Institutional Investor Attitudes to Proxy Voting

Motomi Hashimoto

The attitudes of Japanese institutional investors to proxy voting are changing as pension funds' assets under management and their awareness of their fiduciary responsibilities increase. This report, which is based on interviews, examines institutional investors' attitudes to proxy voting and describes some of the steps that have been taken in other countries to encourage investors to cast their proxy votes. In addition, it examines some of the issues that will have to be addressed if Japanese institutional investors are to use this as a means of inducing companies to do more to increase shareholder value.

1. "Big Bang" and the Growing Importance in Japan of Institutional Investors and Fiduciary Responsibilities

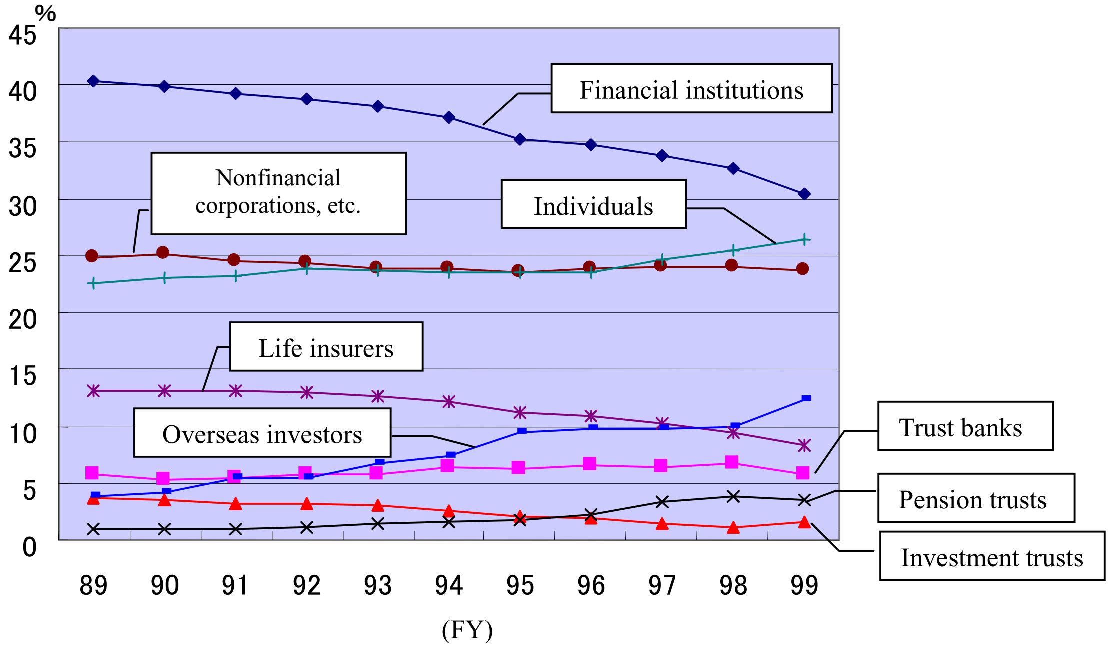
1) The growing importance of institutional investors in Japan and the growing scale of pension fund investment in equities

Since Japan's program of financial reform ("Big Bang") began, a reduction in cross-shareholding by financial institutions and non-financial corporations has been matched by an increase in (Japanese and overseas) institutional ownership of listed companies. Figures from the annual survey of share ownership published each June by the Japanese Stock Exchange Association show that overseas investors and Japanese pension funds have gradually increased their ownership (see Figure 1).

Between March 1989 and March 2000, overseas investors increased their ownership of Japanese equities from 3.9% to 12.4%, while pension funds increased theirs from 0.9% to 3.6%—a steady increase. In contrast, financial institutions and non-financial corporations have gradually reduced their ownership since 1990 from 65% (in 1989) to 54%—a decline of 10 percentage points.

Once considered the most stable of shareholders, financial institutions have been forced by non-performing loans and injections of taxpayers' money to improve their return on assets. Non-financial corporations have found themselves under similar pressure to improve their performance as disclosure requirements (e.g., in the form of consolidation and market value accounting) have increased. Such requirements have been a powerful force in reducing cross-shareholding. It is institutional investors who have been able to bid for blocks of such shares released onto the market. Companies see institutional investors as potential stable shareholders in the post-crossholding era, and more companies are making an effort to woo them.

Figure 1 Shareholder Ownership Ratios



Note: "Financial institutions" includes long-term credit banks, regional banks and nonlife insurance companies but excludes pension trusts, investment trusts and life insurance companies.

Source: NRI, from Kabushiki Bunpu Jokyo Chosa [Survey of Share Ownership] (fiscal 1989-1999), Japanese Stock Exchange Association.

The growing importance of institutional investors has also been reflected in the steady growth of corporate pension fund assets, which increased by 50% (from ¥47 trillion to ¥71 trillion) in the six years from 1992 to 1998. Corporate pension funds have also been back in force on the stock market since it began to recover in the second half of 1999 and plan to increase their exposure to Japanese equities to 40% this fiscal year. This reflects the fact that interest rates in Japan are still extremely low and that fund managers have been increasingly eager to achieve high returns—even if, as in the case of equity investment, this means taking more risks.

With the growth of funds under institutional management expected to increase further, the balance of power among institutions managing pension fund money has started to shift. A breakdown of Japan's leading pension fund managers in fiscal 1997 and 1998 shows that while the proportion of pension fund assets managed by life insurance companies and trust banks declined from 38.6% to 34.8% and from 50.4% to 48.7%, respectively, that managed by asset management companies rose from 11.1% to 16.3%. This is the result partly of a decline in the return on assets managed by insurance companies and partly of a transfer of funds from insurance companies to their asset management affiliates following the collapse of a number of insurance companies. Similarly, figures published by the Association of Asset Management Companies on 22 June of this year show that assets under management at its 140 member companies stood at more than ¥90 trillion as of the end of March (compared with only ¥30 trillion in 1990)—an increase of 30% on last year and the highest figure ever recorded. The figures also showed that pension funds accounted for about 50% of assets under management (compared with only 7% 10 years ago).

2) Proxy voting as one of an institution's fiduciary responsibilities

Unlike in the United States, where pension funds are the largest institutional investors, in Japan the main institutional investors are life insurance companies, trust banks and asset management companies. This is because in Japan pension assets have traditionally been subject to strict regulation and companies have been obliged to have all their pension assets managed externally. Nor has there been much interest in proxy voting; and, until a few years ago, fund managers generally gave companies a free hand in how they managed their operations. However, now that pension fund management has been deregulated and fund managers are more aware of their fiduciary responsibilities, Japanese institutional investors view the companies they invest in with a much more critical eye and expect them to maximize shareholder value so that they (the investors) can obtain a higher return on their clients' assets.

Proxy voting has come to be seen as an increasingly important fiduciary responsibility. The driving force behind this change of attitude has been the Pension Fund Association. In June 1998 (just before its annual general meeting) the association published the results of a survey it had commissioned in the form of recommendations to its members on corporate governance and criteria to be used by external managers when voting on behalf of client members. The statement that external managers had a fiduciary responsibility to use appropriate criteria to judge what was in their clients' best interest when voting on their behalf put pressure on external managers to make the necessary in-house arrangements and draw up guidelines for their staff. Further catalysts may have been the corporate governance principles aimed at Japanese companies that CalPERS and the Japan Corporate Governance Forum published at this time.

Trust banks, life insurance companies and asset management companies have a different legal basis on which they can cast proxy votes with respect to pension assets. In the case of asset management companies, the industry association's rules for self-regulation ("The Correct Procedure for Proxy Voting with Regard to Discretionary Pension Fund Mandates," 28 November, 1990) are quite clear, but trust banks and life insurance companies are not subject to any direct legal requirements. From the point of view of the issuing company, the registered owner of the pension assets is the trust bank in the case of pension trusts and pension "designated money trusts" (tokkin), but proxy instructions must come from the asset management company in accordance with its mandate. In the case of pension assets managed by a life insurance company, it is the life insurance company that is responsible.

In addition, according to the handbook on fiduciary responsibilities compiled by a study group of the Pension Fund Association for the benefit of external managers, the external manager is responsible for proxy voting with regard to pension assets while the client (i.e., the pension fund) is responsible for monitoring the manager's arrangements and the results of his voting. Although an external manager's responsibility for proxy voting is not legally binding, this handbook is the first comprehensive guide on the subject.

2. Japanese Fund Management Companies' Current Stance on Proxy Voting

The following is an overview of the current stance on proxy voting of six trust banks, five life insurance companies and nine asset management companies.

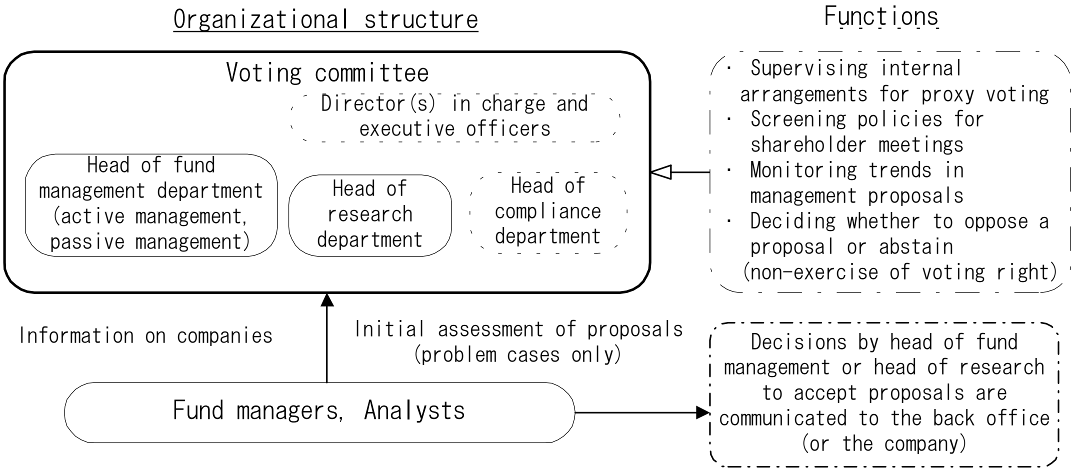
1) Internal arrangements for proxy voting

In recent years and, especially since 1998, to deal with annual general shareholder meetings, which are generally held in June, Japanese fund management companies have put in place structures for proxy voting. Although trust banks and life insurance companies did have arrangements before then for proxy voting, new arrangements (such as written rules for proxy voting and procedures for screening proposals) have been introduced in the past few years as a result of the increased interest in corporate governance since 1998. Meanwhile, there has been a wave of mergers among asset management companies, and new in-house standards appear to have been drawn up following reorganization.

The procedure adopted by external fund managers for proxy voting is as follows. First, the issuer notifies the back office that a meeting of shareholders will take place, and the back office circulates this to the departments concerned—especially the fund managers and analysts in the pension fund management department. The analysts, of which there are about 6-18 covering different sectors, compare the proxy documents and the disclosure documents currently available. The screening process and the collection of information to decide how to vote are an integral part of an analyst's daily work. Some management companies also subscribe to external databases. If the fund managers and analysts come across any problems or if any proposals are particularly difficult to reach a decision on, these are passed for a final decision to the head of the fund management department and a special committee, which issue instructions about how the votes should be cast.

Whereas some management companies have special committees to devise policies and procedures for proxy voting, and decide particular cases, other companies deal with such matters as an integral part of the work of the fund management and research departments. Such committees consist of roughly 10 members: the managing director and executive director(s) in charge of pension fund management, the head of the pension fund management department, the head of the research department and the head of the compliance department (see Figure 2). The committee's main duties appear to be to approve in-house arrangements and policies for proxy voting, and reaching a final decision (including objections and abstentions) on proposals to be put to the annual general meeting of shareholders as well as controversial and important proposals.

Figure 2　Typical Organizational Structure for Proxy Voting



Source:　NRI, from interviews.

2) Proxy Guidelines and the Screening of Proposals

(1) Proxy guidelines

Most of the management companies we interviewed had guidelines for screening proposals as well as internal arrangements for proxy voting (see Table 1). As the basis for their guidelines the companies mentioned the following: the corporate governance principles and

Table 1　Examples of Proxy Guidelines

Type of management company	Main items covered by guidelines
Asset management company	6 items: suitability of directors and statutory auditors, appropriateness of directors' compensation and dividends, disclosure, problematic proposals
	2 items: major losses, no dividend for the past five years and no prospect of one (+ shareholder proposals)
	5 items: composition and reelection of board of directors, suitability of statutory auditors and their reelection, policies on dividends and directors' compensation, general finances, social responsibilities
	6 items: appropriation of earnings (excessive or inadequate payout ratio), number of directors, election of external statutory auditors, retirement bonuses (scandals), changes to the articles of association (new operations), shareholder proposals
Life insurance company	2 items: insolvent or no dividend, auditor's opinion appropriate or not, + special proposals (merger, transfer of business)
	Guidelines for each type of proposal (e.g., appropriation of earnings, election of directors or statutory auditors, capital increases, changes to articles of association), no quantitative criteria
	Is shareholder value being created? Have there been any scandals?
	2 items: normal criteria (e.g., profit or loss) and exceptional criteria (scandals)
Trust bank	3 items: important proposals (appropriation of earnings—failure to make a profit or pay a dividend for two years in succession, mergers and acquisitions), general proposals (election of directors—failure to make a profit or pay a dividend for two years in succession), shareholder proposals
	2 items: failure to make a profit for three years in succession, impairment of shareholder value or antisocial behavior
	3 items: blacklisted, any directors guilty of improper behavior in the past, shareholder proposals—criteria for each type of proposal
	3 items: quantitative criteria (e.g., payout ratio), qualitative criteria (e.g., involvement in scandals), shareholder proposals—criteria for each type of proposal

Source:　NRI.

proxy guidelines produced by CalPERS and TIAA-CREF (Teachers Insurance and Annuity Association/College Retirement Equities Fund); the Pension Fund Association's "Guidelines for the Appropriate Exercise of Voting Rights," the practice of peer companies, and proxy services such as those provided by ISS (Institutional Shareholder Services) and IRRC (Investor Responsibility Research Center).

The guideline contents and the fund management policies fall into the following main categories: (1) management companies that adhere to detailed guidelines and those that increasingly judge each case on its merits; (2) management companies that carry out an initial screening of proposals before notification of a shareholder meeting is received and a follow-up screening afterwards, and those that leave all screening until they receive notification; (3) management companies that inform issuers in advance of their proxy guidelines and indicate their policy indirectly (e.g., in the form of questionnaires), and those that approach issuers before the shareholder meeting about any proposals they are unhappy with. Those companies that said they would accept an issuer's proposals at the final decision stage so long as they did not conflict with their own guidelines said that they basically trusted the management of the companies they were invested in (or were considering investing in) and had no reason to object to their proposals.

(2) Proxy voting at annual general shareholder meetings in June 1999 and June 2000

According to the replies we received, the number of companies covered and screened by management companies at shareholder meetings in June 1999 varied considerably—from 3,000 (not limited to shareholder meetings in June) in some cases to only 200 in others. The number of companies screened varied from the majority of the companies in which shares were held (in cases where portfolios were quite small) to a minority (in cases where portfolios were large). (In most cases, the number ranged between 10 and 300.)

The difference between the way management companies voted in June 1999 and June 2000 was that, whereas many objected, abstained or failed to cast their proxy votes in 1999, some agreed to all the proposals put to them in 2000. Some of the management companies mentioned that companies that had been involved in scandals had anticipated shareholders' views by taking vigorous action against those responsible (e.g., by not paying directors a bonus or not even requesting that the directors in charge of the departments involved in such scandals be reelected or receive a retirement bonus), thereby making it unnecessary for management companies to object to proposals (on the grounds that proposals from a company involved in a scandal should automatically be objected to). Some management companies also mentioned that, in cases where a company had been involved in a scandal, sometimes it completely failed to refer to this. However, in such cases, none of the proposals were related to the scandal, so it was apparently unnecessary for shareholders to express their dissatisfaction.

Where management companies' screening procedures picked out companies after they had sent out notices of a shareholder meeting, those management companies that checked the details and reasons directly with the company concerned or discussed future policy with the person in charge ultimately voted in favor of the proposals.

Objections and abstentions at June 2000 shareholder meetings were made in the case of the following kinds of proposals and companies:

- Proposals to pay a director a retirement bonus when he had been in his post for only a short time.
- Proposals to elect external auditors from among candidates from the same group of companies.
- Proposals to amend a company's articles of association so that directors could receive an increase in their compensation even if a company was making a loss.
- Proposals to reelect directors repeatedly involved in scandals.
- Companies proposing to pay a dividend even though they were making a loss.

When it came to deciding whether to abstain, object or refuse to vote, the following responses were typical: "Our policy in such a situation is not to vote, because, if we abstained, we would be excluded from the quorum"; "Our policy in such a situation is to object, because abstaining is the same as disagreeing"; and "Our policy in such a situation is to abstain, because some other departments would be very unhappy if we objected." Most of the management companies appeared to prefer to abstain rather than object if a proposal did not conform to their guidelines.

As far as shareholder proposals were concerned, these tended to be treated as "special proposals," but it appeared unlikely that any of the management companies we interviewed would support such proposals, as most of them tend to be either social or political in nature. However, it is now more common for institutions (especially overseas investors) to support shareholder proposals such as MAC's proposal that Shoei increase its dividend and appoint external directors, and the proposal from the investor advocacy group Shareholder Ombudsman that Sumitomo Bank disclose the compensation of each director (both of which proposals were defeated). Even among some of the Japanese institutions we interviewed there appears to be a growing willingness to support shareholder proposals.

3) Shareholder pressure on companies

In response to our question whether proxy voting (in the form of an objection or an abstention) exerted any pressure on companies, 90% of the institutions said they believed that it did. The reason they gave was that many investor relations departments now expect shareholders to vote. On the other hand, those institutions that believed that it did not exert any pressure on companies said that more pressure could be exerted by selling shares and pushing their price down. In other words, if a company did not make a case for itself to its shareholders, these were liable to be very sensitive to its results and sell their shares. Therefore if a company wanted institutional investors to be stable shareholders, it was clear that it had to show itself to be responsive to their needs.

Twenty percent of the management companies said that they had later been asked by some of the companies in which they were shareholders why they had abstained or not voted. In particular, some said that if a company failed to meet their screening standards, they would talk to a company representative before a shareholder meeting because they felt that this would make the company more aware of the possibility that they might oppose a proposal or abstain. By not voting in favor of a proposal, these institutions apparently hoped to encourage companies to be aware of their shareholders so that they would either analyze what kind of proposals would elicit objections or abstentions and check before the next shareholder meeting or not make proposals that were likely to incur the displeasure of the institutions at all.

Proxy voting is also sometimes regarded as a means of trying to induce companies to produce higher returns—as well as one of institution's fiduciary responsibilities. Most management companies are obliged to vote properly and are more concerned to show that they are doing this than to actually improve returns on investment.

4) Relations with pension funds

In July 1997 the Pension Fund Association included a section on proxy voting in its Basic Investment Guidelines. We used this as a basis for interviewing management companies to find out how much interest individual pension funds showed in this subject.[1]

Our investigations revealed that pension funds generally made very few enquiries about management companies' policies on proxy voting and about how these were actually implemented. Pension funds (especially the larger general funds) apparently carried out a general check on management companies' attitudes to fiduciary responsibilities by including a question on the subject as part of a questionnaire. However, it appears that they very rarely ask what arrangements a management company has for proxy voting and how it has actually voted.

As far as the management companies themselves are concerned, some report voluntarily to their pension fund clients on their organizational arrangements and how they have voted, but most simply make an internal note so that they can report to their clients if and when necessary.

Some management companies indicated that, unless pension fund clients understand the importance of shareholder activism (e.g., proxy voting) as a means of improving the long-term performance of the companies in which their money is invested (rather than focusing on the short-term performance of their portfolios) and make this part of their policy, management companies will find it difficult to take a more active line on corporate governance. Some of the management companies we interviewed took the view that it was difficult for them to take a more active line when shareholder activism had probably had only limited success so far even in the United States and was still in its infancy in Japan.

5) Need for comprehensive guidelines on proxy voting

There will be situations (such as business dealings or a parent company's relations with an affiliate) which will it make it difficult for an institution to decide how to vote. In order to eliminate such pressures, trust banks, asset management companies and life insurance companies have drawn up comprehensive draft proxy guidelines. However, 80% of the companies we surveyed took the view that there was no need for a comprehensive approach, because it was up to each company to decide for itself how to vote and because different investment styles would require different guidelines. For example, some companies might

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1 Of the 20 companies interviewed, 15 managed funds on behalf of the Pension Fund Association.

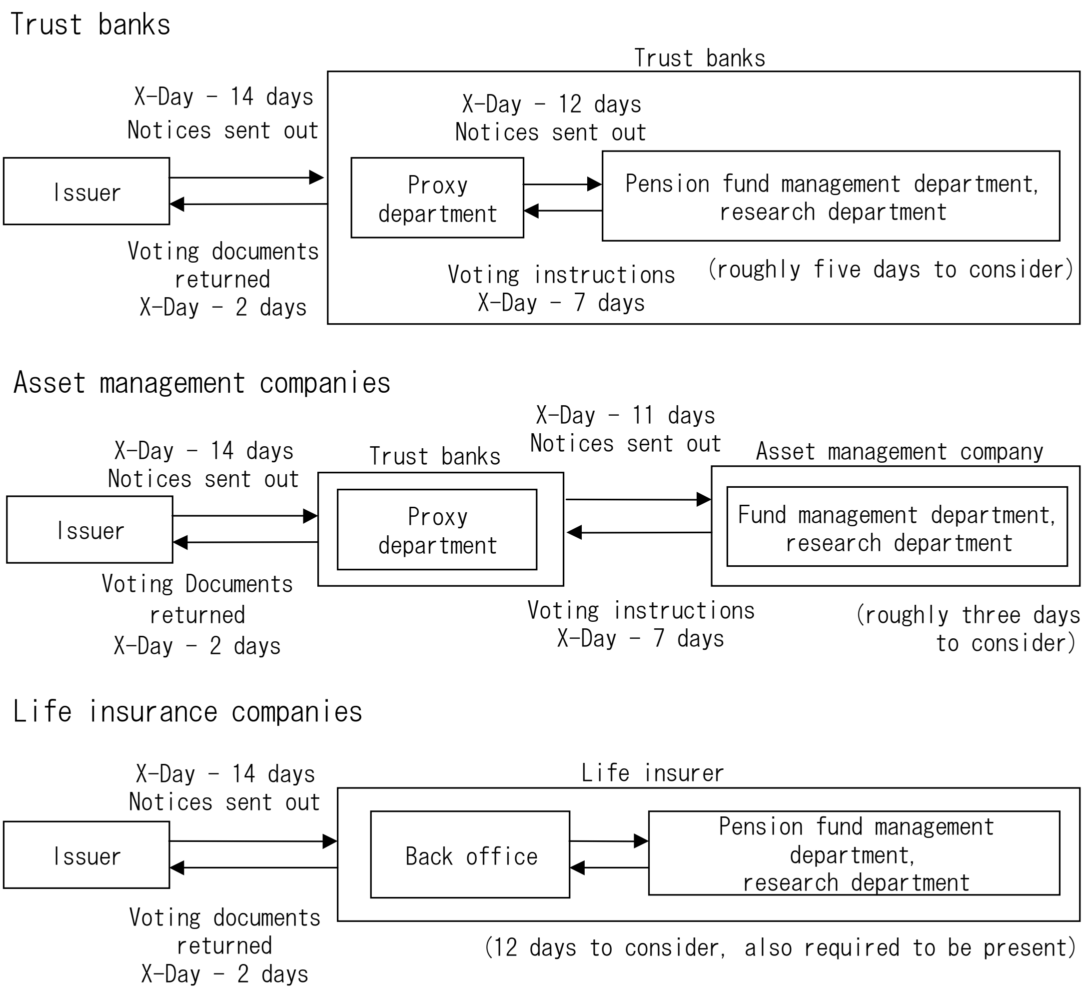
prefer to receive a higher dividend while others might prefer that profits be reinvested. Some of those we spoke to were even concerned that comprehensive guidelines could give the impression that institutional investors were out to take control of the companies they invested in.

Every December, the Life Insurance Association publishes the results of a survey it conducts on the extent to which companies return profits to their shareholders. However, neither the Japan Investment Trust Association nor the Trust Companies Association of Japan appears to be active in the field of corporate governance.

6) Obstacles to proxy voting

Two general, but major obstacles to proxy voting are (1) the short time (by law, two weeks) between when notices of a shareholder meeting are sent out and when shareholders have to return their voting documents and (2) the fact that so many companies in Japan hold their annual general shareholder meetings on the same day in June. Most of the institutions we talked to mentioned the lack of time to consider proposals properly.

Figure 3 Proxy Process



Note: X-Day = date of shareholder meeting; all numbers of days are approximate
Source: NRI.

The time institutions could spend on considering management proposals varied between three days (in the case of asset management companies) and a maximum of 12 (in the case of life insurance companies) (see Figure 3). Exactly how much time institutions can afford to spend on individual proposals will vary according to the size of their portfolios and the number of companies they screen, but it cannot be said to be adequate.

Some management companies also mentioned the lack of disclosure detail of some proposals or the vague reasons given for making the proposals in the first place. There was particular criticism of some of the documentation sent with the notice of the shareholder meeting—for example, inadequate disclosure of in-house expenditure on items such as retirement bonuses; the absence of comparative balance-sheet data in trading statements (which forced management companies to keep or obtain previous statements); and excessive stylization of biographical information on candidates for posts as directors and auditors (which made it difficult to judge their suitability).

3. Need to Streamline Voting Procedures

The biggest obstacle facing institutional investors wishing to cast proxy votes in Japan would appear to be the country's Commercial Code. Particularly problematic—not only from the point of view of overseas investors but also that of Japanese investors—are (1) the short time between when notices of a shareholder meeting are sent out and when voting documents have to be returned, and (2) the fact that 90% of annual general shareholder meetings in Japan are held at the same time on the same day of the last week of June.

The following three measures would help to alleviate the time constraints facing institutions trying to vote:

1) Greater flexibility of timing

Notices of a company's intention to hold a shareholder meeting must be sent out two weeks in advance (Article 232.1 of the Commercial Code). This is the legal requirement for shareholders to be able to decide how to vote, and there must be at least 14 days between the day after the notices are sent out and the day on which the shareholder meeting is due to be held. Otherwise, the notification procedure will be considered defective, and any resolutions may be appealed against. The time available for proper consideration of proposals is constrained further by the fact that, where a large company has 1,000 or more voting shareholders whom it allows to vote by post, the voting documents must be returned by the day before the meeting (Special Provision 21.3.3 of the Commercial Code).

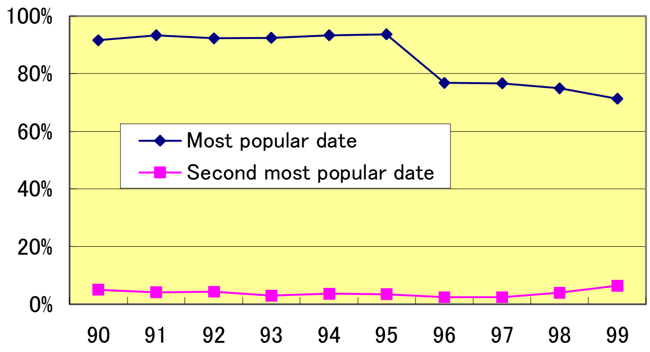
On the other hand, the earliest that notices may be sent out is six weeks before the day on which a shareholder meeting is due to be held—i.e., from the day by which shareholders may submit any proposals of their own (Article 232.2 of the Commercial Code).

In Japan, shareholder meetings must be held within three months of the end of a company's fiscal year (1) because shareholders have to approve a company's financial statements (Article 283.1 of the Commercial Code); (2) because the shareholders' register is closed for up to three months to allow shareholders with voting rights to exercise these at the shareholder meeting;

and (3) because the record date must be no more than three months before the day on which shareholders are due to vote (Articles 224.3.2 and 224.3.3 of the Commercial Code). If these procedures are followed, the date for shareholder meetings will tend to fall in the last week of June. If companies have the same fiscal year, their shareholder meetings will also fall around the same time, reducing the dispersion of the dates on which they are held. According to 1991-1999 data on shareholder meetings, the degree to which they were concentrated in June was more than 90% in 1990-1995 (and greatest, at 93.5%, in 1995), falling sharply to 76.8% in 1996, and declining to just over 70% in 1999. Even in 1999, however, the degree of concentration of the second most popular date for shareholder meetings was only 6.4%—still much less than that of the most popular date (see Figure 4).

Just as it would be difficult to make shareholder meetings an exception to the principle that there should be record dates to establish rights, companies could not be forced to change the date on which they close their books. However, there are ways to enable investors with shareholdings in a large number of companies to have what would effectively be three weeks to consider proposals properly.

Figure 4 Extent to Which June Shareholder Meetings Tend to Be Concentrated in One or Two Days



Source: NRI, from Kabunushi Sokai Hakusho (1991-1999) [White Paper on AGMs], Commercial Law Center.

2) Online proxy voting

In Japan shareholders can vote without attending the annual general shareholder meeting (namely, by returning their voting cards or sending their proxies). In both cases, this must be done in writing.

Even in Japan, issuers would presumably welcome measures (such as online notification of shareholder meetings) that would alleviate cost and time constraints. Sooner or later, Japanese companies (with their high foreign ownership ratios) will find that they have to follow the global trends towards "e-voting." It is quite likely that a consensus on adopting e-voting will emerge in the near future. The Law on Electronic Signatures has already been passed and promulgated, and electronic authentication techniques now have legal status. Although the Commercial Code will have to be revised before further progress in the institutionalization of e-voting can be expected, it would appear from the public pronouncements of the chairman of the Regulatory Reform Committee, Yoshihiko Miyauchi (chairman of Orix) that shareholders will one day be able to vote via the Internet or by fax. The government has also made it clear that revising laws pertaining to information technology is one of its priorities. It is therefore likely that laws relating to the institutionalization of e-voting will be revised before other sections of the Commercial Code are revised in two years.

3) More detailed proposals

In addition to time constraints on proxy voting, there are quite a few information constraints.

During the past few years there have been considerable advances in disclosure based on the Securities and Exchange Law (e.g., in areas such as consolidated accounting, market value accounting and post-retirement benefit accounting). There have also been considerable improvements in investor relations during this period. However, there has been no progress in ensuring that adequate information is provided on general proposals made to shareholder meetings. Similarly, there are strict legal requirements on the information that must be provided in reference documents, and little is left to the discretion of individual companies. Given that institutions carry out rigorous screening when they vote and ultimately decide not to accept a company's proposals, it can hardly be said that the kind of reference documents Japanese companies currently provide shareholders are sufficient to form the basis for reaching a decision.

Consideration also needs to be given to producing annual reports (similar to those shareholders receive in the United States) that include several years' worth of financial data, segment data and consolidated data.

4. Trends in Shareholder Behavior in Japan: From "Exit" to "Voice"

With this year's annual general shareholder meetings in June, institutional investors in Japan seem to have entered a key stage of proxy voting. It would seem that management companies have at last realized that their fiduciary responsibilities require them to cast their proxy votes carefully in order to maximize the return on their clients' assets. If they are to encourage companies to adopt sound, efficient business practices and increase shareholder value, Japanese institutional investors will have to pursue long-term shareholder policies.

1) Changing the attitudes of client pension funds

It is to be hoped that one day institutional investors in Japan will be encouraged to adopt a positive attitude to proxy voting and that their clients will welcome this. At the moment, it would appear that clients (i.e., corporate pension funds) are not showing their clear support for greater shareholder activism by management companies. As far as the management companies are concerned, the fact that they cannot be sure what their clients want and tend to be assessed on their short-term performance means that they tend to minimize risk by disposing of positions. So long as this attitude prevails, they are unlikely to change their approach—from one of "exit" (i.e., reducing risk by disposing of positions and taking new positions in other blue chip companies) to one of "voice" (i.e., trying to influence the management of the companies they hold shares in). If management companies are to adopt a long-term "buy and hold" strategy and their efforts to exert an appropriate degree of pressure on companies to increase shareholder value are to be reflected in the performance of the assets they manage, it is crucial that their pension fund clients change their attitudes.

2) Improving long-term communication with companies

As a result of their day-to-day share dealings, institutional investors are fully aware of how the companies they are invested in are performing. If they suspect that a company has a problem, they can voice their concern directly via analyst meetings. Some people believe that, because institutional investors have better access to company information than ordinary investors and are major shareholders, they also have greater responsibility and an obligation to exercise a management supervisory role.

If a consensus is to be reached that shareholder value should be increased, institutional investors need not only to cast their proxy votes carefully but also to improve long-term communication with the companies they are invested in. Companies need to realize that, although institutional investors are not their real shareholders, they do represent the views of the real shareholders in their capacity as their agents and are obliged to pursue profit on their behalf. Companies need to appreciate that, unless they do increase their profits, their sponsored pension plan assets will not increase and they will have to use other assets to reserve their pension funds, thereby creating a vicious circle.

Until a few years ago, the general view in Japan was that running a business should be left to professionals and that shareholders should keep their opinions to themselves. However, the scandals of the past few years, especially those involving financial institutions and blue chip companies, have made people realize that independent, external controls are necessary if companies are to pursue sound business policies. Companies therefore need not only to strengthen their own compliance arrangements and appoint external directors, but also to welcome the exercise of effective governance by outsiders, including shareholders. Companies themselves would benefit inasmuch as having more long-term shareholders would enable them to pursue sensible, but positive policies. Capital markets in Japan are likely to become increasingly appreciative and aware of the need for institutional investors to help to increase shareholder value by engaging in a dialogue with the companies they invest in.