Mizuho Custody Newsletter

September 2023 | Japan

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I. Market News

1. FSA encourages to expand and strengthen the asset management industry

On August 29, the Financial Services Agency (FSA) published its "Financial Administration Policy for 2023 (2023 July to 2024 June)" In the new policy, FSA states to enhance the investment capabilities of asset management companies and pension funds in order to realize an "asset management-oriented nation" set forth by the prime-minister Fumio Kishida's administration. In Japan, there is a unique inefficient practice of "duplicated calculation" of the net asset value (NAV) of mutual funds by two different vendors for one fund. In Western financial markets, trustees calculate NAV. In Japan, both asset management company and trust bank calculate NAV of a fund and reconciles them. FSA finds this practice redundant, and will review it to attract outsiders into the asset management industry. The government is also going to scrutinize the ways senior management of asset management companies have been selected. In Japan, many of the board members of asset management companies have been seconded or hired from its group companies, which FSA will require those companies to hammer out solutions to ensure a certain independence from its parent company.

It is Kishida administration's intention to defrost huge deposit and savings (about 1,100 trillion yen, ca. USD 7,480 billion) held by the households and encourage people to use such monies for business activities so that more companies could grow and push up their share prices, which would eventually make households richer and wealthier. To make this scenario come true, it is essential to enhance the functions of asset managers, such as investment management companies and asset owners such as pension funds, to achieve better investment returns. FSA now works with the Ministry of Health, Labor and Welfare (MHLW) and other related ministries to enhance the general level and qualities of the asset management industry as a whole. In Japan, it is extremely important to get MHLW involved in tackling this issue, given that there are full of challenges ahead of Japanese corporate pension funds, as small-sized pension funds account for most of the assets and it is not easy to have all of them take a same approach on their issues.

An officer at the FSA says "Some asset management companies and asset owners in Japan have not been doing enough on this issue due to insufficient resources. FSA will identify the problems and create a framework in the market that could monitor and appreciate each companies' efforts."

One example is "duplicate calculation of NAV", where both trustee and investment manager figure out NAV on its own and match the number to each other. FSA finds this practice redundant and a cost pushing factor for investment managers, as only trustee is responsible for NAV calculation in Western markets.

FSA is also looking at the governance of asset management companies. In Japan, many financial services groups have asset management companies within the group. FSA recognizes that some of their parent company transfer someone with insufficient experiences and backgrounds in investment management business to the top management of their asset management subsidiary. In other cases, skillful fund managers had to leave their post due to its parent company's personnel transfer. FSA says it will pay close attention to the management strategy, selection of management, and human resource development in the asset management companies as a part of its policy to urge them to maintain a certain level of independence from their parent company.

FSA stressed the importance of dialogue between the asset management company/asset owners and their investees, and recommends them to interact as much as they can. Through such dialogue, they can share their viewpoints and understandings with each other, which would help enhance the corporate value. From issuers' point of view, it is difficult to find out their final beneficiaries because their shareholders names are indicated on their shareholder list only by the name of a trustee, under the current share registration framework unless otherwise arranged in advance. FSA will review the large shareholding reporting requirements so that issuers can identify its beneficial shareholders with ease.

FSA also intends to prompt investors to trade wider variety of financial instruments, in addition to traditional assets such as stocks and bonds, alternative investment assets including private equities such as startup companies to support them to grow further. For fundraising for startups, FSA believes active use of systems such as equity crowdfunding is one of the subjects to tackle.

FSA plans to catch demands and challenges that foreign entities are facing to penetrate into Japan, by widening communication channel with foreign financial institutions, and to distribute various types of financial-related information to appeal what Japanese market has been doing to enhance its attractiveness to investors and governmental supports for this purpose. For example, the government is holding an event "Japan Weeks," in which overseas financial companies are intensively invited to Japan, FSA takes this opportunity to expand its public relations channels to major overseas media and disseminate information to overseas authorities.

At the announcement of the policy this time, FSA described its basic ideas and policy comprehensively to transform Japan into "asset management-oriented nation". But some of the items in the announcement are make-over of what were discussed in the past. FSA's main focus this time is reform of asset management companies and asset owners. Concrete measures and plans are coming up from now. FSA targets to complete the planning process by the end of the year.

Compiled from Financial Service Agency, Nikkei Shimbun and Mizuho research.

2. Can investment trust funds be salvation for low PBR companies through dialogue?

The Tokyo Stock Exchange (TSE) requested listed companies to disclose their plans to improve their PBR (price-to-book ratio) at the end of March 2023. It is a highly unusual in global financial markets that a stock exchange makes such a request to companies being listed on it. It appears that TSE can no longer overlook the situation that 43% of 500 companies that are the constituents of TOPIX have a PBR ratio of less than 1 as of the end of 2022, far worse than that in the United States (5%) and that in Europe (24%). Going forward, investment trusts funds may play a greater role in salvaging companies suffering from low PBR. Recently, "Engagement-type investment trust funds ("ETITF")" have been launched one after another. ETITFs invest in undervalued stocks and aim to enhance their value through dialogue with the companies. If these funds could collect money not only from individual investors but also from domestic financial institutions, investees of those funds that suffer from low PBR are likely to be pressed to perform better.

A TSE official revealed that orders from institutional investors were placed for an "unfamiliar" securities code when monitoring trading conditions on the RFQ (request for quote) trading system for institutional investors. The institutional investors appear be domestic regional banks.

The code is for an Actively Managed Exchange Traded Fund (ETF), one of the 6 funds which was launched and listed in Japan for the first time on September 7th. The constituents of the fund are all companies with a PBR of less than 1, including major banks, automobile manufacturers, and major trading companies.

The aforesaid ETF is run by an independent asset management company, applying the know-how of active engagement investment strategies, which the company have been providing to institutional investors. This strategy involves dialogue with companies on various subjects, such as share buybacks, dissolution of parent-subsidiary listings, and even proposals for management buyouts (MBOs), aiming to enhance corporate value for higher returns. Another asset management company plans to launch an open-end fund with a similar investment concept that emphasizes dialogue with companies on September 19. The fund managers will work together with the engagement team to promote the improvement of investment targets' value. Another Japanese asset management company is also considering launching a "low PBR engagement type" investment trust.

These companies are keen on launching funds investing in low PBR stocks because such companies' shares, regarded as undervalued shares, still have rooms for improvement in corporate value. According to TSE's research of the listed companies' reports on corporate governance, only about 30% of the companies listed on the Prime market (with FY end of March) made disclosures in accordance with TSE's request to manage the business with more consciousness on capital cost and share prices.

One of the strategists at a local securities company said, "I have had an impression that very few companies, most of which are auto parts manufacturers and had PBR below 1, had ever announced reasonable measures to make their low PBR turn better. Some major companies also made no description how they would deal with the low PBR issues in their reports on corporate governance in spite that their PBR ratios were below one.

Actively Managed ETFs disclose constituent issues of the funds on daily basis. Publicly offered investment trust funds do so monthly. The CEO of the asset management company that operates the aforesaid Actively Managed ETF specialized in stocks with PBR below 1 said, "ETF launched with such concepts may make constituent companies feel dishonored for being included in the fund, and I am hoping that would urge them to consider more seriously to improve their PBR." Although the fund still has a long way to go (net asset: JPY 2.7 billion: ca. USD 18 million as of Sep 12, 2023), we aim to attract 1 trillion yen (ca. USD 6.8 billion) in combination with the two other Actively Managed ETFs they launched on September 7.

A TSE officer says 'The asset management company designed a product in ways we have wanted them to, based on the concept of getting out of "PBR below 1". If investment trusts funds with "dialogue-oriented" concept could attract funds from individual and institutional investors that would make voices from asset managers to issuers stronger. These investment trusts funds with new concepts can be another driver for undervalued shares beside TSE and activist investors

Compiled from Nikkei Shimbun and Mizuho research.

3. Government to support startups to attract skilled employees by facilitating stock purchase rights programs

The government of Japan is altering some compensation programs for startups to attract skilled talent more. The government is going to simplify rules and procedures to grant stock options to outsiders, such as engineers, with tax breaks for startups. This aims to lead to the creation of new industries and new jobs by encouraging more people to come into this business.

This is part of efforts of the government to proceed the "new capitalism" advocated by the administration of Prime Minister Fumio Kishida. The Ministry of Economy, Trade and Industry ("METI") will incorporate this program in its request for tax reform for fiscal 2024, and METI will begin talks with the Liberal Democratic Party, the core of the ruling coalition parties.

In startups, outsiders are more and more getting involved in setting up businesses as their sideline. The government plans to relax conditions for granting stock options, assuming the targets to those such as, programmers, designers and management consultants.

Currently, outsiders requires approval from the government to be eligible for a stock option program at a company. A candidate must have at least three years of working experience in the industry, experience as a board member of a listed company, a national qualification such as a lawyer, a doctorate or, etc.

When the system was first launched in 2019, stock option was granted only to "highly skilled personnel," but companies complained about its inconveniences. Eligibility for the program has been granted to only less than one hundred people to date.

Under the new system, anyone who is involved in a startup's business will be eligible for stock options with some tax breaks, regardless of whether they have experiences as corporate executive or have any specific qualifications. Certification from the government on eligibility remains to be required.

In 2021, 96.9% of startups that went public (IPO) offer stock options to reward their executives and employees, according to a startup information service company.

Stock options has been recognized as an effective item to strategically recruit talented people for startups with limited funds, only a while after their foundation, and companies have been calling for easing requirements for eligibility to external talents. Companies have also another aim to deal with various working styles, such as having side jobs, self-employed or freelance, which have been getting more popular in Japan.

Stock options being discussed here are “tax-qualified stock options”. Tax qualified stock option is entitled free of charge and those who are entitled may get tax benefits by meeting certain conditions.

For example, tax is deferred until sale of the shares obtained by exercising the stock option, and the tax rate applicable at the time of the sale is also favored at about 20% as capital gains. If the conditions are not met, sales proceeds of the shares entitled will be deemed as a “wage” which is taxed 55% at maximum under the progressive taxation rule.

Currently, shares entitled to an employee with tax benefited by exercising the stock option rights can be purchased up to 12 million yen. METI is considering either eliminating the limit or raising it significantly.

Plans to promote development of startups were implemented in the fiscal year 2023 national budget and the tax reform, but the plans mostly focused on improving investment environment for startups. In the budgets for FY2024 and the requests for tax reform for FY 2024, the government intends to institute measures focusing on more specific business areas to support startups in more efficient ways.

For example, the METI will spend more than 200 billion yen over 5 years to support the development of startups in business areas related to “green transformation”, such as utilization of hydrogen and CO2 capture and storage.

The government is going to support startups engaged in deep tech sectors, such as artificial intelligence and biotech. In such fields, it is extremely tough for startups to secure financial sources just by themselves, as it takes time to put their technologies into practical use.

The government also has plans to subsidize R&D costs for large companies nurturing start-ups under their arms until their business becomes stable and ready to spin-off. Under large companies, promising startups could grow and commercialize the technologies that they are working on with less woes than doing on their own, which may help keep them in good shape.

Compiled from Nikkei Shimbun, and Mizuho research.

4. Listed companies struggling with TSE’s calls for better PBR

The Tokyo Stock Exchange (TSE) has urged listed companies to improve their PBR (price-to-book value ratio), and the companies are tackling the issue by unwinding their cross-held shares and paying more dividends. As of the end of March 2023, the number of cross-held shares declined by 6% from the previous period, to the record low since inception of the disclosure on cross-shareholding, with a total of 53,500 issues. On another subject, 43 companies have revised their dividend projections upwards for the fiscal year 2024, following their financial results for the April-June 2023, which is the third highest number since the global financial crisis. As a whole, 30% of the listed companies are going to pay more dividends than they did in the previous year, with a projected total dividend amount of 15 trillion yen, which is a record high.

Nikkei-Shimbun, Japan’s leading financial daily, analyzed the securities reports of approximately 2,200 companies (excluding financial sector and companies with irregular accounting rules) with fiscal year end in March 2023. Cross-held shares (including unlisted stocks) were sold for approximately 1.99 trillion yen (ca. USD 15 billion), which is the second-highest level after March 2022 (approximately 2.31 trillion yen, ca. USD 19 billion). Cross-held shares in market capitalization of listed companies accounted for 70% at the end of 1990 fiscal year, but it declined to over the level of slightly above 30% as of the 2022 fiscal year end.

Companies are examining whether it is worthwhile for them to keep cross-holding of shares in terms of their capital efficiency, and might sell them in phases to reallocate funds to areas in which further growth can be anticipated such as decarbonization. Companies are being urged to unwind their cross-held shares under pressure from the market, getting stronger year by year. The Corporate Governance Code established in 2015 requires companies to explain reasons to the public if they need to maintain the cross shareholdings.

Some proxy advisory companies recommend their users to vote against executive appointments, if amount of cross-held share holdings is on or above a certain level. This is another reason why companies are being urged to reduce this practice. A leading proxy advisor in US recommend to vote against a company's proposal for executive appointments, if the company's cross-held shares account for 20% or more of its net assets. Other advisor sets the threshold at 10%, which is much stricter than the first one.

Institutional investors are also following suit of the 20% threshold introduced by the first leading proxy advisor mentioned above, and the market has been looking more closely at the situation year by year.

A major ceramic manufacturer whose cross-held shares account for 49% of its net assets, explained that it had been holding the shares in question since its foundation, and this was not for crossholding purposes. However, the major proxy advisory company described above, recommended to vote against a proposal of appointments of the chairman and the CEO at the shareholders' meeting in June. The proposal obtained 64-65 percentage percent of supporting votes, which fell by 13-16 points from the previous appointment proposed in 2021.

Given that TSE is encouraging companies with low PBR to improve its capital efficiency, the current trend to unwind cross-held shares would continue for a while. The aforementioned ceramic manufacturer announced to aim to reduce their cross-held shares by 5% or more of its book value by the end of March 2026. A leading printing company set a target to sell its cross-held shares up to the cash amount of 220 billion yen by March 2028, and lower the cross-held shares ratio to less than 10% of its net assets.

The total dividend projections was calculated by Nikkei Shimbun covering 2,360 companies whose fiscal year end on March 2023. 43 companies revised their annual dividend outlook upward after the quarterly financial announcement for April-June 2023. In the quarter of April-June in 2021, staggeringly 98 companies revised dividend outlook upward, due to rapid economic recovery after COVID-19 pandemic had subsided. At that time, as many as 20% of these companies revised their earnings forecasts for the better. This year, it was only 8%, but in order to improve their PBRs, they have been actively returning earnings to shareholders due to the listed companies' (excluding financial sectors) abundant cash on hand as of the end of June, which amounted to almost 100 trillion yen. (ca. USD 690 billion).

Overall, 30% of the companies Nikkei analyzed, or approximately 740 companies, plan to pay more dividends than they did last fiscal year. The total amount of dividends to be paid is estimated to be approximately 15.3 trillion yen (ca. USD 103.5 billion), 1% increase from the previous year which is a record high. Given that individual investors own approximately 20% of the shares of listed companies, about 3 trillion yen of earnings could be returned to households, which would boost consumption.

Companies have been doing so in view of improving their PBR. A major petroleum wholesaler which revised its dividend projection from 200 yen per-share to 250 yen has a PBR lower than 1. The petroleum wholesaler stated in March that it would target to increase its total return rate (calculated by dividing dividends and share buybacks by net profit, excluding inventory valuation) by from 50% to 60% or more. The company's executive officer said at its financial results conference, "Even if we pay annual dividend of 250 yen per share, it would not be sufficient to attain the total return rate of 60%.", implying to conduct additional "shareholder return" events.

The current trends to expand investor returns seem continue for a while. The net profit for the March 2024 fiscal year of the companies listed on TSE Prime market (excluding subsidiaries of parent companies, etc.) is expected to reach a record high, an increase by 6% from the previous year. The cash on hand as of the end of June remains abundant, leaving plenty of room for returns.

The TSE's persistent requests for companies to keep trying to get off the hook of PBR below 1 also prompt them to return more to shareholders. PBR of a company tends to go up if their share price rises. One theory for calculating theoretical share prices defines that share price of an issue consists of aggregated amount of the present value of dividends of the issue to be paid in future. Under this theory, paying more dividends will have positive effects to share prices. A chief strategist at a domestic securities firm assumes that companies will continue to pay more dividends in the fiscal years 2023 and 2024, and low PBR companies may also increase shareholder returns in semi-annual financial announcements for April-September 2023."

Compiled from Nikkei Shimbun, and Mizuho research.

II. New Equities Listing Approvals

Listing Date	Name of Company	ISIN Code	MKT
Sep-21	Angel Group Inc.	JP3169000001	P
Oct-03	Seibu Giken Co., Ltd.	JP3415750003	S
Oct-03	Nippon Insure Co., Ltd.	JP3687450001	S
Oct-04	Caster Co.Ltd.	JP3242650004	G
Oct-04	Kusurinomadoguchi, Inc.	JP3266230006	G
Oct-17	K Pharma, Inc.	JP3280900006	G
Oct-23	Ureru Net Advertising. Co., Ltd.	JP3159880008	G
Oct-24	Japan M&A Solution Incorporated	JP3389530001	G
Oct-25	KOKUSAI ELECTRIC CORPORATION	JP3293330001	PR
Oct-25	ZENHOREN CO. LTD.	JP3430100002	G
Oct-26	Emimen Co.,Ltd.	JP3167360001	G
Oct-27	DreamArts Corporation	JP3639400005	G

**Information compiled based on postings from the Prime (PR), Standard (ST), Growth (G), Tokyo Pro Market (P), NSE (N)、FSE (F) & SSE (S).*

***Board lot size is unified to 100*

III. Foreign Ownership Limit Ratio

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