in inward FDI has not persisted. Moreover, interest regarding corporate governance seemed to die down after Koizumi stepped down (Figure 37: Indicator of Corporate Governance awareness, Japan). However, the Corporations Law has undergone further reform since enactment, from 2008 to 2012. Meanwhile, PM Abe's work on Japan's stewardship code as well as the Tokyo Stock Exchange's corporate governance code since then have revived interest in corporate governance. The debate on governance is one we expect to escalate in the APEC region, particularly as reforms to China's financial systems and state owned enterprises progress.

Bottom-up evaluation: Case Studies

The following individual case studies highlight key lessons learned from 2006 reforms:

1. The Japanese Investment Trust market was a clear beneficiary of the FIEL, expanding in size and range under new streamlined regulations.
2. Two high-profile cases first built then dashed hopes for a new market for corporate control under the New Corporations Act. Subsequent revisions to the Act and new Stewardship and Corporate Governance codes however give investors reason to hope for (albeit slow) change.
3. The spectacular legislation of Postal Privatisation demonstrated the benefits of policy sequencing and its disappointing implementation, the pitfalls of policy gradualism. Subsequent developments meanwhile show that reform is not completed with privatisation alone; additional regulatory and structural adjustments are often necessary accompaniments to large-scale government privatisations.

³⁷ (Hoshi and Kashyap, Why Did Japan Stop Growing? 2011)

3.1. Lessons from the Financial Instruments and Exchange Law: case study of the Investment Trust market

Although it would be overstating the benefits of FIEL to say it “completed” Japanese reforms in a general sense, there were some examples of “market completing” functionality. Legislators had learned lessons from reactive and incomplete market-opening reforms in the 1980’s, and sought to strengthen the legal, regulatory and macroprudential aspects of Japan’s securities law in keeping with developments

overseas (specifically, Sarbanes-Oxley).

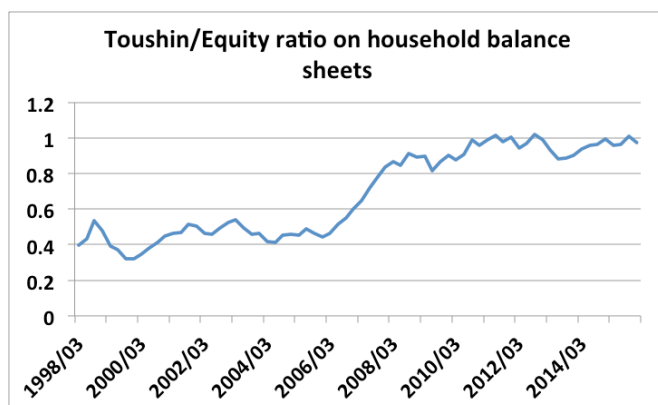


Figure 14: The ratio of investment trusts to equities on the Japanese household balance sheet

Source: BOJ, Europacifica

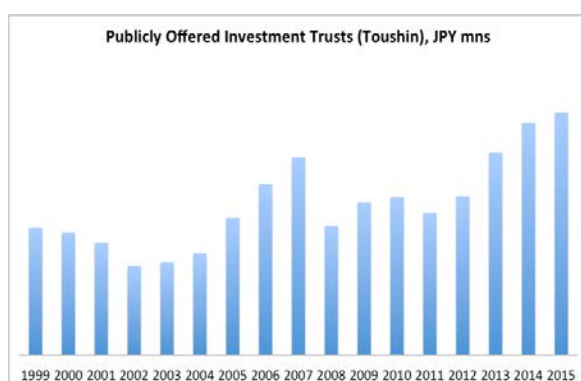


Figure 15: Publicly Offered Investment Trusts

Source: Japan Investment Trust Association

Examination of the investment trust (*toushin*) market reveals both benefits and costs associated with FIEL. The introduction of new registration and disclosure requirements in the *toushin* market imposed clear compliance costs upon a growing industry (which was setting up for expansion alongside planned postal privatisation). Upon inception of FIEL in September 2007, investment trust registrations declined, as they fell subject to new reporting and disclosure regulations, where prior to FIEL they were exempt.

It is unclear how much of the decline, in absolute terms, was due

to tighter regulation and how much was due to risk-aversion associated with volatile risk assets alongside the outbreak of the Global Financial Crisis. However, we might adjust for the effects of the crisis on the household balance sheet by examining the ratio of *toushin* to stocks (thus comparing two classes of risk assets and adjusting for fluctuations in risk tolerance (see Figure 14).

The ratio of *toushin* to equity investments shows a clear structural shift in late 2006, testifying to the success of reforms within this industry sector.

This was due to the streamlining effects of the FIEL upon registration and disclosure of new products. Introduction of cross-sectional consolidated regulation was broad in scope, covering not only investment trust beneficiary rights and mortgage securities but also collective investment schemes. Not only did this framework of application

do away with the necessity for redundant regulatory adjustments product-by-product, but allowed for some flexibility, extending the scope of application of existing regulation to new products sharing similar aspects to products already covered at inception of FIEL.

It is possible that the immediacy with which the Financial Services Agency went to work on updates to the newly implemented regulations (its “Plan for Strengthening the Competitiveness of Japan’s Financial and Capital Markets” was made public in December 2007, and was approved in the Diet in 2008) also created a springboard for further growth in Investment Trusts

After an initial setback in expansion of the Investment Trust market in 2008 (due largely to effects of the Global Financial Crisis), the *toushin* market resumed expansion to new highs in net asset value (see Figure 15: Publicly Offered Investment Trusts). The result suggests that the benefits of well-designed regulatory reform, even in the presence of compliance costs, may be realised over the long term.

With regards to impact to Global Value Chains, the benefits provided by streamlined approval of new investment trust products under FIEL may facilitate and enhance participation in region-wide initiatives such as Asia Regional Funds Passport.

3.2. Lessons from the New Companies Act: case studies in corporate governance

In the words of Columbia Professor Curtis Milhaupt, Japan has chosen “enabling” over “mandatory” reforms to corporate governance. This is a significant difference between US and Japanese corporate governance systems, and one that international investors find hard to appreciate.

One “enabling” facet of Japanese law is that it is left intentionally vague, as to allow flexibility of interpretation. Less charitably, vagaries may have paved the way for discretion by bureaucrats, who have incentives to preserve their policymaking power. Protection of Japan’s traditional model of stakeholder capitalism (rather than Anglo-Saxon shareholder primacy) was “enabled” in the process of legislation of the commercial code reforms, and its arena following 2006 reforms was the market for corporate control.

Hostile takeovers, which were alien M&A practices to Japan until the mid-2000’s³⁸. The scene was set in the early 2000’s, when, prior to the legislation of the New Companies Act, banks began to unwind cross shareholdings (with the help of the Bank of Japan), as to reduce systemic risk. The sale of cross-held shares eroded one pillar of the “stable shareholding” system prevalent from the time of the *zaibatsu* system, exposing firms to the rising prospect of unfriendly takeovers.

³⁸ As mentioned in section 2.1, the threat of forced mergers was traditionally used as an incentive for lagging firms to boost performance and thus takeovers historically carried a social stigma

Figure 16: Key Events surrounding the Livedoor-Fuji TV takeover battle for NBS (2005)

Jan. 17 -- Fuji TV announces a public tender offer to acquire a more than 50 percent stake in Nippon Broadcasting.

Feb. 8 -- Livedoor boosts its stake in Nippon Broadcasting to 35 percent in terms of outstanding shares by acquiring a 29.6 percent portion through the Tokyo Stock Exchange's off-hours trading system.

Feb. 9 - Fuji TV rejects Livedoor's proposal for business cooperation, saying it will counter the Internet service provider's acquisition of a major stake in Nippon Broadcasting.

Feb. 10 - Fuji TV cuts its equity stake acquisition goal in its public tender offer for Nippon Broadcasting to 25 percent in a bid to secure its success.

Feb. 23 - Nippon Broadcasting announces a plan to issue Fuji TV warrants for 47.2 million new shares to ward off Livedoor's takeover bid.

Feb. 24 - Livedoor takes legal action, asking the Tokyo District Court to bar the radio network from issuing share warrants to Fuji TV. Fuji TV extends the deadline of its tender offer for Nippon Broadcasting to March 7.

March 8 - Fuji TV says it has secured 36.47 percent of all outstanding shares in Nippon Broadcasting through its successful public tender offer through March 7.

March 11 - The Tokyo District Court issues a preliminary injunction to bar Nippon Broadcasting from issuing Fuji TV share warrants. Nippon Broadcasting immediately files an objection to the ruling with the same court.

March 15 - Fuji TV decides on a sharp dividend increase to 5,000 yen per share for the fiscal year to March 31 to raise the price of its stock and make it less affordable for a company pursuing a takeover.

March 16 - The Tokyo District Court dismisses Nippon Broadcasting's objection over the court's decision. Nippon Broadcasting immediately appeals to the Tokyo High Court. Livedoor's stake in Nippon Broadcasting exceeds 50 percent in terms of voting rights.

March 22 - Fuji TV says it has filed registration with the government for the issuance of up to 50 billion yen in new shares to existing shareholders.

March 23 - The Tokyo High Court upholds the lower court ruling banning Nippon Broadcasting from issuing warrants for new shares to Fuji TV. Nippon Broadcasting gives up on the "poison pill" plan.

March 24 - Softbank Investment Corp. becomes Fuji TV's largest shareholder by borrowing a 13.88 percent stake held by Nippon Broadcasting.

March 31 - Nippon Broadcasting fixes the record of shareholders.

April 18 - Fuji TV and Livedoor amicably settle their battle for control of Nippon Broadcasting.

Late June - Nippon Broadcasting will hold a regular general shareholders meeting.

Source: Kyodo News

In early 2005, the high-profile domestic takeover attempt of Nippon Broadcasting System (NBS), a subsidiary of Fuji TV by upstart internet firm Livedoor (targeting the 22.5% stake NBS held in Fuji) suddenly brought the corporate governance debate to the fore (see Figure 16: Key Events surrounding the Livedoor-Fuji TV takeover battle for NBS (2005)). The Tokyo High Court ruling that the Fuji TV takeover defense strategy was "grossly unfair" was a landmark precedent which in turn could have marked the beginning of a market for corporate control in Japan. Things looked promising for activist investors when only days after the first Tokyo District Court ruling in the Livedoor-Nippon Broadcasting case in March 2005 (in favour of Livedoor), the Tokyo Courts also struck down a poison pill strategy adopted by Nireco, a maker of hi-tech measuring devices.

But Nireco turned out to be an outlier; in the two years subsequent to the Livedoor/NBS case, over 400 firms officially adopted takeover defence strategies. In hindsight, the alarm regarding hostile takeovers was excessive. There were only 23 reported hostile takeover attempts between 2000 and 2013, according to Dealogic, of which only seven were successful.³⁹

This may have been because the incipient market for corporate control was met by a disproportionately vehement reprisal by a combination of bureaucratic intervention and idiosyncratic interpretation of the law. Widespread fear of hostile takeovers triggered by the Livedoor case prompted bureaucrats (METI and MOJ) to compile Japan's "Takeover Defense Guidelines" in May 2005. This was a logical response to prospects of a rise in hostile takeovers but the fervor with which firms adopted takeover defences was disproportionate to the number and scale of actual attempts.

The outcome of subsequent contests for corporate control, this time involving foreign stakes, sent a discouraging message to foreign investors, who may have reached the conclusion that reform had once again been hijacked by bureaucrats and non-market actors with vested interests.

One such high-profile case was *Steel Partners Japan Strategic Fund (Offshore), L.P. v. BullDog Sauce Co* (see **Figure 17**). Steel Partners, an activist US hedge fund, set out to acquire a controlling stake in BullDog Sauce, a manufacturer of condiments and sauces which also had a real estate division. BullDog Sauce adopted takeover defences, diluting Steel Partners' interest, which Steel Partners tried legally to contest, and was ultimately unsuccessful.

One of the key determinants of the case was the approval of defence measures by resolution at a general shareholders' meeting. In itself, a court of law upholding shareholders' decisions is not unusual. Yet many foreign investors perceived the response to Steel Partners' appeal to the Tokyo High Court's ruling in favour of BullDog sauce as pointedly aimed against their interests and against those of "free fair and global" markets.

A second (more nuanced) reason for foreign investors' dismay over the outcome may have been that the validity of the shareholder resolution - the most consistently upheld argument in defence of BullDog Sauce came not from law or precedent, but from the bureaucracy's interpretation of the New Companies Act - from METI and MoJ Guidelines.

³⁹ As cited in the *Wall Street Journal*:
<http://www.wsj.com/articles/SB10001424127887324216004578482943175923954>

3.3. Lessons learned from postal privatisation: case study in policy sequencing

Although perceived as the boldest of Koizumi's reform measures and one that could have reshaped the financial sector entirely⁴⁰, postal privatisation has, in implementation, fallen far short of its original ambitious goal. Lessons learned might be divided into three parts – firstly the elements of its successful legislation, secondly the characteristics of its much delayed⁴¹ and scaled-back implementation and thirdly, the necessity for ongoing reform

Figure 17: Key Events in the “BullDog Sauce” case

May 2007: US activist hedge fund Steel Partners' Japan Strategic Fund owns 10.25% equity stake in BullDog Sauce, a manufacturer of sauces and condiments with a real estate division.

18 May 2007: Steel Partners makes tender offer for BullDogSauce, of JPY1584 per share. BullDog's board responds by questioning how the company would be run were the bid successful.

7 June 2007: BullDog Sauce rejects the bid, claiming that it is not in the shareholders' interests, at the same time announcing plans for to propose a special resolution before the general shareholders' meeting on 24 June to authorise the company to issue warrants to the company's shareholders.

Conditions of the warrants:

- All other shareholders who owned shares on 10 July would receive three warrants for every share owned.
- Warrants could be exercised in September for the price of JPY1.
- The company would exercise unused warrants for three shares.
- If exercised, Steel Partners would be left with only 2.82% of outstanding shares; thereupon BullDog Sauce would purchase Steel Partners' warrants for JPY396 each, allowing Steel Partners to purchase sufficient shares to take holdings back to their pre-warrant percentage.
- If the offer were abandoned before 5 July, BullDog sauce would not issue warrants.

13 June 2007: Steel Partners seeks an injunction from Tokyo District Court to prevent new share issuance on the basis of (a) shareholder inequality (article 109 of the Corporation Law) and (b) unfair issuance (article 247 of the Corporation Law)*

24 June 2007: 83% of BullDog Sauce shareholders on record vote to adopt the resolution.**

28 June 2007: Tokyo District Court rules in favour of BullDog Sauce, on the grounds that shareholders have equal rights to new issues and that the decision was approved by the majority of shareholders, per METI/MOJ guidelines. Steel Partners appeals the decision to the Tokyo High Court.

9 July 2007: Tokyo High Court affirms the ruling in favour of BullDog Sauce, ruling that (i) Steel Partners is an abusive acquirer; (ii) the offer was not made in good faith; and (iii) the offer was detrimental to the value of BullDog sauce and its shareholder (justifying unequal treatment of Steel Partners as shareholders); Steel Partners appeals the decision to the Supreme Court.

7 August 2007: Supreme Court rejects Steel Partners' appeal opening the way for new share issuance, declining however to endorse the ruling of the Tokyo High Court that Steel Partners is an abusive acquirer, instead upholding the validity of a shareholder resolution, in line with METI/MOJ guidelines.

* Steel Partners sought precedence in the Livedoor ruling, where Fuji TV's plan to issue warrants was deemed “grossly unfair”.

Source: (Padgett 2011), (Lessambo 2016), (Linklaters 2007)

following privatisation.

⁴⁰ (Fink 2010)

⁴¹ The original target date for full privatisation was 2010; currently, the target date for partial privatisation (full float of *Yucho* and *Kampo* is 2017).

As highlighted above, the Koizumi administration's institutional framework –specifically the Council on Economic and Fiscal Policy (CEFP) - was pivotal both to resolving Japan's banking crisis and to the success of legislating the subsequent structural reforms of 2006. The sequence of these reforms was of paramount importance.

Indeed, one of the most valuable lessons learned by Koizumi and his team of reformists while in office was that of “reflation before reform”, in policy sequencing⁴². Koizumi's reform experience taught us that in Japan's case (an aging, stagnant developed economy plagued by deflation and ever-expanding public sector debt), reflation creates more palatable conditions for introducing structural reform.

At a visceral level, even moderate wage growth and asset reflation made all the difference in the world when asking the public to accept an unpalatable reform (with implicit job losses and removal of a popular risk haven). Given the significant number of jobs as well as influential regional votes influenced by the Postal lobby, it is argued that, absent reflation and concomitant prospects for employment growth, there would have

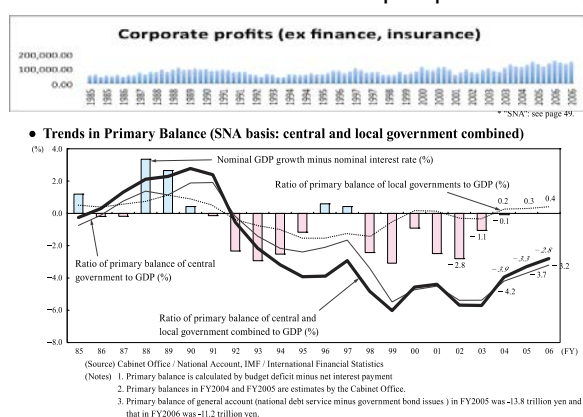


Figure 18: Reflation helped Japan surpass fiscal targets

Source: Ministry of Finance, Japan

corporate Japan became profitable (and went from paying 0% to 40% tax), fiscal revenues exceeded targets, curtailing the government's primary balance deficits at a faster pace than expected.

The benefits of reflation were eminently applicable to postal privatisation. Japan Postal Savings was a necessary partner in Koizumi's reform of the Fiscal Investment and Loan Program (FILP), one major avenue of cutting down on public expenditure. Prior to FILP reform, postal savings as well as pension reserves were obligatorily made available to the FILP, a major government programme for social welfare and infrastructure finance. FILP reform established independence in management of both pension reserves and Postal deposits, upon which Government Pension Investment Fund as well as Japan Post holdings of FILP paper was wound down⁴³.

Although much delayed from its initial target date of 2010, the JPY1.4 trillion float of the postal savings and insurance arms of Japan Post Holdings in November 2015 showed, a public offering more easily absorbed in an environment of rising stock prices (thus increasing direct revenue associated with the stock float). There are further benefits yet to accrue from postal privatisation; as demonstrated above, revenues to the government

⁴² Emergency Countermeasures to Deflation (Japan Cabinet Office 2002)

⁴³ see http://www.mof.go.jp/english/filp/filp_report/zaito2011/zaito2011-4-05.html

from a privately operating firm also tend to improve during times of economic expansion and reallocation of debt-heavy portfolios toward stocks might also assist in both reflation and fiscal reconstruction.⁴⁴

That reflation is a necessary condition for fiscal as well as structural reform is a pivotal assumption to test for sequencing of PM Abe's "three arrows" of reform today.

Unfortunately, the benefits of policy sequencing only enjoyed a limited window of success. The same year as the Postal referendum, Koizumi's term as leader of the LDP expired, upon which he was required to step down as Prime Minister. The reforms spearheaded by Koizumi were dependent on succession, which alongside the advent of the Global Financial Crisis proved damaging for the implementation of postal privatisation.

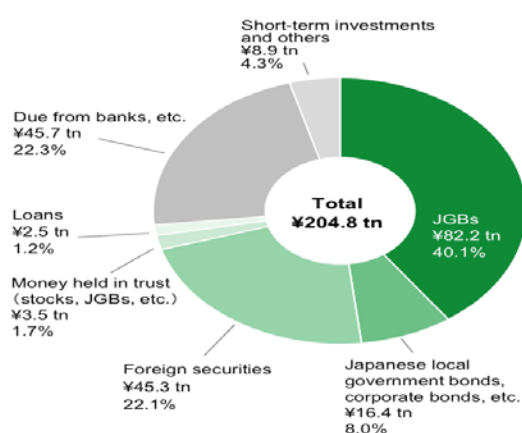


Figure 19: Composition of assets, Japan Postal Insurance (Kampo)

Source: Japan Post

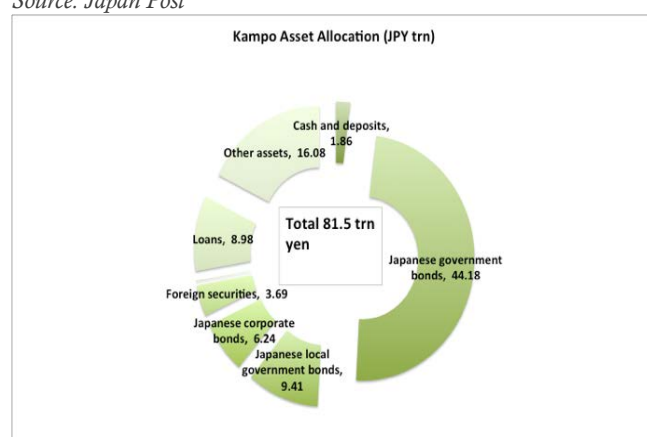


Figure 20: Composition of assets, Japan Postal Insurance (Kampo)

Source: Japan Post

After several years of rapid leadership turnover within the LDP and deteriorating sentiment accompanying the Global Financial Crisis, a frustrated Japanese electorate handed the reins to the opposition party. The CEF as we knew it was subsequently dismantled by the Democratic Party of Japan in 2009⁴⁵, which may have undermined credibility in the party's leadership credentials, giving rise to difficulties in legislating further reform measures.

Though reinstated by Prime Minister Abe upon the LDP's return to power in 2013, the CEF's policymaking power was no longer as centralised as under the Koizumi administration, with many of the central policy reforms siphoned off to a "growth strategy" rather

⁴⁴ (Fink, The Business Case for Reforming Japan Post 2010)

⁴⁵ Japan's ruling Liberal Democratic Party lost a 2009 election to the DPJ, led by PM Yukio Hatoyama. The Hatoyama administration rebranded the CEF as the "National Strategy Office" and divested it of one of its key policy functions, the compilation of *Honebuto no Houshin* or "Big Boned Policy". The *Honebuto no Houshin* were reinstated in 2013 (with the

than on a central structural policy platform.⁴⁶

Again however, reflation came to the rescue – a rebound in asset markets and growth since the start of the Abe administration provided favourable conditions to renew the privatisation process, and as such Japan Post Bank and Insurance arms of Japan Post Holdings were listed and partially privatised in 2015.

The partial float of November 2015 (in which retail investors were heavy participants, divesting themselves of cash) represented progress in structural reform. Both *Yucho* (postal savings) and *Kampo* (postal insurance) are diversifying their investment portfolios away from Japanese Government Bonds, increasing their allocations in foreign assets. Japan Post Bank increased its allocation to foreign bonds from 15.9% as at the end of fiscal 2014 to 22.1% (JPY45.39trn) as of April 2016; *Kampo* meanwhile raised its foreign bond allocation from 2.5% to 4.9% of its JPY81.5trn portfolio over the same period.⁴⁷

Bringing the case study analysis to its last point, despite progress in the privatisation of Japan Post, the flow-on benefits of privatisation to Global Value Chains still appear limited. At time of writing, Japan Post remains a largely government-controlled juggernaut in the financial and insurance sectors. *Yucho* (postal savings) and *Kampo* (postal insurance) balance sheets remain inflated by cash that flowed in from households when the Japanese banking crisis was in full swing and sentiment was at its worst.

Because of Japan Post's long history as a government-owned institution and also because of the government's ongoing interests in the holding company, many private sector competitors in financial services and insurance remain skeptical of the benefits of privatisation. Competitors are apprehensive that in the absence of regulatory harmonisation, privatisation might merely transform an explicit government guarantee to the largest, government-protected players in financial services and insurance to an implicit one. An implicitly protected Japan Post, if awarded a more extensive mandate than before, might dampen rather than promote competition in the financial sector. Some of the same concerns voiced by foreign competitors in the late 2000's have been repeated again under the Abe administration.⁴⁸

Complete privatisation (release of government control) *alongside* harmonisation of regulation for all institutions (including Japan Post) in these sectors would approximate the creation of a "level playing field" for both domestic and international players in the financial and insurance sectors, which is likely to have a positive impact to global value chains.

3.4. Contributions to Regional and Global Value Chains

Compared to the principal role Japan played in economic diplomacy following the Asian crisis as well as the resulting regional financial infrastructure⁴⁹, Koizumi's regional legacy is mostly indirect; free market values were internalised in Koizumi's reforms rather than

CEFP reverting to its original nomenclature) upon the LDP's subsequent return to power under current PM Abe.

⁴⁶ (H. Takenaka, 久々の「骨太方針」をどう読むか?" [How to evaluate the revived Honebuto-no hōshin?] 2014)

⁴⁷ Japan Post website, 2016

⁴⁸ American Chamber of Commerce in Japan 2016)

⁴⁹ The Chiang Mai Initiative, or network of bilateral Central Bank swap agreements was built upon facilities originally established by the New Miyazawa Initiative in 1998, agreed in ASEAN + 3 discussions.

aggressively pursued; the use of “*gaiatsu*” (external pressure) as a policy tool may have been under-utilised. This perhaps explains stunted growth in competitiveness of Japanese financial sector exports (see Figure 7: Financial and Insurance Services, % of total exports).

Under the current Abe regime however, pursuit of TPP and other multilateral trade accords may assist in promoting internal structural reforms.⁵⁰

Within the region, the indirect benefits of structural reform are well recognised as substantial. In its *Asia Pacific Regional Economic Outlook* in April 2015, the IMF remarked that, “Structural reforms remain critical to boost productivity growth across the region,

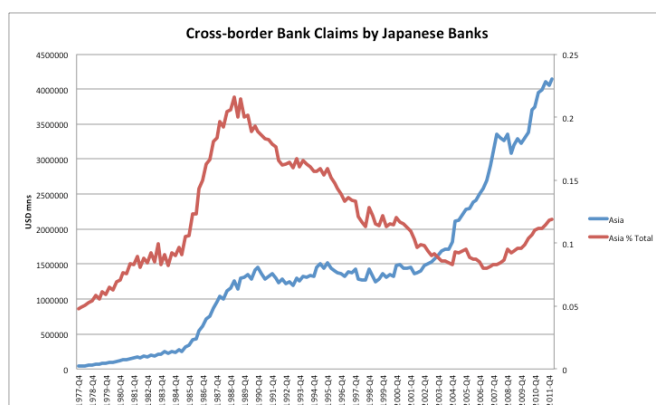


Figure 21: Surge in Japanese cross border bank claims, Asia Region

Source: Bank for International Settlements (BIS)

including... initiatives to raise services productivity and labor force participation in Japan.” Recalling that services comprise over 70% of Japanese output, understanding the drivers of Japanese services sector underperformance is a vital input to successful structural reform.

Until recently, Japan was the world’s second-largest economy, of which consumption still remains the largest share of GDP (above 60%); of this, imported goods and services comprise a significant share.

Japan’s successes or failures in stoking domestic recovery cannot help but exercise an impact upon both regional and global supply chains and production.

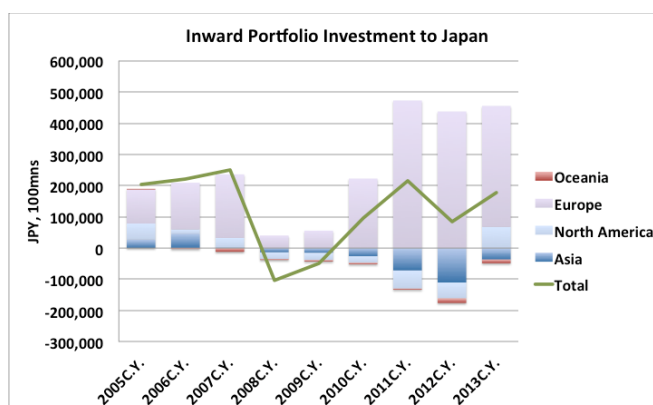


Figure 22: Net liquidation of Japanese securities by Asian investors

Source: Bank for International Settlements (BIS), Japan Ministry of Finance (MOF)

The impact of Koizumi’s financial services reforms upon the Japanese economy was mostly positive. As demonstrated above, the resolution of Japan’s banking crisis removed one barrier to growth of the world’s second (now third) -largest economy.

⁵⁰ (Urata 2016); also see, from Keidanren (Japanese Business Federation): <https://www.keidanren.or.jp/english/policy/2000/033/proposal.html>

Domestic bank lending recovered; cross-border claims also recovered as Japanese banks renewed overseas lending. Cross-border loans to Asian borrowers grew at a more subdued pace than to North American and European borrowers, until the time of the Global Financial Crisis, whereupon they rebounded (see Figure 21: Surge in Japanese cross border bank claims, Asia Region).

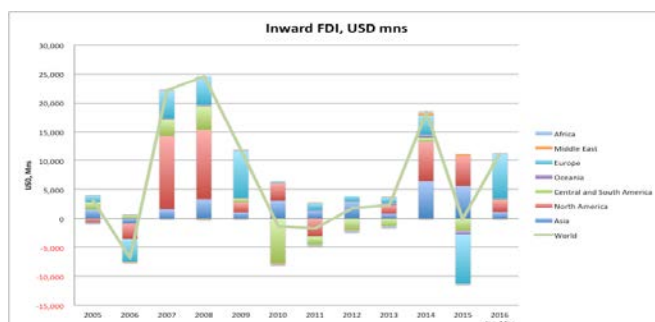


Figure 23: Asian Investors show smaller but steady interest in Japanese FDI

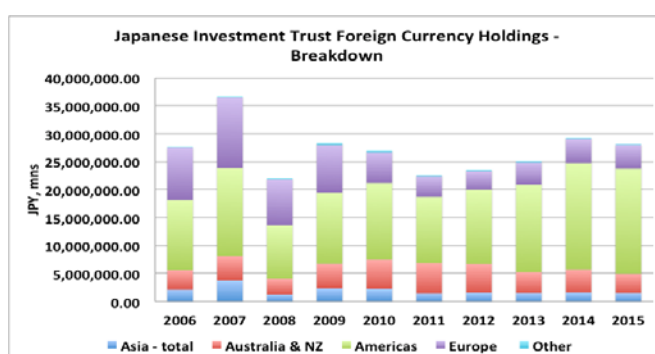


Figure 24: Strong interest in Oceanic currency-denominated investment trusts

Source: JETRO, ITA

Outward portfolio investment grew as investment trusts flourished and large public pools of funds (such as Postal Savings, Postal Insurance and the Government Pension Investment Fund) diversified away from domestic bonds, into foreign assets. Inward direct investment only temporarily recovered moreover remained muted compared to outward direct investment by Japanese firms. Interestingly however, the Asia Pacific region was a smaller but steadier source of FDI inflows into Japan since 2006.

To highlight specific contributions of the 2006 reforms to regional market development, we

point firstly to the ongoing growth in the Japanese Investment Trust market since the introduction of FIEL. It is interesting to note the disproportionately high share of Australian and NZ dollar assets among investment trusts' foreign currency-denominated offerings (see Figure 24), thanks to higher yields associated with these currencies among developed country assets.

Going forward, the ability to extend the scope of existing regulation to new products sharing similar aspects to products already covered at inception of FIEL should prove beneficial for regional initiatives such as Asia Regional Funds Passport, which aspires to establish region-wide fund portability.

There was, on the positive side, a surge in awareness of matters concerning corporate governance alongside the implementation of the New Corporations Act. Some regional trade partners welcomed the reforms. APEC credited the code with success in promoting business growth (pointing to a 10% increase in the number of business start-ups since the abolition of minimum capital requirements) even as it "strengthened certain corporate disclosure requirements". Other large market participants were less generous in their

evaluations. In 2007, TSE President Atsushi Saito aired his exasperation with the state of Japanese corporate governance at a UBS conference, pointing to the role of poor disclosure and oversight in dimming the attractiveness of Japanese shares to foreign investors.

Eventual recognition of those inadequacies however gave rise to further regulatory amendments. Boding well for greater representation of minority shareholders, if not full convergence toward a model of shareholder primacy, Japan's government pension investment fund (GPIF) has shown incipient signals of activism. Japan's stewardship code was drafted in 2014, which included both a more activist remit for the GPIF as well as endorsement of the Nikkei 400 Index⁵¹, which lists firms meeting specific governance criteria.⁵² The Stewardship Code builds upon reforms enacted during the Koizumi era.

There remains much work to be done, however. Although GPIF is a signatory to the code, it has yet to incorporate the code into its own investment principles. Corporate governance "best practices" remains a work in progress in Japan, and is a matter of region-wide interest, as global financial systems become ever more interrelated. APEC highlights the importance for corporations within the region to "hold the resources of their investors in good stewardship" and to "act in the interests of shareholders by transparently ensuring that investments create the highest possible rate of return" (APEC Secretariat 2006).

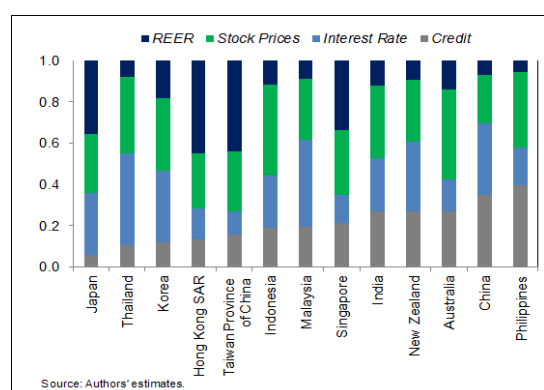


Figure 25: Contribution of Financial Variables to IMF Financial Conditions Indices

Source: (Osorio, Pongsaparn, & Unsal, 2011)

3.5. Applicability of lessons learned for the APEC region

In order to evaluate the impact of Koizumi's reforms on the region, it is useful to recall APEC's definition of structural reform (see Section 2), and also added clarification from APEC's 2006 policy report that "the spotlight has naturally shifted to the structural and regulatory obstacles that inhibit cross-border trade by creating behind-the-border barriers to doing better business". Keeping this theme in mind the following are areas in which APEC economies may benefit from Japan's experience in overcoming –

or at least attempting to overcome – such barriers:

- The complementarity of capital reforms to reforms in financial services: China is learning the pitfalls of partial reforms in implementation, yet necessity to move forward in the process of capital account deregulation given ballooning shadow banking, "hot money" flows.
- Policy sequencing: economic expansion makes structural reform more palatable. This may be another policy lesson useful for China in its market-opening reforms (noting delay in capital market reforms following bouts of market volatility).

⁵¹ see: <http://www.jpx.co.jp/english/markets/indices/jpx-nikkei400/>

⁵² (Japan Financial Services Agency 2014)

- Policy sequencing must account for “news shocks” to capital markets. Other countries vulnerable to capital market shocks (Malaysia, Thailand, Korea – see Figure 27).
- Compliance costs associated with harmonisation to global regulatory standards in financial systems where banks operate a traditional model of lending and deposit taking. This is relevant in discussions pertaining to Basel IV reforms. Many Asian economies see compliance costs as weighty against the perceived benefits of these reforms.
- Idiosyncratic application of the rule of law may diminish the comparative appeal of investment into a regional economy. Rule of law is one of the items many investors look for in all Asian economies (Ease of Doing Business Index)
- “Mandatory” corporate governance regimes might be more transparent than “enabling” regimes in the eyes of foreign investors; e.g. Korea is moving toward more “mandatory” governance— Milhaupt & Gilson (2004)
- Given the greater role of non-shareholding stakeholders in many Asian models of governance, there may be merit in collectively exploring alternative models to Anglo-saxon governance models. Good corporate governance may not rely on shareholder primacy alone (e.g. cross-shareholdings in Korea (Kim and Sung 2009)), but does require standards of “best practices”.
- Strong and centralised political leadership may be a pre-requisite to achieve success when battling vested interests to enact reform (this depends however on appointment of a reformist leader, in any nation)
- Gradualist financial reform agendas run the risk of falling behind global trends and failing to achieve desired reform. This concept may be applied to other countries with tightly regulated industries or capital controls (e.g. China, India) who are gauging speed and sequencing of deregulation.

4. Next steps in the economy reform process

Areas of the reform process where further developments are expected are:

- i. Continuing sell-off of cross-held shares and reform of corporate boards, alongside the restructuring of main bank relationships. These measures remain pivotal to productivity improvements in the financial sector.⁵³
- ii. Ongoing efforts to diversify the Japanese household balance sheet “from savings to investment”.
- iii. Ongoing adaptation of FIEL (Financial Instruments and Exchange Law) and Corporations Law to reflect new products and technological development, as well as in favour of further market opening measures.
- iv. Use of multilateral agreements and regional initiatives as levers to speed domestic reforms (e.g. the Trans-Pacific Partnership and Asia Regional Funds Passport)

⁵³ The hostile takeover debate is related, but not interchangeable with the argument of reduction in cross-shareholdings. Although the latter presents systemic risks, as seen during Japan’s financial crisis and their decline may create greater opportunities for hostile takeovers, there is evidence against the argument that absence of hostile takeovers owes primarily to cross-shareholdings. (Kim and Sung 2009)

- v. Target creation of a “level playing field” for competitors in the financial and insurance sectors in Japan’s ongoing postal privatisation.
- vi. Ongoing promotion of corporate governance including enhancements to Japan’s Stewardship Code, transition from passive to more active investment by GPIF and new products focused upon governance.

Since the advent of financial globalisation, there is evidence that foreign pressure (*gaiatsu*; see section 2.1) has been, in some cases, successful in motivating domestic reform. Trade partners’ lobbying for reduction of trade barriers in agriculture in the negotiation of the Trans-Pacific Partnership (TPP) has given rise to hopes for domestic agricultural reform. Regional accords may similarly become catalysts for reform in the Japanese financial sector. One such example is Japan’s signing on to the Asia Regional Funds Passport (ARFP). The need to adapt domestic practices for regional cooperation might yet motivate further domestic reform, and produce greater efficiencies in the sector. The benefits that the investment trust market has reaped from market-opening reforms so far make it a promising platform for market-leading reform in the financial sector.

There are likely to be benefits to be achieved from full privatisation and reduction of Japan Post’s power in the financial and insurance sectors (providing a “level playing field” is established for all market participants). There is empirical evidence that reducing the power of oligopolies in sectors of high market concentration (such as the financial sector) and boosting services sector productivity not only boosts GDP but an expansion in the elasticity of GDP to services sector productivity.⁵⁴

5. Policy Recommendations:

In addition to advancing policies enumerated in section 2.5 (next steps), we recommend the following:

- a. Design deregulation incentives in the non-IT services sector not only to boost innovative capital but also to reallocate capital away from non-innovative “dead weight” capital, which dulls productivity. Strengthening corporate governance is vital to such incentives, given high likelihood that improvements to corporate governance will lead to improved asset allocation.
- b. Collect and publish further empirical data on characteristics of “good corporate governance” at firm and industry level; development of trackable metrics would prove an important complement to existing empirical analysis on asset allocation and productivity.
- c. That the GPIF adopt a more formal Statement of policy for corporate governance to supplement its existing Investment Principles⁵⁵:
- d. Introduce clearer metrics when in regard to market-opening reforms going forward, with the aim of increasing the ease of doing business in Japan. One option is that proposed by Haidar and Hoshi in 2015.⁵⁶
- e. In order to more thoroughly quantify the impact of reforms on the entire Japanese economy independently of cyclical and idiosyncratic non-policy factors simulation-based modeling techniques such as CGE (Computable General Equilibrium) may be appropriate. Compilation of a CGE model

⁵⁴ (Tyers and Asano 2015)

⁵⁵ see http://www.gpif.go.jp/en/about/pdf/investment_principles.pdf

⁵⁶ (Haidar and Hoshi 2015)

inclusive of both benefits and compliance costs might better account for the instantaneous impact of reforms upon the Japanese economy.

- f. The accuracy of cost-benefit calculations of reforms within the financial sector will be a vital input to CGE calibration. A comprehensive ex-post facto cost-benefit review of FIEL and the New Corporations Law, inclusive of compliance costs, for example might hone the accuracy of the model.
- g. A Dynamic General Equilibrium framework could be developed when in regard to policy sequencing accounting also for the sensitivity of Japanese productivity to “news shocks”.
- h. Consider once again consolidating the CEFP’s structural reform policymaking platform under the *Honebuto no Houshin* (Big-boned policy) framework, which was instrumental to PM Koizumi’s policymaking successes.

Appendices

Appendix 1 – Empirical studies on productivity

APEC cites the benefits of market-opening structural adjustments in allowing an economy to “better capitalize on technological growth” (APEC Secretariat, 2006). It is possible to examine, empirically, the ability of Japan to capitalise on technology by examining developments in Japanese Total Factor Productivity.

Hayashi and Prescott demonstrated in their groundbreaking analysis in 2002 the applicability of the Neoclassical Model of Growth in explaining the source of Japan’s “lost decade” of growth. In it, a slump in exogenous total factor productivity (TFP) was the shock that dragged Japan’s potential growth (it’s “balanced growth path”) lower.

Decomposing growth accounting using the same methodology as Hayashi and Prescott, Fink (2015) singles out the services sector (inclusive of financial services) as a candidate for structural reform. Further studies decomposing productivity are reviewed below, focusing specifically on (a) the relationship between regulation and total factor productivity and (b) the ability of disparate sectors to capitalise on technological growth.

The argument finds basis in three stylised facts on total factor productivity, as well as their implications.

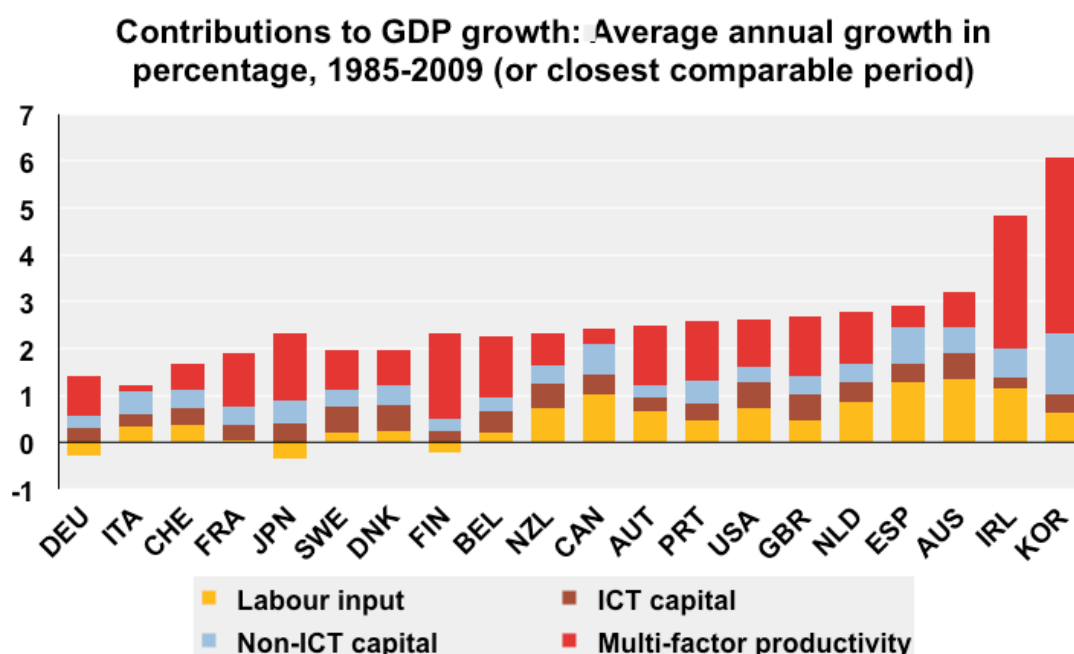


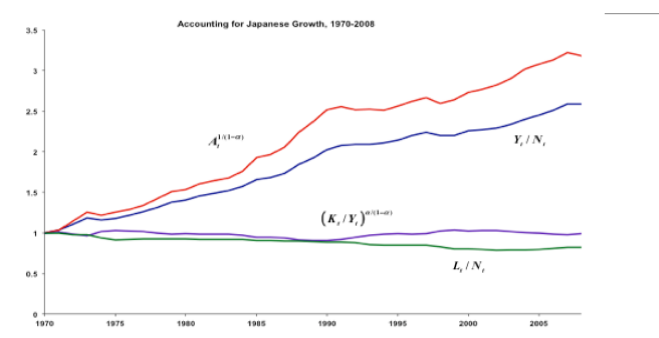
Figure 26: Growth Accounting in the OECD

Source: OECD

Fact 1. Total factor productivity is the #1 contributor to growth: In comparison with other OECD countries, TFP (or multifactor productivity, to use OECD conventions) is a significant

contributor to overall output growth, offsetting the negative contribution of labor input growth between 1985 and 2009:

As might be seen from the below graphic (a growth accounting exercise from (Fink, 2015)), output per capita correlates strongly with total factor productivity (the Solow Residual, or $A^{1/(1-\alpha)}$ in the graphic):



Fact 2. There is a significant divide (heterogeneity) in productivity between sectors

Figure 27: Japanese growth accounting, 1970-2008

Source: (Fink, 2015)

Japan experienced a high rate of TFP growth until 1990, upon which there was a period of significant stagnation. Hayashi and Prescott put forward in 2002 (using the neoclassical model of growth) that Japan's "lost decade" owed mostly to slumping total factor productivity. Although the tech boom of

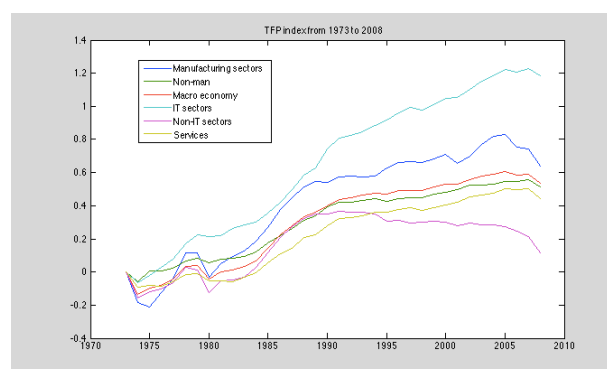


Figure 28: TFP (indexed at 1973=1)

Source: (Fink, 2015)

the late 1990's brought renewed growth, there was a significant split between productivity in the manufacturing and services sector, and in the IT versus non-IT sectors:

It is clear that productivity in the services sector lagged behind manufacturing; even starker is the divide between IT-related businesses and non-IT related businesses (see **Figure 29**).

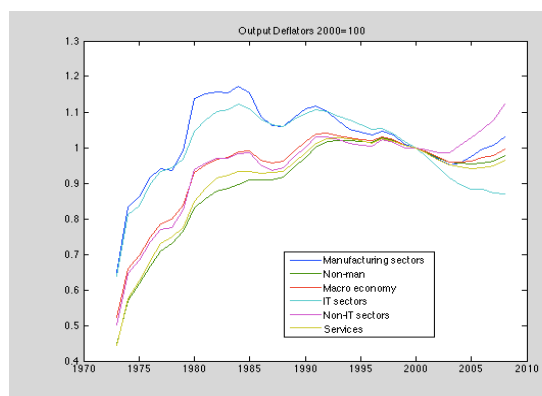


Figure 29: Deflation in the IT sector

Source: (Fink, 2015)

Fact 3. IT sector deflators posted negative growth from 2000 onward

Fink (2015)⁵⁷ examines the sources of the divide in total factor productivity growth, putting forward the hypothesis that relative deflation in the IT sector (see **Figure 5**) represented technological advancements represents a positive contribution to productivity, in the form of Investment-specific technology.

The explanation: Investment-specific technology (IST) growth

Fink (2005) finds a much-improved fit when simulating Japanese growth accounting using the neoclassical model of growth with Investment-Specific Technology, versus base-case (Hayashi-Prescott) model⁵⁸. Simulations use the Conesa Kehoe and Ruhl model (Conesa, Kehoe, & Ruhl, 2007). Fink (2005) estimates that IST explains roughly one-third of total factor productivity growth since the 1970's.

Implication: Productivity is heterogeneous, and IST a differentiator

The implication of the large role of IST in overall TFP growth is that sectors closer to the technology frontier – manufacturing and IT - are likeliest to benefit from the gains in IST – and services, particularly non-IT services are likeliest to suffer. The opposing forces of cost-saving technological gains in IT sector output combined with a slump in economic activity accompanying Japan's financial crisis gave rise to a two-speed economy in Japan that persists to this day.⁵⁹

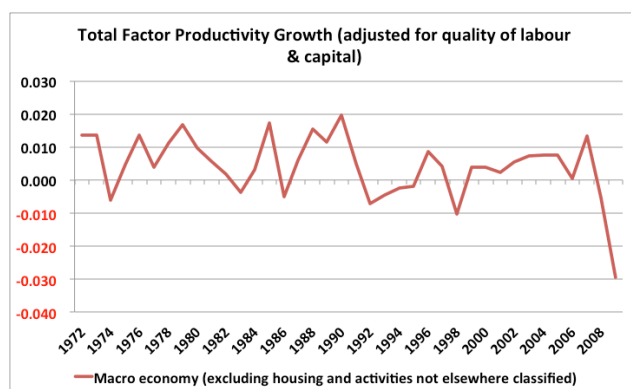


Figure 30: Japanese TFP growth, Adjusted

Source: JIP Database, Europacifica

Focusing on the contribution of Information Communications Technology (ICT) to Japanese output growth, Fukao, Miyagawa, Pyo and Rhee⁶⁰ find a suitable comparison in fellow “input-led growth” economy, South Korea. Both Japan and Korea were characterized by high productivity growth in IT sectors and low growth in non-IT sectors from the late 1990's onward; both economies are also characterized by significantly lower productivity in

their services sectors than their manufacturing sectors, even though Korean productivity rebounded shortly after the Asian crisis.

⁵⁷ (Fink, Heterogeneity in Japanese TFP, Part 1: Why Overcoming Deflation Alone is Not Enough 2015)

⁵⁸ (Hayashi and Prescott 2002)

⁵⁹ (Fink, Heterogeneity in Japanese TFP, Part 2: Regulation, Capital Allocation, and TFP in Japan, 2016)

⁶⁰ (Fukao, et al. 2012)

Poor growth in capital services, particularly non-IT capital services

In their analysis of Japanese growth accounting inclusive of capital services compared to that of other developed countries, Fukao et al find the most egregious difference in the *contribution of non-IT capital services to overall growth*. When decomposed at the industry level, the researchers find that (non-IT) services industries are the largest offenders.⁶¹

One important hypothesis arising analysis by Fukao, Miyagawa et al. was that the low comparative productivity witnessed in services sectors is most likely attributable to “excessive regulation and a lack of competition in service sectors” which in turn “seem to have impeded introduction of ICT in service industries”.⁶²

Hypothesis: excessive regulation + poor asset allocation = poor TFP growth

This hypothesis motivated industry-level fixed effects panel analyses by Fink in 2016, which found that both deregulation and greater allocation to innovative capital were consistent with TFP growth in the services sector (both IT and non-IT services sectors).⁶³ The period of analysis of regulation and productivity (1978 to 1998) were inclusive both of the globalisation and accompanying deregulation of manufacturing as well as of “Big Bang” reforms.

Deregulation may work for highly regulated services, up to a point

Nonetheless, Fink is unable to generalise the result to the entire economy; the regulation coefficient inverts for highly deregulated manufacturing; a marginal decrease in regulation is consistent with a drop, not a rise in manufacturing productivity. Fink’s findings suggest that deregulation may be consistent with a rise in TFP up to a certain point, beyond which deregulation may not help.

In a subsequent panel regression, Fink finds that a firm’s investment in innovative capital (a subset of intangible capital) tends to be consistent with rising productivity across most sectors.⁶⁴

Productivity during the Koizumi administration

Taking a look at cycle-adjusted total factor productivity (adjusted for quality of labor and capital), Total Factor productivity growth was positive over most of the Koizumi administration (2001-2006), surging in 2007 before falling prey to a steep decline amid the global financial crisis from 2008 onward:

⁶¹ (Fukao, Miyagawa, et al. 2012) p. 19. Miyagawa et al single out Distribution Services, finance and business services and personal and social services as under-performing industries in terms of capital services input growth.

⁶² Ibid, p. 1

⁶³ (Fink, 2016)

⁶⁴ Ibid, p. 18

Financial sector productivity

Separately, it may be observed that total factor productivity growth in the financial sector accelerated in the early years of the Koizumi administration, but the improvement was temporary. The sector subsequently succumbed to a decline in 2004, as Japanese banks deleveraged. Nevertheless, financial sector productivity troughed in the midst of the Global Financial Crisis, even as productivity in both manufacturing and other services sectors underwent a steep slump:



Figure 31: TFP growth - Overall, Financial Services

Source: JIP Database, Europacificica

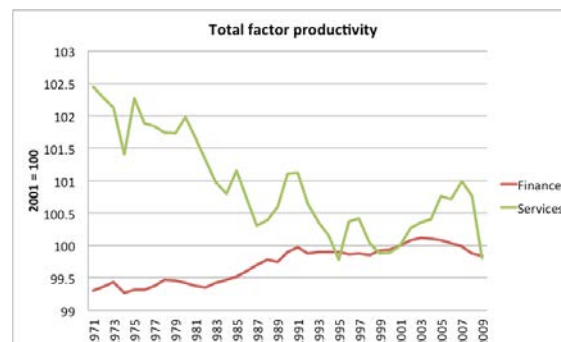


Figure 32: TFP (indexed) in Services vs Finance

Source: JIP Database, Europacificica

Did deregulation help recovery in Japanese financial sector productivity?

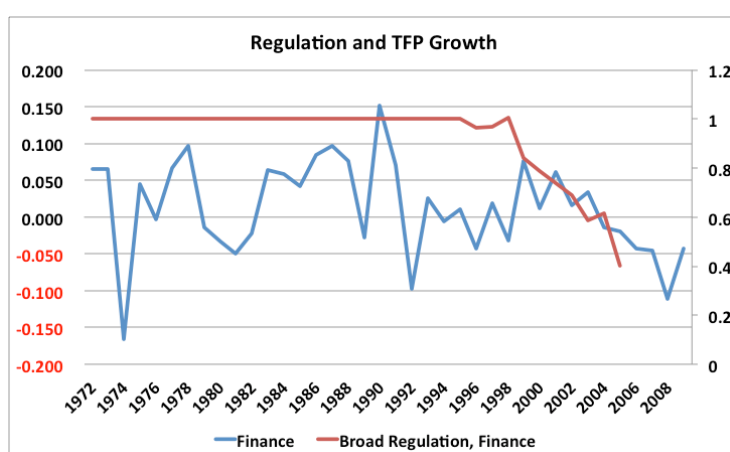


Figure 33: Regulation and TFP growth in Financial Services

Source: JIP Database, Cabinet Office, Europacificica

It is possible that deregulation, starting with the “Big Bang” and extending into the Koizumi era were responsible in part for the rise in cyclically adjusted productivity in the financial sector from the late 1990’s into the early 2000’s, as may be seen in **Figure 33**.

High intangible investment: positive for financial services productivity:

As Fukao, Miyagawa and Hisa note, the financial industry was one of those industries in which the ratio of intangible investment to gross value added (GVA) is highest, and in which the ratio of innovative property to GVA (consistent with TFP growth (Fink, 2016) was also highest (Figure 34). Consistent with the idea that deregulation may be consistent with better capital allocation; the financial industry raised its investment in intangibles in the wake of the Big Bang (Table 1).

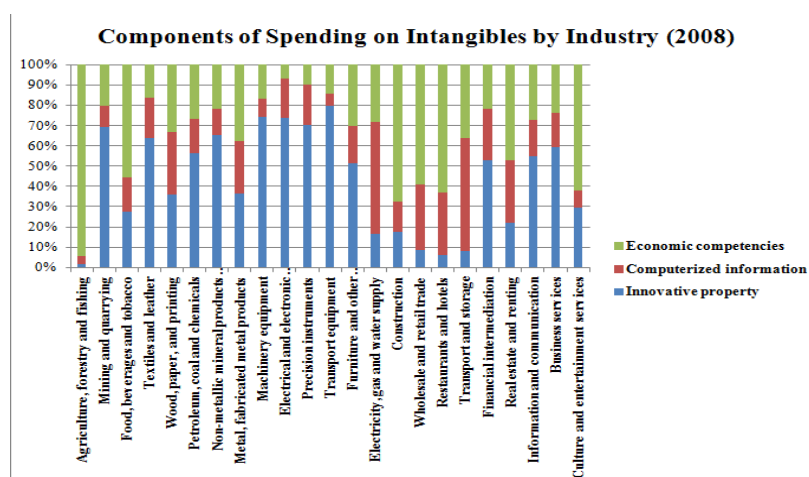


Figure 34: Components of Spending on Intangibles by Industry (2008)

Source: (Fukao, Hisa, & Miyagawa, 2012)

Industry name	1980	1985	1990	1995	2000	2005	2008
Agriculture, forestry and fishing	2.11%	1.95%	2.12%	2.68%	3.12%	2.56%	4.53%
Mining and quarrying	36.29%	41.13%	37.28%	51.85%	50.37%	24.44%	11.50%
Food, beverages and tobacco	3.96%	5.65%	7.49%	7.80%	8.16%	8.54%	7.79%
Textiles and leather	4.60%	5.43%	6.93%	8.80%	10.41%	11.83%	16.85%
Wood, paper, and printing	3.73%	5.19%	5.84%	6.84%	7.99%	8.18%	9.86%
Petroleum, coal and chemicals	13.13%	15.63%	18.77%	20.16%	23.00%	20.74%	22.51%
Non-metallic mineral products except petroleum and coal	4.55%	6.88%	7.64%	8.86%	9.31%	6.44%	8.35%
Metal, fabricated metal products	6.67%	5.61%	6.15%	7.12%	7.73%	7.58%	6.78%
Machinery equipment	6.73%	7.64%	8.87%	11.66%	14.03%	13.32%	12.93%
Electrical and electronic equipment	18.47%	21.45%	23.44%	24.37%	29.58%	34.75%	42.71%
Precision instruments	12.55%	18.77%	22.96%	32.69%	39.26%	48.16%	36.84%
Transport equipment	10.68%	12.80%	17.13%	17.64%	20.94%	20.97%	20.83%
Furniture and other manufacturing industries	8.90%	12.96%	13.02%	16.54%	29.06%	15.45%	18.71%
Electricity, gas and water supply	1.93%	2.77%	4.25%	4.47%	5.85%	6.51%	8.93%
Construction	2.41%	3.36%	3.47%	3.90%	4.32%	3.69%	3.34%
Wholesale and retail trade	3.90%	5.47%	6.16%	5.66%	6.63%	5.64%	5.38%
Restaurants and hotels	2.51%	3.81%	4.77%	4.22%	5.01%	5.55%	4.93%
Transport and storage	2.32%	2.13%	2.63%	2.90%	3.26%	4.85%	4.69%
Financial intermediation	11.55%	14.79%	12.05%	15.76%	19.00%	20.15%	25.46%
Real estate and renting	0.70%	0.97%	1.09%	1.20%	1.29%	1.24%	1.24%
Information and communication	5.90%	11.23%	18.01%	15.08%	20.69%	21.10%	21.95%
Business services	4.72%	6.33%	7.94%	7.53%	9.86%	9.37%	10.87%
Culture and entertainment services	4.31%	6.78%	4.73%	5.90%	6.39%	5.88%	5.25%

Table 1: Expenditure on Intangibles/GVA Ratio by Industry

Source: (Fukao, Hisa, & Miyagawa, 2012)

Caveat: financial intermediation shocks a bottleneck for other sectors

However, it may also be demonstrated that shocks to balance sheets of financial sector firms were also responsible for “lost decade” dynamics (Muto, Sudo, & Yoneyama, 2016), dulling the intermediation function of financial intermediaries and prompting inefficient allocation of firm balance sheets.

In light of these results the resolution of the Japanese financial crisis under Koizumi is at least likely to have contributed positively to productivity; we lastly demonstrate that the dip in productivity and output following the 2008 Lehman shock follows the “news shock” pattern (Beaudry & Portier, 2006), where expectations are encapsulated in stock prices (“news shocks”) rather than policy shocks, which in turn may influence business cycles short-term.

“News shocks” of GFC greater than Koizumi impact on TFP

We run an orthogonalised VAR (4) on quarterly Japanese TFP growth (Solow residual, using similar methodology to Fink (2015)), examining two shocks – one to TFP and the other to stock prices. When we observe the 5-quarter lagged negative “news shock” to TFP (upper right corner), we note that the “news shock” for the entire data set is greater than the data set prior to the GFC. Conversely, we note that the lagged impact of the news shock is little changed in the data sets before (1972 – 2001) and after Koizumi (1972-2008), but before the GFC. We achieve the similar results if we set the ‘Koizumi’ period to 2006 (implementation of the reform packages). The results argue that it is more likely the GFC shock rather than policy failure that motivated the subsequent slump in TFP and thus in output.

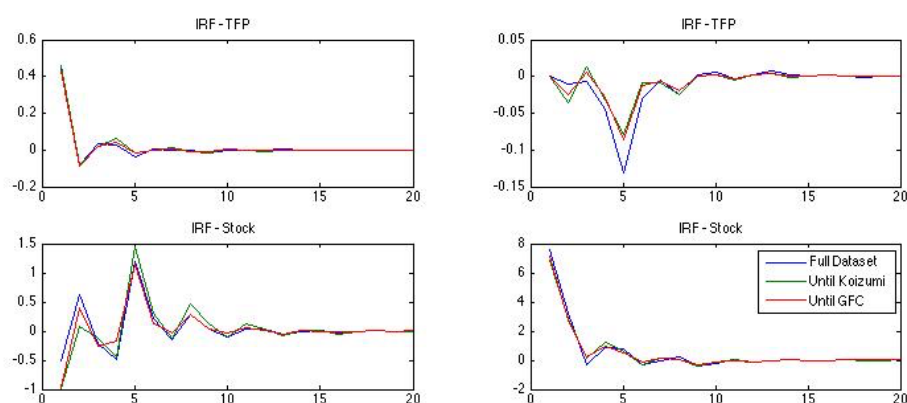


Figure 35: Impulse Response Functions for Japan “News Shocks”

Source: Europacifica

Empirical basis of policy recommendation (see Section 3): Koizumi’s policy of *tokku* or “special zones” (experimental zones where policy was relaxed) while hailed by APEC in 2006 as an “innovative solution” appeared to fade into obscurity until revived under Abenomics. The policy was not viewed as a success in retrospect. Apart from the obvious difficulties involved with preventing regulatory arbitrage in the absence of capital controls, government-led “innovation zones” may not have addressed the right problems.

Failure of this policy might have had more to do with a poor understanding of the relationship between regulation and productivity, which varies between sectors. Results obtained by Miyagawa and Hisa (2013) and again by Fink (2016) demonstrate that policies designed to promote growth via intangible investment in services sector in the early 2000's may have been misplaced. Increasing intangible capital alone has proven no indicator of rising TFP in the services sector. Per results obtained by Fink (2016), incentives designed both at once to decrease "dead weight capital" as well as to increase investment in innovative capital (a subset of intangible investment) might prove more appropriate; meanwhile, as Fink (2016) demonstrated, deregulation can only go so far.

Meanwhile, corporate governance is one major determinant of capital allocation in a market-determined economy (see Appendix 2). Further empirical analysis on characteristics of "good corporate governance" could complement existing analysis on productivity. Development of trackable metrics at firm and industry level would be desirable.

Appendix 2 – Outline of contemporary issues surrounding corporate governance

What constitutes good corporate governance? This is one of the most currently pressing topics in the APEC region, as well as for investors in global financial markets. In a general economic sense, good governance should aspire to efficient allocation of limited resources as to maximise the profits of the firm, which if generalised, should lead to higher productivity growth for the economy.

For many regional stakeholders however, an important related question is whether good governance necessarily follows the model of shareholder primacy, characteristic of American-led financial globalisation?

If the answer is yes, this puts the traditional Japanese model of administrative guidance (*gyōsei shido*) at odds with global best practices. Yet expecting political, bureaucratic or private sector leaders in Japan, all those with vested interests in their model of “bargained-for, negotiated policymaking and implementation by reciprocal consent”⁶⁵ to summarily abandon it is irredeemably naïve and thus doomed to failure. To differing extents, this may many states in the East Asian region, in which there is a higher level of involvement by the public sector than in Anglo-Saxon liberal market economies, face the same quandary.

It is useful, for the purpose of developing Japanese corporate governance best practice, to assume that “good corporate governance” may still exist without strict shareholder primacy. The example of Koizumi however has shown us that despite widespread resistance within the governing LDP toward deregulation, privatisation and free-market principles, a place may be made for them within the Japanese model, even though finding it will inevitably involve compromise.

To generalise, vested interests are powerful, yet ongoing economic stagnation will repeatedly invite questioning of the *status quo*, particularly given increasing globalisation of the political economy. Likewise, we would expect variants of the process of finding a “middle ground” to be present in many East Asian economies. Japan, as the second-largest economy in the region and home of the largest stock market by capitalisation, might have a considerable say in the debate over corporate governance, if only its large institutional investors (such as public pension funds) would engage in the debate.

APEC economies may benefit from lessons learned by Japan (both positive and negative) in the search for alternatives to US-style shareholder capitalism, in the attempt to balance unique inherent structural factors with need for greater market-driven financial sector efficiencies. Some of the pivotal topics in the debate are framed, as follows:

Why the focus on corporate governance?

According to Nicholas Benes of the Board of Directors Training Institute,

⁶⁵ Haley as quoted in (Hook 2005), p.5

The main reason why the Japanese economy is sluggish is because Japanese companies do not withdraw from unprofitable operations and/or engage in sufficient industry consolidation, and as a result corporate assets are not reallocated to their best uses.⁶⁶

As described above, total factor productivity growth is the main driver of growth in Japan. APEC cites findings by Nicoletti and Scarpetta (2003) that “reforms to private sector governance and competition policy have a positive impact on total factor productivity... a key determinant of economic growth.” In the context of empirical analysis presented in Appendix 1, the combination of deregulation and better capital allocation conducive to greater productivity in the services sector might best be served by improving the capital-allocating function of firms themselves. This may be done by improving corporate governance.

Why do investors expect Anglo-Saxon governance norms (of shareholder primacy)?

As demonstrated in Appendix 4 (below), US households (either singularly or due to pension savings programmes) tend to have a greater bias toward equities than their OECD counterparts in Asia. Although the US is a net external debtor, the institutional savings pool in the US is massive. According to OECD figures, US pension savings constituted almost 60% of pension savings in the OECD. Pension funds in the US tend to be particularly activist, having their say in corporate governance reforms.

One example of a large institutional activist investor is Calpers (the California Public Employees Retirement System). Calpers sees proxy voting as “the primary way [Calpers] can influence a company’s operations and corporate governance.” Calpers publicly post their “Statement of Investment Policy for Global Governance” which clearly state expectations on “shareowner rights, board quality and diversity, executive compensation, corporate responsibility, and market conduct”. Calpers also clearly states that, “[i]n instances where companies fail to meet the standards of conduct defined by our Global Principles, CalPERS may file shareowner proposals to achieve governance reforms.⁶⁷

Separately, over 40% of world market capitalisation (of listed companies) resides in the US, another reason why expectation setting for shareholders is dominated by the US model.

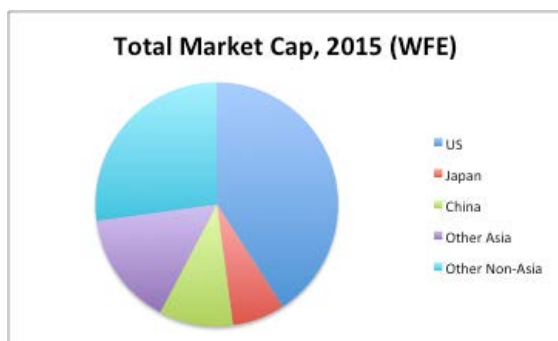


Figure 36: Composition of world market capitalisation

Source: World Federation of Exchanges

Within Asia, many regional economies have made strides in improving corporate governance, to the satisfaction of global institutional investors. Regional economies in which corporate governance is considered to be strong include Singapore and Hong Kong. Others such as Malaysia, Thailand and India have shown improvements in recent years.⁶⁸ Many of these economies experienced inflows into their stock markets following the withdrawal of Japanese bank loans at the time of the Japanese banking crisis.

⁶⁶ see: <https://bdti.or.jp/en/blog/en/proposals-for-raising-productivity-in-japan-by-nicholas-benes/>

⁶⁷ see <https://www.calpers.ca.gov/page/investments/governance/proxy-voting>

⁶⁸ ACGA; see http://www.acga-asia.org/public/files/CG_Watch_2014_Key_Charts_Extract.pdf

Who could be catalysts for change in this model?

Japan's pension market accounts for roughly 6% of the total OECD pension pool (a large part of which resides in Japan's mammoth Government Pension Investment Fund), the second largest within the OECD. Presently, the GPIF outsources its proxy voting to fund managers (under periodic supervision), though there have been discussions of bringing the corporate governance function in-house. Greater activism from the GPIF could be one marginal catalyst for a "middle way" between more shareholder-centric US-style governance and the traditional stakeholder model. Liberalisation of the Chinese capital account would be another large catalyst for change in this mix. The ongoing review of Chinese equities' inclusion in the MSCI indices highlights the importance of global market standards in the internationalisation of the Chinese bourse.

Are hostile takeovers necessary for "good corporate governance"?

One of the central debates dividing Japanese and Anglo-Saxon modes of governance concerns the role of hostile takeovers. As shown in Sections 2.2 and 2.3, hostile takeovers tend to carry a stigma in consensus-loving Japan, while in the liberal market economy model favoured by the US, they represent discipline that investors efficiently mete out to corporate managers as to optimise the management of scarce resources. Research in the legal field is divided on the matter. Dore (2007) proposes an alternative framework in Japan that would facilitate takeovers in a more consensus-driven fashion. Meanwhile, Puchniak (2009) suggests that viewing hostile takeovers as symptomatic of efficient corporate governance is a "dubious assumption". Milhaupt (2011) provides a comparative summary of hostile takeover practices around the world, and suggests that emerging market governance could learn from the Japanese approach to its own "hybrid" takeover policy, which remains a work in progress.

Do cross shareholdings preclude hostile takeovers?

As footnoted in section 2.5, the hostile takeover debate is related, but not interchangeable with the argument of reduction in cross-shareholdings. Although the latter presents systemic risks, as seen during Japan's financial crisis and their decline may create greater opportunities for hostile takeovers, there is evidence against the argument that absence of hostile takeovers owes primarily to cross-shareholdings. (Kim and Sung 2009)

How important are outside directors?

Although the presence of independent directors cannot prevent corporate misdeeds, their participation may be crucial in challenging management decisions that could be damaging to company prospects. As such, the inclusion of stricter compliance pressures under Japan's Stewardship Code to appoint one or more independent directors is a step forward, noting that in 2012, the industry federation (Keidanren) successfully lobbied against its inclusion in updates to Company Law.⁶⁹

⁶⁹ See <https://bdti.or.jp/en/blog/en/jefferies-naomi-fink-unrevolutionary-governance/> for a review of some aspects of 2012 policy see.

Proposed metrics for improvement of overall governance

As noted in section 3, Haidar and Hoshi propose the use of the World Bank's Doing Business rankings to measure and propose improvements to governance in Japan.⁷⁰ Overall, Japan ranks 24 out of 34 OECD countries and 34 globally (out of 189). One of the ranking metrics is "protection of minority investors" in which Japan ranked #36 out of 198 worldwide, down from #33 in 2015. There is clearly room for improvement; that Japan however ranks much lower in "starting a business" (#81), "getting credit" (#79) and Trading Across Borders (#52) suggests that there may be more pressing industry-improving reforms than legislation of hostile takeovers. There remains room however for development of additional metrics dealing with best corporate governance practices in Japan.

Stewardship code: one step forward, but further ground to be covered

In light of Japan's deep-seated reticence toward hostile takeovers, historically passive institutional investors and recent resistance to appointment of external directors, the Stewardship Code recently put forward by the Abe administration is a big step forward. Nicholas Benes of the Board of Directors Training Institute (BDTI) suggests that raising awareness about corporate governance is an important precursor to governance-boosting legislation. One metric useful in tracking the priority of corporate governance is the

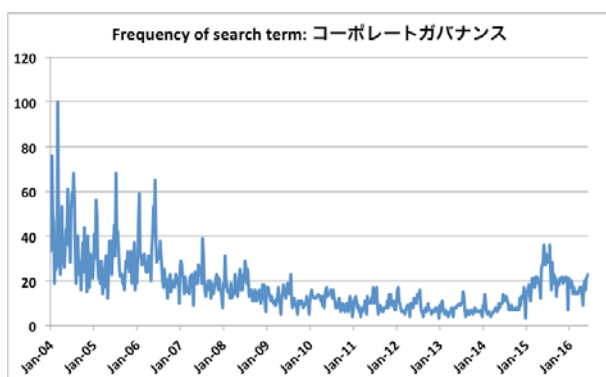


Figure 37: Indicator of Corporate Governance awareness, Japan

Source: Google, BDTI

search frequency of the term "corporate governance" in Japanese. Benes points out that interest dropped after Koizumi left office but revived with the advent of the Stewardship code (see Figure 37: Indicator of Corporate Governance awareness, Japan).

PM Abe has but laid the foundations for further work on a more cohesive set of guiding principles for Japanese corporate governance.

The role of "*gaiatsu*" in promoting domestic reform, redux

Although it may be unrealistic to assume that Japan will conform unconditionally to a US-style

model of shareholder primacy, there is a role for foreign trade partners in pushing for improved governance (even if ultimately "improved" does not imply "American"). The American Chamber of Commerce in Japan highlights the absence of corporate governance or proxy voting principles at Japan's largest pension fund and urges GPIF to "set a good example of modern pension fund management and stewardship for other pension funds in Japan", to officially recognise the Stewardship code (to which GPIF is signatory) as well as the importance of corporate governance in its investment principles (which it has yet to do).⁷¹

⁷⁰ (Haidar & Hoshi, 2015)

⁷¹ (The American Chamber of Commerce in Japan 2016)

GPIF: recommending a greater voice in Japanese governance

To capitalise on the stewardship code, we recommend that the GPIF assume more active leadership in shaping a Japanese approach to corporate governance. This may be done not only via proxy voting but also by clearly stating its principles regarding key issues in governance (similarly to Calpers), also participating in regional fora on the topic. As a first step, we recommend that GPIF adopt a more formal Statement of policy for corporate governance to supplement its existing Investment Principles⁷².

⁷² see http://www.gpif.go.jp/en/about/pdf/investment_principles.pdf

Appendix 3 – Significant updates to FIEL and the New Corporations Act

FIEL

- In March 2008 (one year after promulgation) the FSA submitted a bill to revise FIEL. Amendments included:
 - Diversification of ETFs,
 - Creation of markets oriented toward professional investors
 - Revision of firewall regulations among securities firms, banks and insurance companies, with a broadening of scope for banks and insurance groups.
 - Broadening of scope of listed investment trusts (ETF's) to invest directly in commodities.
- In 2011 (effective 2012), registration requirements were relaxed for investment management businesses dealing exclusively with professional clients.
- In 2013, the Diet approved the revised Financial Instruments Exchange Act and Act on Investment Trust and Investment Corporations, reviewing disclosure regulations for investment trusts (tightening) and introducing new products covered in the REITs market, including J-REITS in existing insider trading regulation and removing barriers to investments in overseas real estate (loosening).⁷³
- Japan is moving toward IFRS (International Financial Reporting Standards) as specified by IASB (International Accounting Standards Board). In 2010, internationally active companies have been able to voluntarily adopt IFRS. Given few companies voluntarily adopted the standard, requirements were relaxed in 2013.
- In 2013, there were major reforms to insider trading regulations, driven by abuse of privileged information around secondary offerings (capital increases). Regulations around communicating sensitive information and recommending transactions were introduced, and monetary penalties for violation were stiffened.

Corporations Law

- MOJ Legislative Council started work on revision of the Corporate Law in 2010.
- A bill to amend the act was put to the Diet in 2013 and approved in June 2014. Key issues addressed in the amendment were relevant to corporate governance, including:
 - New regulations on procedures and disclosure designed to deter abusive cash-out (squeeze-out) of minority shareholders
 - Injunction against fundamental changes to the corporate structure (with similar motivation to minority shareholder protection)
 - Regulation over large share placements (again to mitigate conflicts between controlling and minority shareholders)
 - Expansion of scope of liability to be pursued by derivative action (to increase minority shareholder rights).
 - Addition of a third option for the governance of large, public companies – to set up an “audit and supervisory committee” dominated by outside directors and no statutory auditor, under which⁷⁴
- One notable recommendation by the Legislative Council – the mandatory appointment of at least one outside director - was blocked by Japan Business Federation (*Keidanren*) in 2012.

⁷³ see (Japan Investment Trusts Association, 2015)

⁷⁴ Previously, the two available options were either a two-board system with the board of directors plus a board of statutory auditors or (alternatively), a three-committee board of directors (dominated by outside directors) in charge of nomination, audit and remuneration.

Appendix 4 – checkered results for “from savings to investment” policies

Koizumi’s “from savings to investment” policy pillar enjoyed some certain success: between 2005 and 2010, the ratio of Japanese savings to investment did, in fact decline, and that ratio remains the lowest among many of its East Asian neighbours.

Still, whatever the instigators, Japanese households remain staunchly conservative in their allocation of

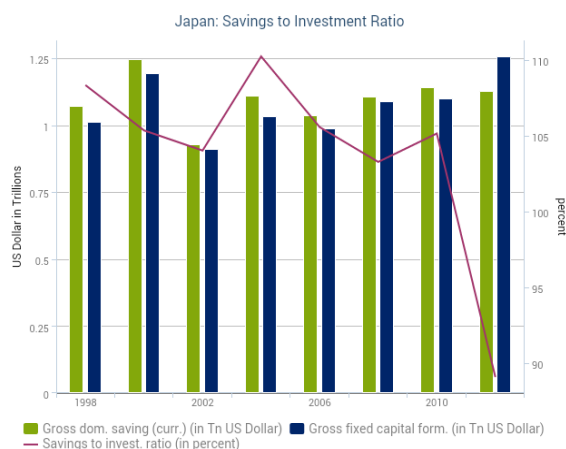


Figure 38: Decline in Japanese savings/investment ratio

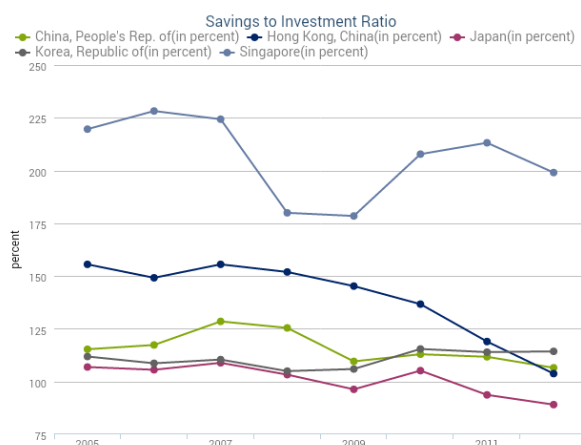


Figure 39: Comparative savings/investment ratios in Asia

Source: ADBi

financial assets by developed country standards. In comparison to American households, who invest 45.2% of their funds in securities and only 51.9% in cash deposits, Japanese households still invested 81.4% of their funds in cash deposits, insurance funds and pension funds as of 2013, with only 14.5% of their funds in securities (including *toushin*).⁷⁵

As **Figure 40: Japanese vs US Household Balance sheets** shows, the Japanese household held half of its balance sheet (including insurance funds, pensions and other financial assets) in cash as of 2014; American households, in contrast hold only 13% in cash. Investment in equities is a far greater proportion of US household balance sheets (nearly one-third) as opposed to only 8% of Japanese household balance sheets. Remarking the relevance of equity share as indicative of risk preferences, we calibrate OECD risk preferences (**Figure 43: Risk preferences in the OECD**) and find that Japanese investors are one of the most risk-averse in the OECD. This is a poor testimony to the success of “from savings to investment”. Part of this has been due to risk-aversion and valuation surrounding the global financial crisis. As **Figure 41: Japanese household balance sheet** shows, there was a drop in household shareholdings between 2005 and 2010. However, that there was no rebound between 2010 and 2012 (the first year of “Abenomics”, a good year for equities) is symptomatic of high risk-aversion.

⁷⁵ (Japan Securities Research Institute 2014)

Unless there is risk reallocation, demographics do not favour growth in Japanese household stock investments; the Tokyo stock exchange reports that the number of individual shareholders has been stagnant since around 2009 (**Figure 42: Number of Individual Shareholders, Japan**) the year the Japanese population started to shrink.

Conversely, the market for investment trusts (*toushin*) has expanded, and may soon occupy a similar place on the Japanese household balance sheet as in the US. Responsible in part for the rise may have been increasing deregulation around this market, with ongoing enhancements to FIEL (see Appendix 3).

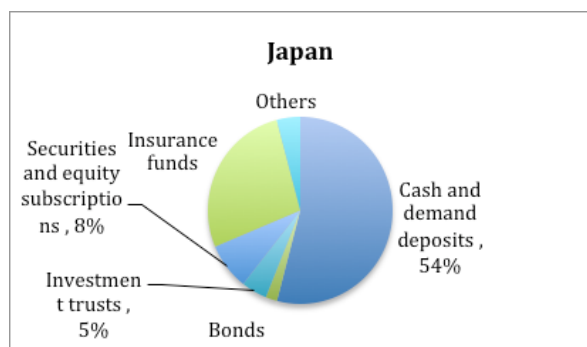
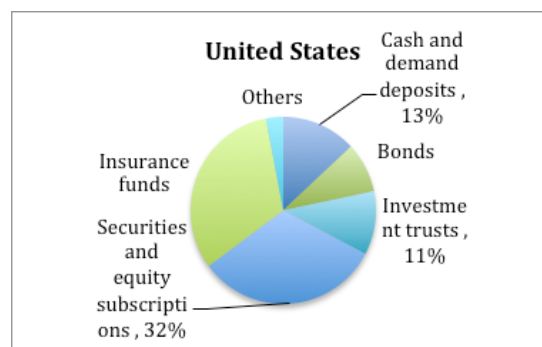


Figure 40: Japanese vs US Household Balance sheets



Source: JSRI

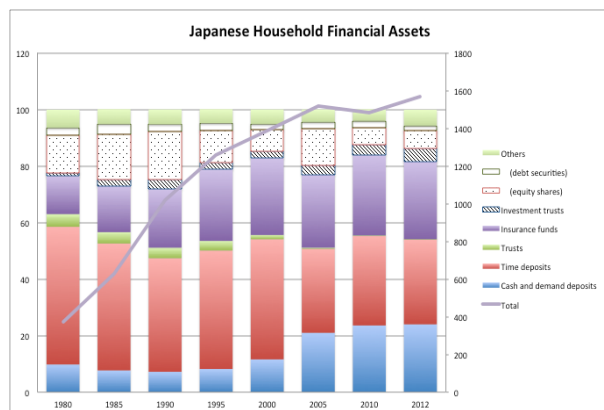


Figure 41: Japanese household balance sheet

Source: Bank of Japan's, JSRI

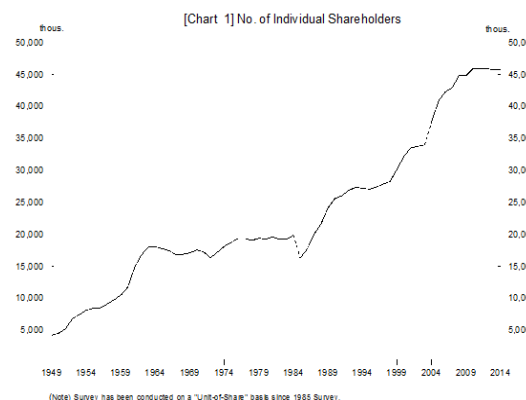


Figure 42: Number of Individual Shareholders, Japan

Source: JPX

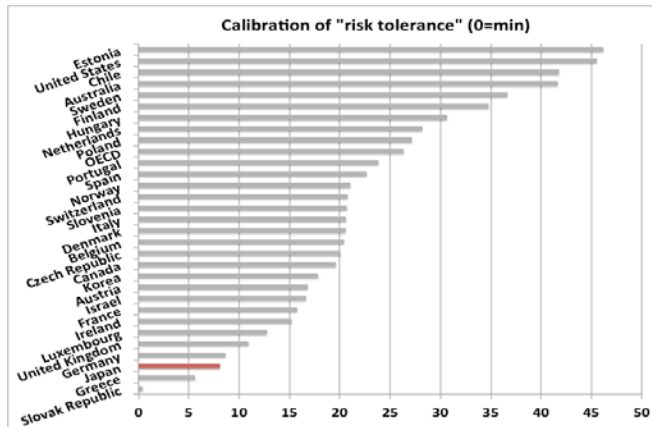


Figure 43: Risk preferences in the OECD

Source: Europacifica Consulting

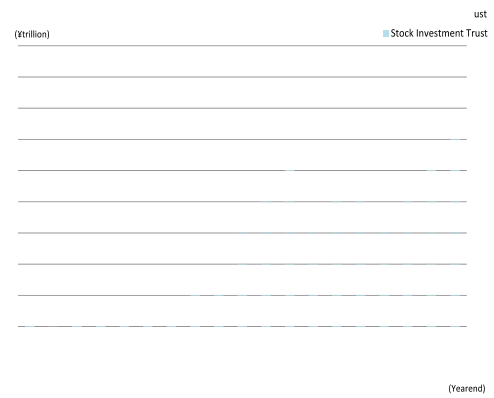


Figure 44: Growth in the Tousein market

Source: Japan Investment Trust Association

Appendix 5: Japanese financial sector reform and regulation in historical context

Immobilist tendencies postwar: Despite the political and economic upheaval of the 20th century, Japan has demonstrated strong resistance to institutional change. Some experts argue that revolutionary institutional change in Japan last took place in the late 1800's, with the Meiji Restoration. James Malcolm's *Financial Globalisation and the Opening of the Japanese Economy* (2001) provides a comprehensive review of the history of Japanese financial regulation, up to the time of Japan's "Big Bang" reforms of the 1990's. As Malcolm points out, occupational reforms to Japan's financial sector following the Second World War were superficially new but strongly shaped by pre-war institutional and regulatory structures. Key characteristics of the system included a bias toward indirect financing, low levels of explicit legal codification and indirect state involvement in private sector activities.⁷⁶ Malcolm argues that Japan's adoption of the US banking system post-war was essentially cosmetic; its main legacy was Article 65 of Japan's Securities and Exchange Law (based on the US Glass-Steagall Act, separating the activities of banks and securities businesses).

The overt public sector direction of private sector assets during wartime merely went underground postwar, with the government retaining significant influence over the allocation of private capital. Government involvement in the banking system took both direct and indirect forms. Government patronage of the four main banks at the centre of financial-industrial conglomerates (or *zaibatsu*) is an example of the latter. Direct assistance from the Bank of Japan to troubled firms (via *madoguchi shidō* or window guidance) exemplified the former.

Conversely, no support was offered to stock markets, which as a result remained volatile and underdeveloped for many years. As a result, individual investors preferred either postal deposits (with an explicit government guarantee) or bank deposits (with an implicit government guarantee). The bias toward cash deposits on household balance sheets exists to this day; cash accounts for nearly half of Japan's 1.2 quadrillion yen in household assets, while investments in stocks accounted for less than 10% as of 2013 year-end, a low percentage in comparison with the OECD average.

This is not to say that the system was devoid of competition, specialisation or development of economies of scale. Instead however, a heavily structured and segmented financial system took shape in the early 20th century. Divisions of financial activities were based on functions of client institutions rather than size or financial product. This segmentation of the financial sector, on one hand, contributed to its stability for many years; on the other hand, these structural characteristics were – and remain – extremely resistant to change.

On the other hand, rigid segmentation by client function created market distortions. While suppressing competition between segments of the financial sector, segmentation gave rise to fierce intra-segment competition. As a result, many firms resorted to non-price means of competition, which led to market distortions.

Gyōsei shido (administrative guidance) as principal regulatory tool: The primary financial rule-maker and enforcer in postwar Japan was the Ministry of Finance (MOF), whose main tool was extrajudicial "administrative guidance" or *gyōsei shido*. Banking laws of the early 20th century had been kept purposefully vague to confer maximum benefits to government-directed financial support to industrial-financial conglomerates (*zaibatsu*); postwar reforms failed to strengthen the rule of law and in this respect, ensured that the Ministry of Finance remained the sole interpreter of Japan's legal code. Via *shingikai* (or administrative committees), the Ministry of Finance exercised hawk-eyed supervision over

⁷⁶ (Malcolm 2001)

financial institutions and the development of new financial products in order to preserve the existing division of labor and allocation of assets.

The prevalent institutional structure was an “escorted convoy method” (*gosōsendan hōshiki*)⁷⁷, over which the MOF reigned virtually uncontested, using branch and licensing restrictions to slow the pace of leading firms and the threat of forced mergers to hurry the development of lagging firms.⁷⁸ Its main regulatory vehicles were *shingikai* or oversight committees, who engaged in *ex ante* monitoring. Although this structure ensured a significant degree of diversification of financial intermediaries, it also contributed to the rigidity of the system, with little incentive to innovate, with conservative guidance hemming in the distribution of new financial products (and thus discouraging their development). The original rule of thumb was “no rule means prohibition”.⁷⁹

Although the convoy method worked well when Japan was developing and mobilising resources, by the time the economy reached maturity in the 1970’s, the drawbacks of the system had started to outweigh the benefits. A spate of industry consolidation in the 1960’s demonstrated that asset allocation was of greater importance to economic growth than asset mobilisation alone; efficiency of asset allocation began to matter much more than before. No longer a mere tool to prevent monopoly power, the convoy system contributed to the misallocation of financial resources, thanks in part to the practice of *amakudari* (dispatch of MOF retirees to private sector firms). Unwilling to damage post-retirement prospects, active MOF officials of the 1970’s had clear incentives to discourage consolidation, also to cave into political pressures to oppose hostile takeovers of clearly inefficient firms.

Arguably, by this point, the damage to market mechanisms had been done. Generations of negative associations with and political incentives to oppose hostile takeovers left a strong social imprint. Despite subsequent reforms that gradually eroded the unilateral rulemaking power of the MOF, opposition to hostile takeovers of firms had become deeply ingrained, and persists to this day.

1970’s - Globalisation was mostly one-way: Deregulation of Japan’s bond markets in the 1970’s conformed to APEC’s description of externally motivated structural reform. The breakdown of Bretton Woods contributed pressures for yen revaluation and overhaul of Japan’s foreign exchange controls. Meanwhile, the escalating pace of financial globalisation manifested in the rapid expansion of the eurodollar market, which in turn contributed to the weakening of the rigid rate structure prevalent until the late 1970’s.

⁷⁷ Alternatively *gosōsendanteki gyousei* (or convoy-based group administration)

⁷⁸ (Malcolm 2001), p.67-68; Malcolm notes that the MOF enjoyed an unusually broad regulatory mandate within the OECD, exercising powers usually shared between central banks and branches of national or local government. Instead of overt checks and balances, conflicting mandates within the MOF, interministry competition and vested political interests (such as powerful lobbies among regional Post Office employees and agricultural groups) exercised a type of “organic” check to the MOF’s power.

⁷⁹ Ibid; Characteristics of Japanese postwar regulation and the MOF’s role in interpretation of a skeletal legal code are somewhat reminiscent of Chinese financial regulation currently undergoing reform within Shanghai’s Free Trade zone, where liberalisation includes introduction of a “negative list” of prohibited activities in place of blanket prohibition of activities not expressly permitted.

As Malcolm (2001) emphasises, reforms of this period however were reactive and piecemeal.⁸⁰ Moreover, even after some degree of internationalisation, the convoy system was very much intact.

As a result, although Japanese banks were heavy participants in the eurodollar market, flows tended to be one-way and the playing field was far from level. As Japanese industry found a foothold overseas, their main banks accompanied them by opening branch offices, intermediating “foreign” financing in foreign currencies. Conversely however, foreign players were still largely excluded from domestic banking operations in Japan.

Even despite significant consolidation and restructuring in the Japanese banking system since the 1970's, domestic banking operations to this day remain dominated by Japanese banks. Moreover, outward foreign direct investment (undertaken now by Japanese nonfinancial firms and large banks in foreign markets) by far exceeds inward investment. Otherwise stated, “internationalisation” of Japanese markets has remained mostly one-way.

1980's – *Gaiatsu* as an effective driver of domestic policy reform: In the 80's, Japan began to face the two opposing pressures of harmonisation with accelerating financial globalisation and conservation of its traditional financial model, pressures which persist to this day.

Substantial deregulation in the 1980's, driven greatly by developments abroad and foreign pressure (or *gaiatsu*) for reform, changed the financial scenery but failed to shift the underlying institutional structure, to disastrous ends.

Under pressure from the Reagan Administration as trade surpluses burgeoned, Japan's New Banking Law of 1981 claimed to espouse harmonisation to OECD standards in opening the banking system and treatment of foreign firms in Japan. In reality however, banking reform remained very much dictated by the MOF's administrative guidance, under which the rigid structure of Japan's domestic banking system remained little changed.⁸¹

Still, external pressures had a hand in propelling a number of market-opening reforms to implementation; pressures from the Reagan Administration culminated in the Yen-Dollar agreement of 1983.⁸²

Under PM Nakasone (1982-1987), the government consulted private advisory groups of professionals and academics, culminating in the Maekawa report of 1986, in which three of six proposals for industry deregulation related to financial sector reforms. The implementation of the Plaza Accord in 1985 to restrain further appreciation of the dollar cemented this period of externally driven change, as Finance Minister Takeshita voluntarily proposed a 10% appreciation in the yen. In 1989, the US and Japan began the bilateral Structural Impediments Initiative, mostly designed to address economic policies and business practices in Japan perceived by the US as barriers to exports and investment⁸³. At least superficially, it appeared as though *gaiatsu* achieved every success in motivating domestic reform.

As a result, the structure of Japan's manufacturing sector underwent fundamental change, with corporations relocating facilities (as well as revenues) overseas. Banks' overseas

⁸⁰ (Malcolm 2001)

⁸¹ (Shimojo 1982)

⁸² The Reagan administration came forward with a formal list of demands to PM Nakasone for Japanese reform, which culminated in the Yen-Dollar accord of 1983, committing Japan to financial services reform.

⁸³ (Posen and Changyong 2013), p. 25

operations and revenues surged alongside those of their principal customers. As outward FDI surged, the contribution of export revenues to the current account decreased, as investment income increased.

Nevertheless, the combination of incomplete deregulation in Japan (recalling that the MOF still held iron-fisted autonomy over domestic financial infrastructure) combined with the reactive – and hence delayed – nature of Japan’s market-opening measures ultimately led to market failure and crisis.

1990 - Regulatory arbitrage, bubble, bust: However effective foreign pressure may have been in speeding up market-opening measures, it was ineffective in completing market reform. Not only did the rigid domestic market structure remain in place (under the MOF’s strict administrative guidance) but it was incapable of competing with newly liberalised and globalised markets in the US and UK. Meanwhile, market opening measures in the absence of macroprudential regulations or administrative reform created inefficiencies for domestic monetary policy. As the yen strengthened, the Bank of Japan (BOJ) cut rates, attempting to follow the examples of the Federal Reserve and Bank of England in fighting currency strength in the mid-1980’s. It is possible that the BOJ had miscalculated the effects of yen appreciation; current account surpluses in the mid-80 have remained intact (in contrast to persistent US and UK external deficits) even as private capital poured out of Japan (with little concern for investment risks) into “cheaper” foreign markets. The BOJ’s drastic cuts meanwhile gave rise to double-digit growth in the Japanese money supply in the late 1980’s, fuelling a bubble in stock and property markets.

Paradoxically, the veneer of success projected by booming markets relieved both domestic and foreign pressure for ongoing regulatory reform. Housing affordability plunged even as the inflation rate remained firmly below 5%. The central bank, fearing its reaction function well and truly broken, aggressively hiked rates from a low of 2.25% in 1987 to 6% in 1990, piercing the property and stock bubbles. The immediate result was a simultaneous sell-off in Japanese stocks, property and bonds – an enormous destruction of domestic wealth. The mid-term consequence was domestic financial crisis. Long-term, the subsequent surge in depreciation costs and plunge in productivity heralded the start of Japan’s “lost decades” of growth, from which Japan has yet to recover.

Figure 45: Japan's Big Bang

Legislation

- Commenced in November 1996 under principles “free, fair and global” with aims to compete with New York and London
- Foreign Exchange Law adjustment in 1998, totally liberalizing cross-border transactions.
- Revisions to Banking Law, the Securities and Exchange Law, and the Insurance Business Law enforced in Dec 1998 as Financial System Reform Law

Key reforms

- **Asset management:** introduction of new investment trusts, over-the-counter sales of investment trusts by banks and other financial institutions; liberalization of dealings in securities derivatives
- **Inter-sector competition:** switching from the licensing system to a registration system for securities companies, fully liberalizing brokerage commissions, scrapping obligatory use of premium rates set by the non-life insurance ratings agencies
- **Diversifying markets and channels for fund raising:** permitted off-exchange stock trading and electronic trading systems. Tokyo Stock Exchange establishes MOTHERS, a new market for start-up firms
- **Disclosure and transparency:** fair trading rules (stricter insider trading control, protection against bank failure). From March 1999: financial institutions required by law to disclose information on non-performing assets, under standards based on those set by the US SEC

Source: (Japan Financial Services Agency 2000)

1990's – “Big Bang” undermined by crisis; MOF authority lingers: Market failure and banking crisis, exacerbated by insider trading and loss-compensating scandals in the 1990's⁸⁴ revived calls for administrative reform. A plan was formulated by the Hashimoto administration in 1996 that culminated in the “Big Bang” financial reforms.

The “Big Bang” reforms were put forward to the Diet in 1998 as the Financial System Reform Law. The reforms were heralded as the “most extensive revamping of the Japanese Financial System since the end of World War II”.⁸⁵ Alongside the introduction of new products and technologies, reforms promoted de-segmentation of Japan's financial services sector, greater codification and regulatory transparency (see Figure 45: Japan's Big Bang).

The boldness of the plan lay in its call for the end of the “convoy” system of regulatory protection that compelled healthy banks to share the burden of would-be failed institutions.⁸⁶ Prospects for true administrative reform had never been greater.

Nonetheless, the legislation still bore the imprint of the MOF's *shingikai* (deliberative committees). Predictably, substantive portions of administrative reform components – such as the set-up of Japan's own version of the US Securities and Exchange Commission and to break up the MOF - were ultimately diluted. Upon the creation of the Financial Services Agency (FSA) under the jurisdiction of the Cabinet Office in 1998, Planning and Financial Policy remained under the MOF umbrella.

Reforms were not entirely lacking in substance. The revision of the Bank of Japan Law in 1997 did enhance the central bank's independence from the central government and policy-making transparency (Dwyer 2004). One of the biggest achievements of the Big Bang was convergence between the cost of capital in the US and Japan, if temporarily.⁸⁷

Yet when put to the test, traditional methods prevailed. As soon as domestic crisis struck the financial sector⁸⁸, slapping a risk premium on Japanese funding, the MOF was quick to backtrack on reforms, resuscitating the interventionist convoy system to keep widespread bank failures at bay. Externally, as the Asia crisis roiled regional markets in 1997, major regional lenders (the Japanese Banks), saddled with mounting nonperforming loans, were powerless to lend support to regional recovery. The target completion date of 2001 for the “Big Bang reforms” was missed. Meanwhile, comprehensive reform remained elusive as an aging demographic, slumping productivity and deflation gripped Japan.

For Japan, the interruption of Big Bang reforms by domestic banking crisis echoed a recurring theme; once again, intended structural reforms, grand in scale and intention, were wound back in crisis circumstances. Expectations for revolutionary changes in Japanese financial services and reform-driven resurgence in growth were disappointed.

Meanwhile, the failure of banks to rapidly dispose of non-performing assets eroded their ability to serve as effective arbiters of financial liquidity; even as existing bad loans crowded out new lending, banks' eroding balance sheets posed a threat to their own existence and a

⁸⁴ Loss-compensating and accounting scandals at Daiwa, Yamaichi Securities and 18 other securities companies, the crisis among *jūsen* (nonbank mortgage lenders) and the 1997 *sōkaiya* racketeering scandal underscored the need to update Japan's commercial code.

⁸⁵ (Malcolm 2001), p. 107

⁸⁶ (Ito and Melvin 1999)

⁸⁷ Ibid

⁸⁸ The Long-Term Credit Bank (LTCB) and Nippon Credit Bank (NCB) failed in 1998. The bank failure put a swift end to LTCB's asset management joint venture with the Swiss Bank Corporation (later UBS). LTCB was later nationalised.

systemic risk to the Japanese financial system. The shock of Japan's financial crisis may have led firms in the services sector in particular to lag their global counterparts in adopting new technology, thereby depressing services sector productivity. See Appendix 1 for an empirical analysis of Japanese productivity.

Meanwhile, laws remained sufficiently vague as to allow selective interpretation by key administrative stakeholders (particularly the MOF).

Japanese financial reform is cumulative, gradualist and iterative

On the other hand, the sum of financial services reforms over the postwar period to the time of the Big Bang reforms was considerable. Japan had broken down barriers to international financial transactions, liberalised interest rates, updated legal frameworks to accommodate new products, and enhanced the functioning of its capital markets. Market deregulation (culminating in the Big Bang) did assist corporations in relying more on capital market financing and less on bank loans.⁸⁹ And by 2001, the MOF's interventionist power of administrative guidance had been diluted, although not fully checked.

The main lessons from Japan's postwar history of financial reform are that traditional administrative structures have compelled piecemeal and gradualist reform, and as a result reform has been a cumulative, iterative process, tending to lag other major global centres when responding to financial globalisation. These are lessons that must be kept in mind when evaluating the Koizumi reforms.

⁸⁹ (Hoshi and Kashyap, *The Japanese Banking Crisis: Where Did It Come From and How Will It End?* 1999)

Appendix 6: Current structure of the Japanese financial sector

The structure of the financial services sector, though no longer rigidly segmented, retains the traces of postwar “escorted convoy” system, as may be seen in Figure 46: Structure of the Japanese Banking Sector (Source: Zenginkyo).

We provide further graphics (below) on the composition of overall financing among Japanese nonfinancial corporates, noting that bank borrowing comprises less than 30% of corporate financing; the balance comes mostly from capital markets or intercompany credit.

A breakdown of bank financing (loans and discounts) is provided (from Zenginkyo). It is useful to note that services, wholesale and retail sectors together comprise over 20% of overall bank lending. These sectors typically contain many small businesses particularly reliant upon bank financing with limited recourse to capital markets. To provide additional detail, we contrast the lagging lending environment among small services sector firms when in comparison to large firms. This is a factor affecting many employers in the Japanese economy – with reference to the Bank of Japan’s chart on composition of Japanese firms by size.

Finally, we include the asset management industry, which alongside foreign investors, form the market for capital market securities issued by Japanese corporations. We observe that households and pension funds (and among them, the GPIF) are the largest beneficiaries of the industry’s assets.

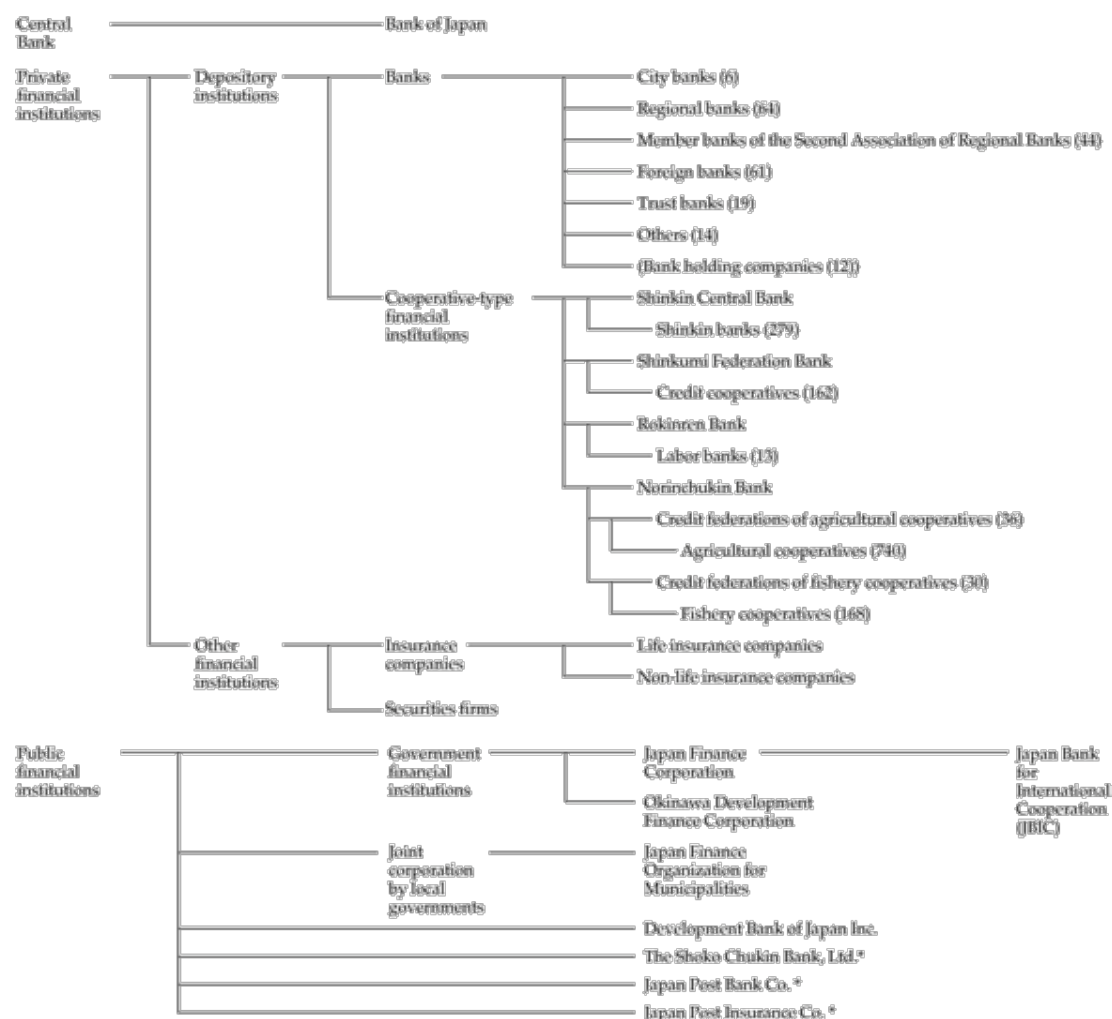


Figure 46: Structure of the Japanese Banking Sector (Source: Zenginkyo)

Zenginkyo notes that the numbers in parentheses represent number of institutions in each category. The Banking Federation classifies Postal Savings and Insurance as “public financial institutions” because they are “in a transition period toward final privatization slated for the end of September 2017 at the latest”. Zenginkyo finally notes that the Development Bank of Japan, Inc. and The Shoko Chukin Bank, Ltd. are scheduled for sometime during the period from 2017 to 2019.

Further information on the structure of the Japanese banking sector (such as the function of each type of institution) may be found on <http://www.zenginkyo.or.jp/en/banks/banking-businesses/>

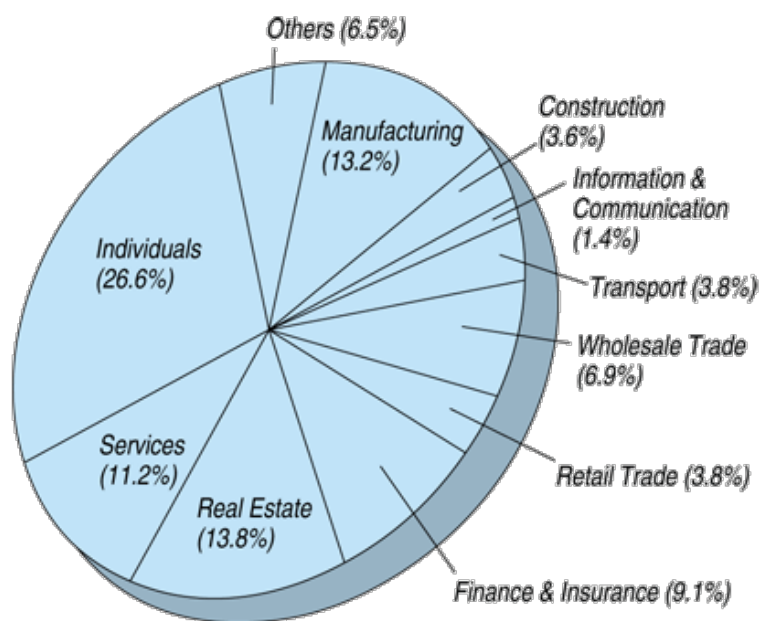


Figure 47: Sector breakdown of Bank Loans & Discounts (Source: Zenginkyo)

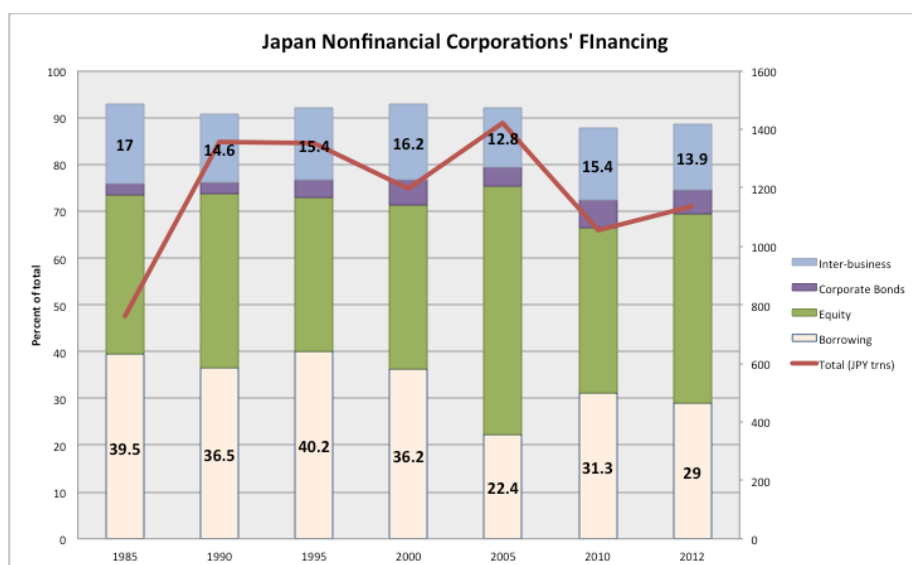


Figure 48: Decomposition of Japanese nonfinancial firm financing (Source: Bank of Japan)

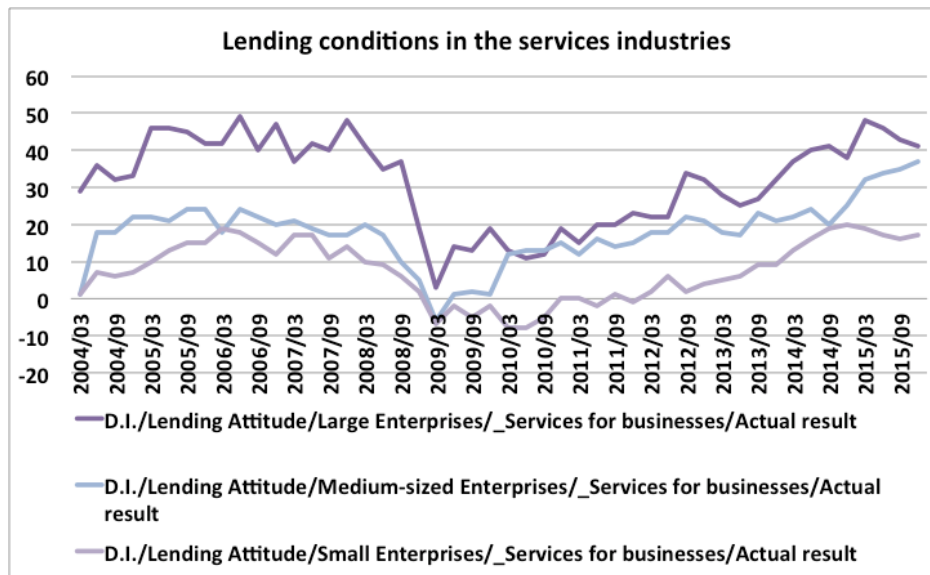
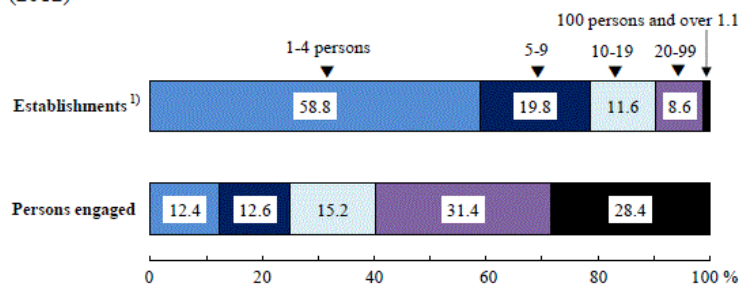


Figure 49: Dispersion in bank lending conditions (Small vs. Large Businesses) (Source: Bank of Japan)

Figure 3.6
Shares of Establishments and Persons Engaged by Scale of Operation (2012)



1) Excluding establishments consisting of only loaned or dispatched employees.
Source: Statistics Bureau, MIC; Ministry of Economy, Trade and Industry.

Figure 50: Composition of Japanese Industry by firm size (Source: Bank of Japan)

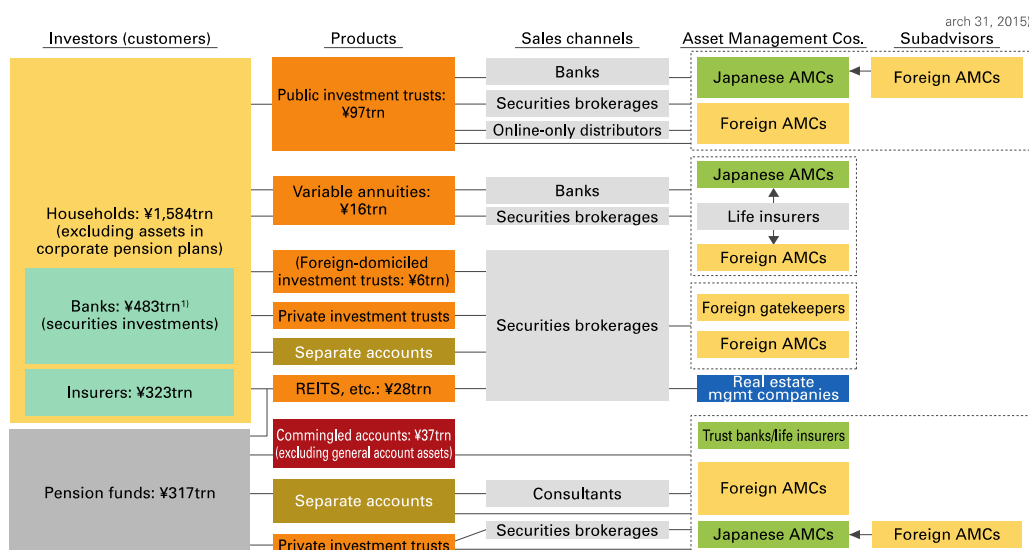


Figure 51: Japan's savings and investment industry structure (Source: NRI)

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