

The Growth Strategy of Abenomics and Trends in the Japanese Corporate Sector

October 8th 2014

Kiyoto IDO

Institute for International Economic Studies

*The views expressed by the presenter do not necessarily
reflect the views of IIES.*

Update on “Third Arrow”: Electricity

◆ An overhaul of the system for the first time in 60 years

- Challenges: Japan’s electricity suppliers have been granted a regional monopoly.
- Policy Objectives: Abolish regional monopolies to build a competitive nationwide grid
- Action:
 - 1) A bill was passed on June 11 to fully open up retail business to new entrants. (As of August 19, 323 companies have registered as suppliers.)
 - 2) In 2015, another bill will be submitted to require distributors be legally unbundled from suppliers.

Update on “Third Arrow”: Agriculture

◆ Drastic moves to change Japan’s agriculture into “business”

- Challenges: Productivity is low due to fragmented farmland and the Production Adjustment Promotion Program (PAPP) for rice.
- Actions being taken to boost large-scale agri-business:
 - 1) Consolidating farmland.

⇒A bill was passed to establish “Farmland Banks” (with tax incentive to lease farmland to banks) which play an intermediary role between lessors and lessees.
 - 2) Phasing out PAPP of rice.

Update on “Third Arrow”: Corporate Governance

- ◆ Better corporate governance (CG) attracts...
 - more investment (capital),
 - high quality staff (labor),
 - and better investment for higher returns (productivity).
- Priority is given to the evolution of Japanese corporate culture, in particular enhancing the role of major shareholders (e.g. institutional investors) for better oversight of management and higher ROE.
- Measures to enhance CG in the 2013 growth strategy
 1. Japan's Stewardship Code
 2. New Stock Index: JPX-Nikkei 400
 3. Amendment to promote outside directors

CG: Japan's Stewardship Code

- Priority is given to enhancing the role of major shareholders and ROE.
- The Japan's Stewardship Code (SC) encourages institutional investors (e.g. trust banks and asset management companies) to fulfill their fiduciary duties for their clients through enhanced dialogue with investee companies, as major shareholders.
- The investors adopting SC are required to disclose their voting policy and voting result for investee companies.

[Results]

(1) 160 investors have adopted SC and the FSA updated the list of 160 investors on September 2, 2014. It will update the list every 3 months.

(*) The 160 investors include: 6 trust banks, 109 investment managers, 17 pension funds, 21 insurance companies, and 7 service providers.

CG: JPX-Nikkei Index 400

- A new stock index launched by JPX and Nikkei in January
- The selection criteria for the **400 constituents** are **expected to give incentives to enhance CG and ROE:**
 - 1) **ROE (40%) and operational profit (40%)** (+ market capitalization etc.)
 - 2) some other supplementing criteria such as “the appointment of **at least two independent outside directors.**”
- The list of the 400 companies will be reviewed every year.
- There are ETFs indexed to JPX-Nikkei 400, which has been outperforming the Nikkei Stock Average by around 2%.

CG: Outside Directors

- An amendment was passed in June, which provides that any company without an outside director (OD) shall explain why it is inappropriate to have an OD.

[Results]

- Now **74%** of listed companies (in TSE 1st section) have at least one outside director as of June 2014
- Examples of Japanese companies that appointed ODs for the first time in corporate history:
 - ✓ Toyota (3ODs) *[June 2013]*
 - ✓ Mizuho Bank (2) *[November 2013]*
 - ✓ Canon (2) *[March 2014]*
 - ✓ Nippon Steel & Sumitomo Metal (2) *[June 2014]*

CG Next Step : the Corporate Governance Code

- A more comprehensive code to strengthen corporate governance is being prepared.
- “The Japan Revitalization Strategy Revised in 2014 ” (approved on June 24, 2014) states that:

“The Corporate Governance Code will be drafted, specifying the principles of corporate governance to be followed by listed companies.....To that end, a council of experts established under a secretariat run jointly by the Tokyo Stock Exchange and the Financial Services Agency will work out a basic concept by around autumn of 2014. The Tokyo Stock Exchange (TSE) will provide support so that the Corporate Governance Code can be formulated in time for the 2015 general shareholder’s meetings season. The new Code will require listed companies to “comply or explain” (comply with the principles of corporate governance, or, when not complying, explain the reason for non-compliance) in accordance with the TSE’s listing rules. “

GPIF Reform

- Measures stipulated in the “Japan Revitalization Strategy Revised in 2014” :

- **Revising the policy asset mix (basic portfolio) of the GPIF**

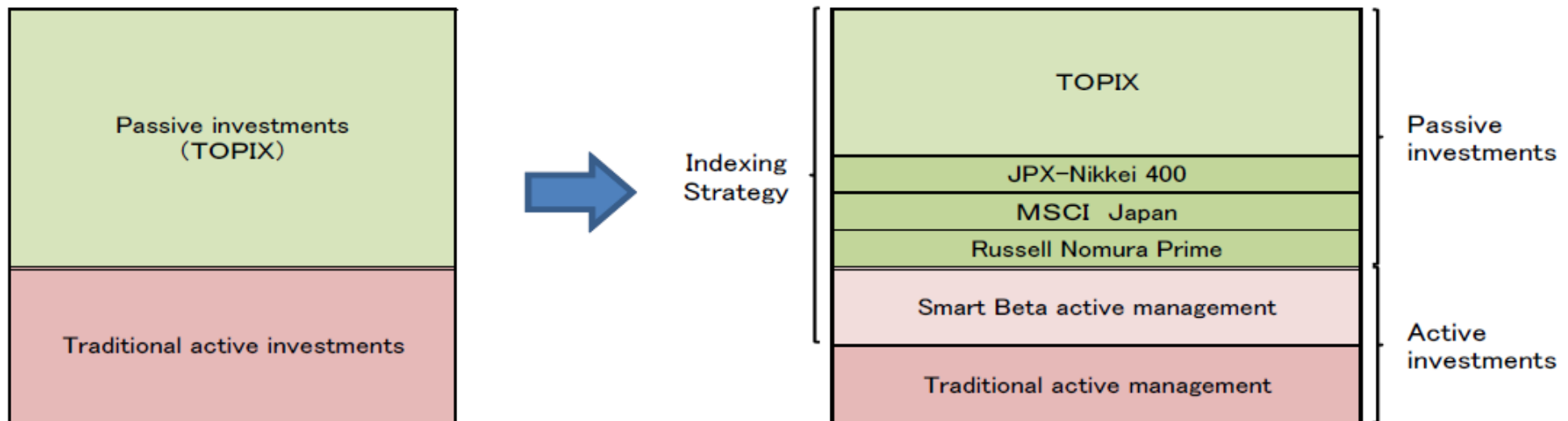
- **Enhancing the governance structure of the GPIF**

- **New investment policy on domestic equity** announced on April 4

To respond to long-term economic changes and secure sound pension finance over an extended period of time, appropriate revisions will be made to the policy asset mix as quickly as possible.

- **Reshuffle GPIF investment committee members** on April 22

appointing multiple full-time members to the investment committee



National Strategic Special Zones

- National Strategic Special Zones (NSSZs) aim to attract FDI and active corporate operations by relaxing regulations in areas such as medical care, employment, agriculture and education.
- Government designated 6 NSSZs in March. Specific action plans are being worked out in each NSSZ.
- Supporting legislative measures are to be taken as necessary to produce results (such as deregulation and tax cuts for CAPEX and R&D) .
- Each zone will trial reforms appropriate to local economic priorities.

6 Strategic Special Zone Projects

Examples of regulatory reforms within National Strategic Special Zones

6 Special Zone Project

International business and innovation hub (Tokyo metropolitan area)

Center for innovation in medical care, entrepreneurial support (Kansai area)

Center for employment system reform for business creation (Fukuoka city)

Center for agricultural reform in large-scale farming (Niigata city)

Center for agricultural reform in hilly and mountainous areas (Yabu, Hyogo Pref.)

Center for international sightseeing (Okinawa prefecture)

Examples of Planned Regulatory Reforms

Relax regulations concerning zoning restrictions and urban development:
(Relaxation of floor area ratio restrictions, streamlining of approval processes for urban planning projects and other permits)

Clarification of employment conditions
(Assist in providing advice at "Employment and Labor Advisory Centers", using "Employment Guidelines" so that global companies and others accurately understand employment rules in Japan)

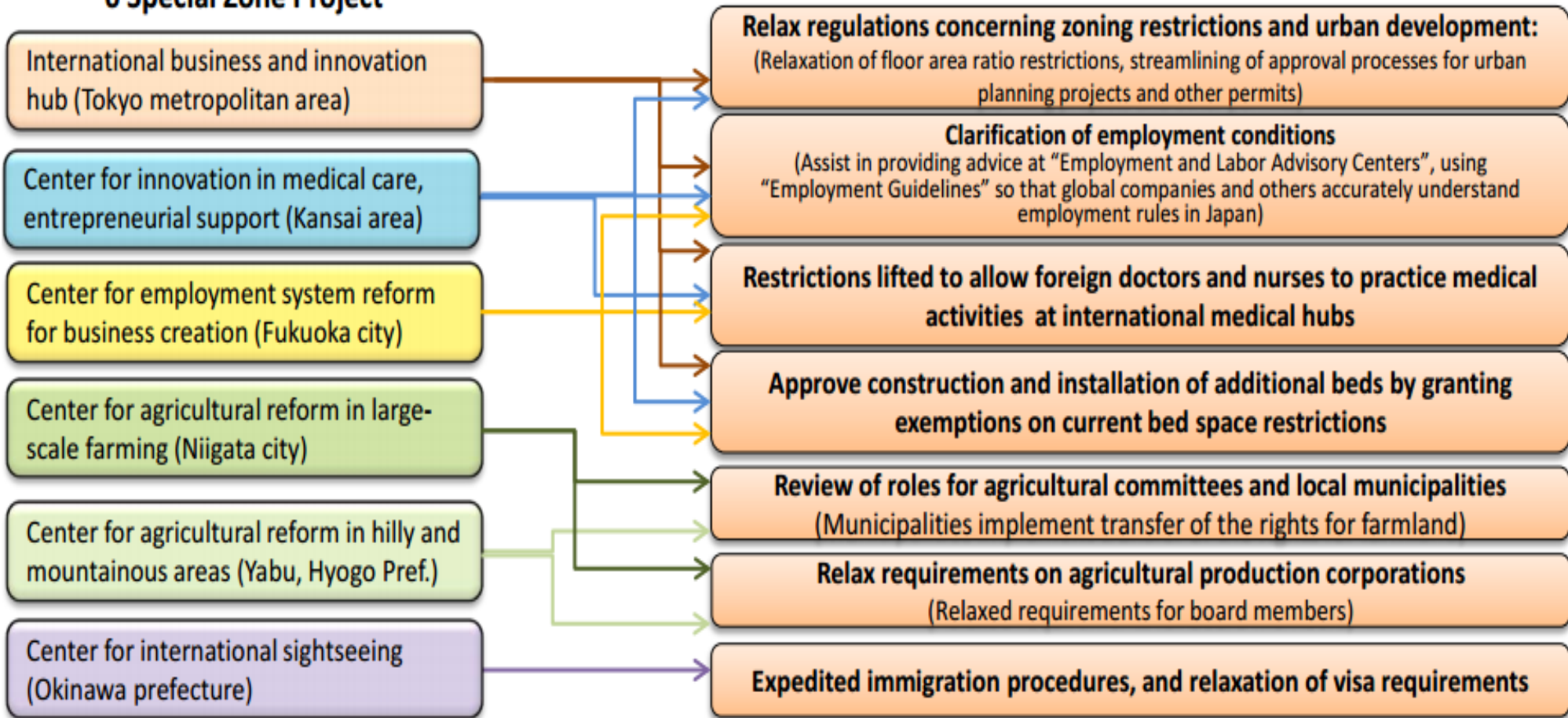
Restrictions lifted to allow foreign doctors and nurses to practice medical activities at international medical hubs

Approve construction and installation of additional beds by granting exemptions on current bed space restrictions

Review of roles for agricultural committees and local municipalities
(Municipalities implement transfer of the rights for farmland)

Relax requirements on agricultural production corporations
(Relaxed requirements for board members)

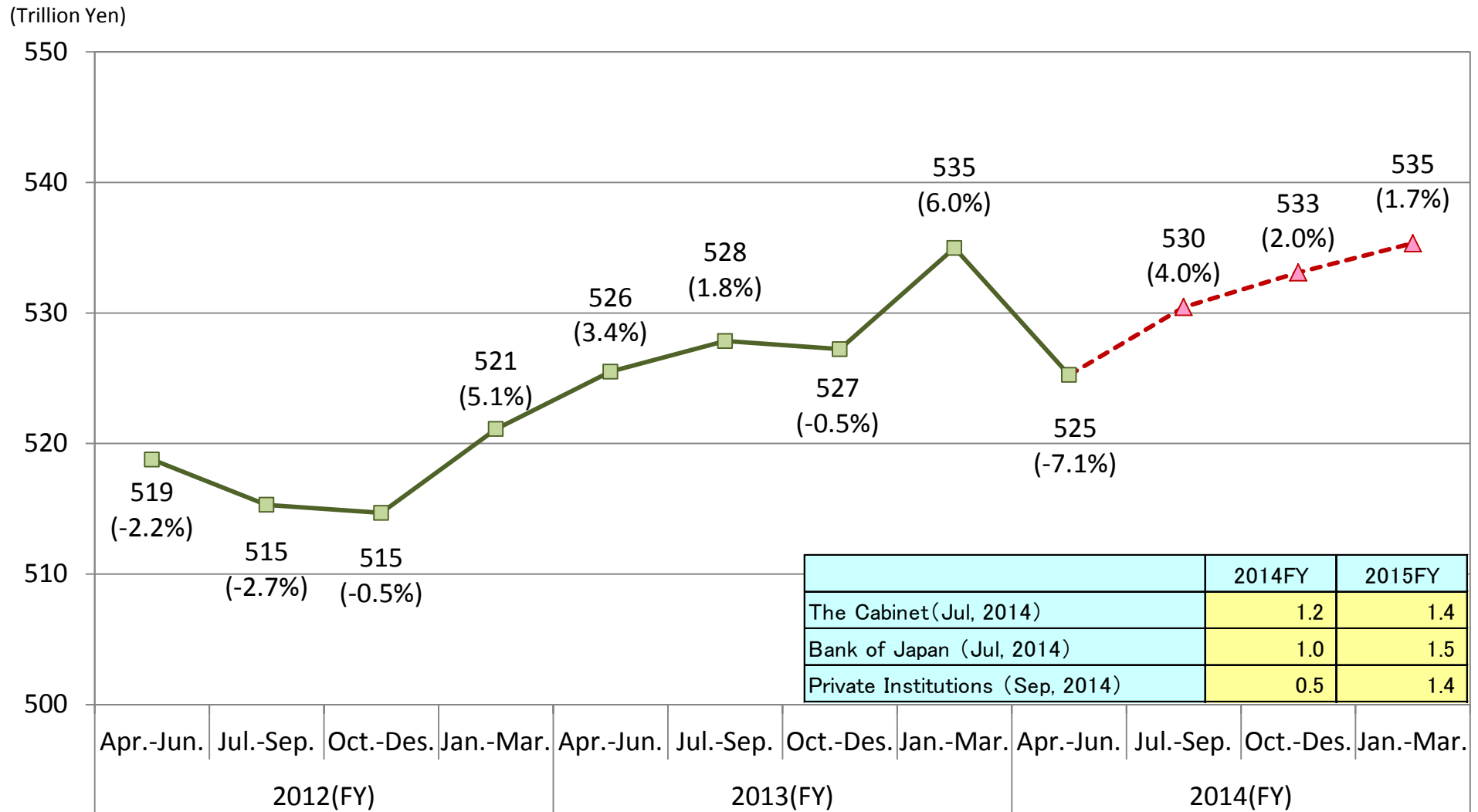
Expedited immigration procedures, and relaxation of visa requirements



Tokyo Metropolitan Area

- **Tokyo is the host of the 2020 Olympics and Paralympics.** Working under this theme, TMG is taking the opportunity to accelerate reforms and get on a growth path towards 2020.
- **Tokyo Metropolitan Area's reforms (announced on October 1st, 2014)**
 - Foreign doctors can treat foreigners and use new drugs.
 - Foreign workers and working mothers can employ foreign housekeepers.
 - Set up one-stop application windows for foreign entities wishing to start up businesses in Tokyo
 - More foreign nursing care staff
- Tokyo Metropolitan Area has also launched “**Initiatives for the Tokyo Global Financial Center.**”

Forecasts of real GDP by leading economists



(Source) "Mid-Year Economic Projection for FY2014" (Cabinet Decision July 22th 2014)

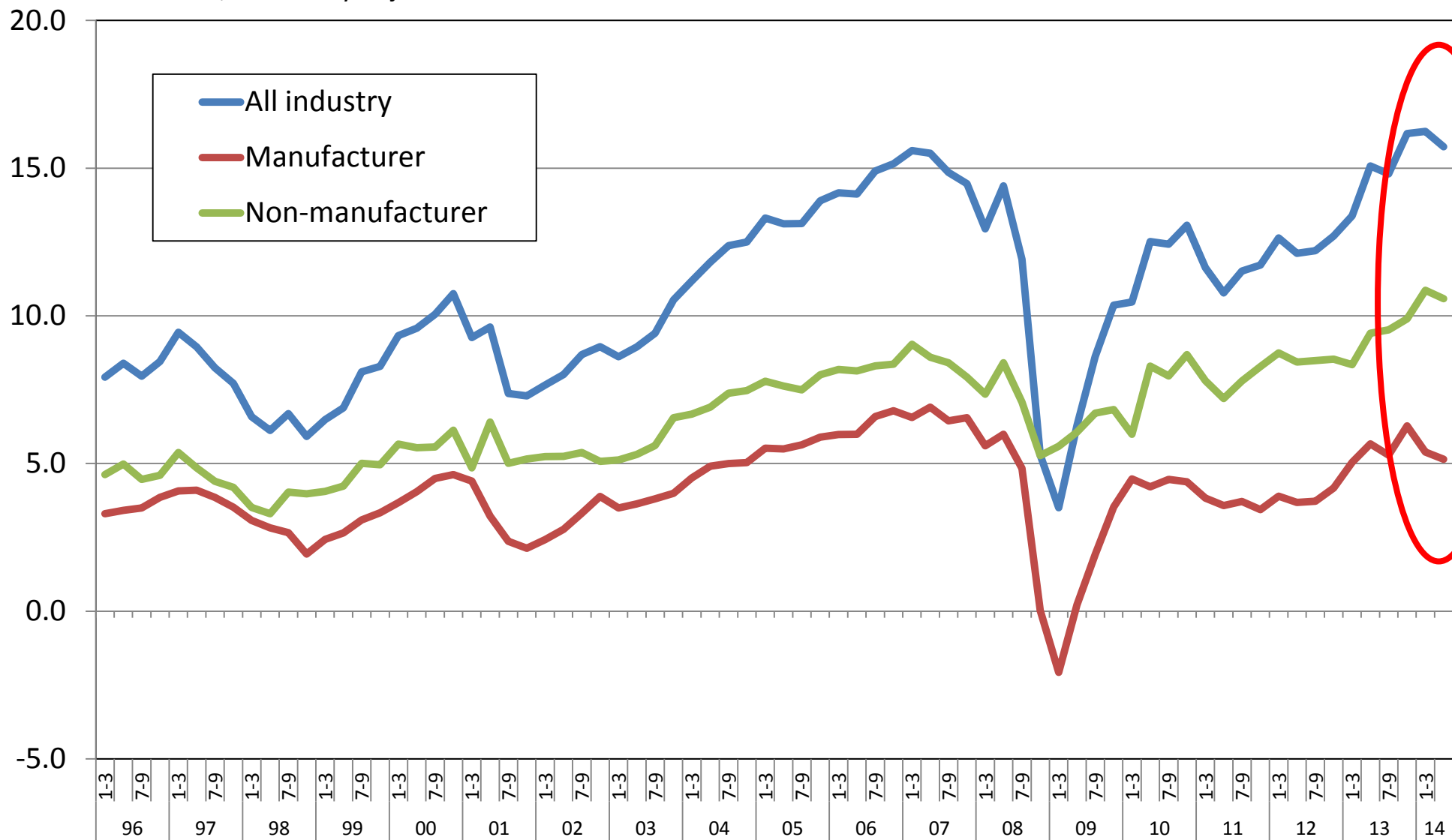
Cabinet Office "National Accounts", Bank of Japan "Outlook for Economic Activity and Prices (interim assessments)" (July 15nd 2014)

Japan Center for Economic Research "ESP Forecast" (September 5th 2014)

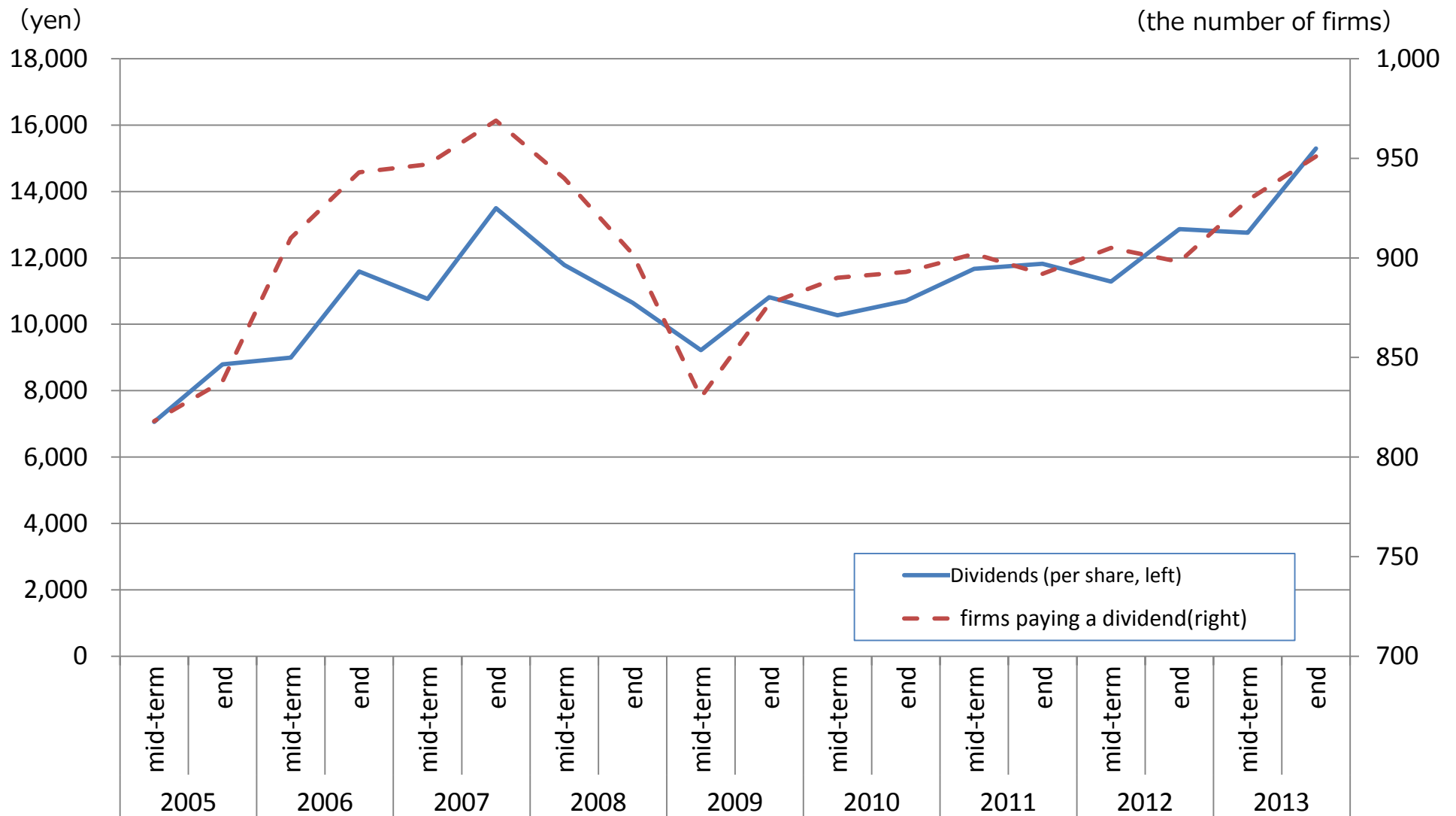
Corporate earnings remain at a high level.

Ordinary income

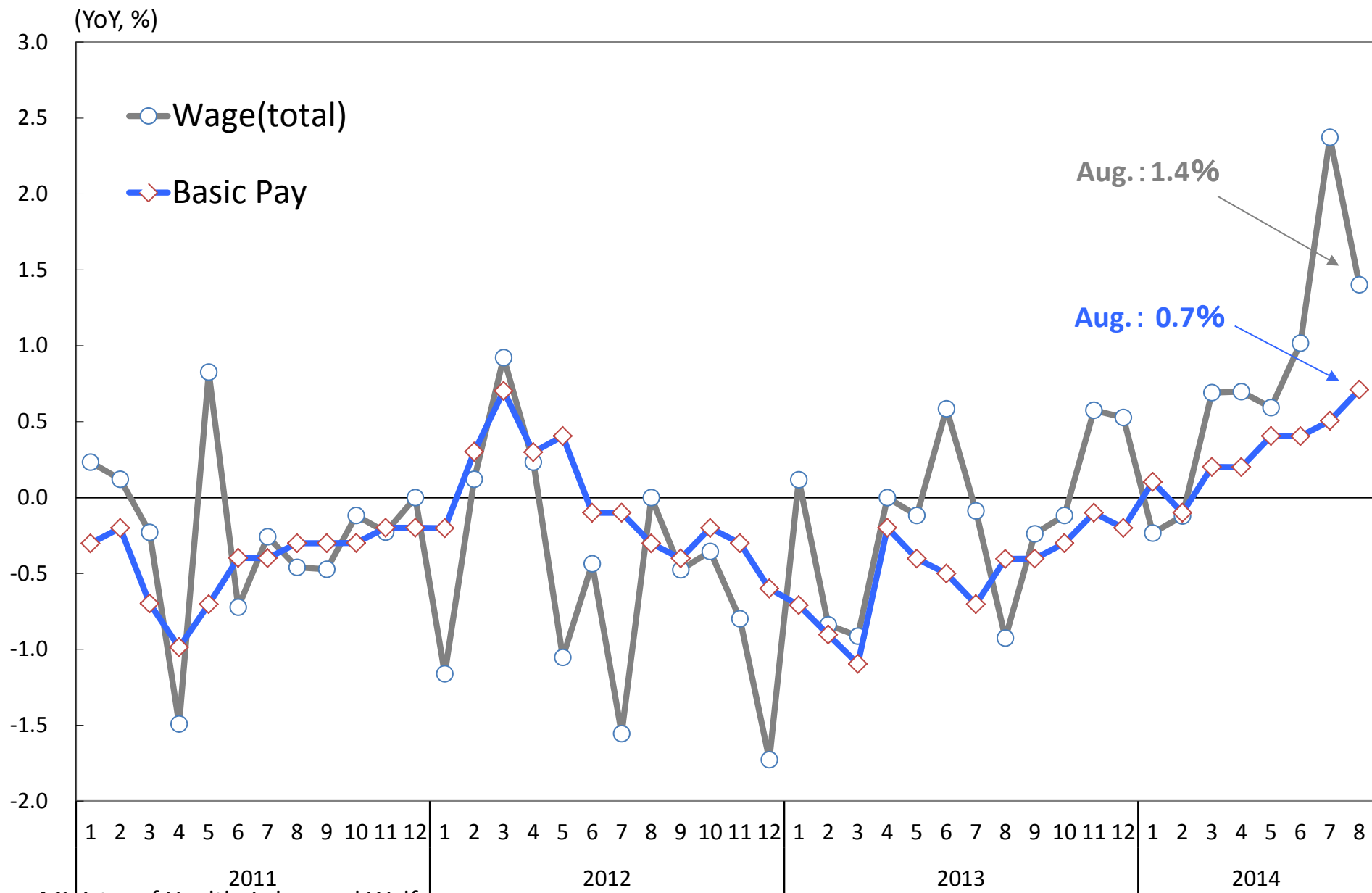
(Trillion Yen , Seasonally Adjusted)



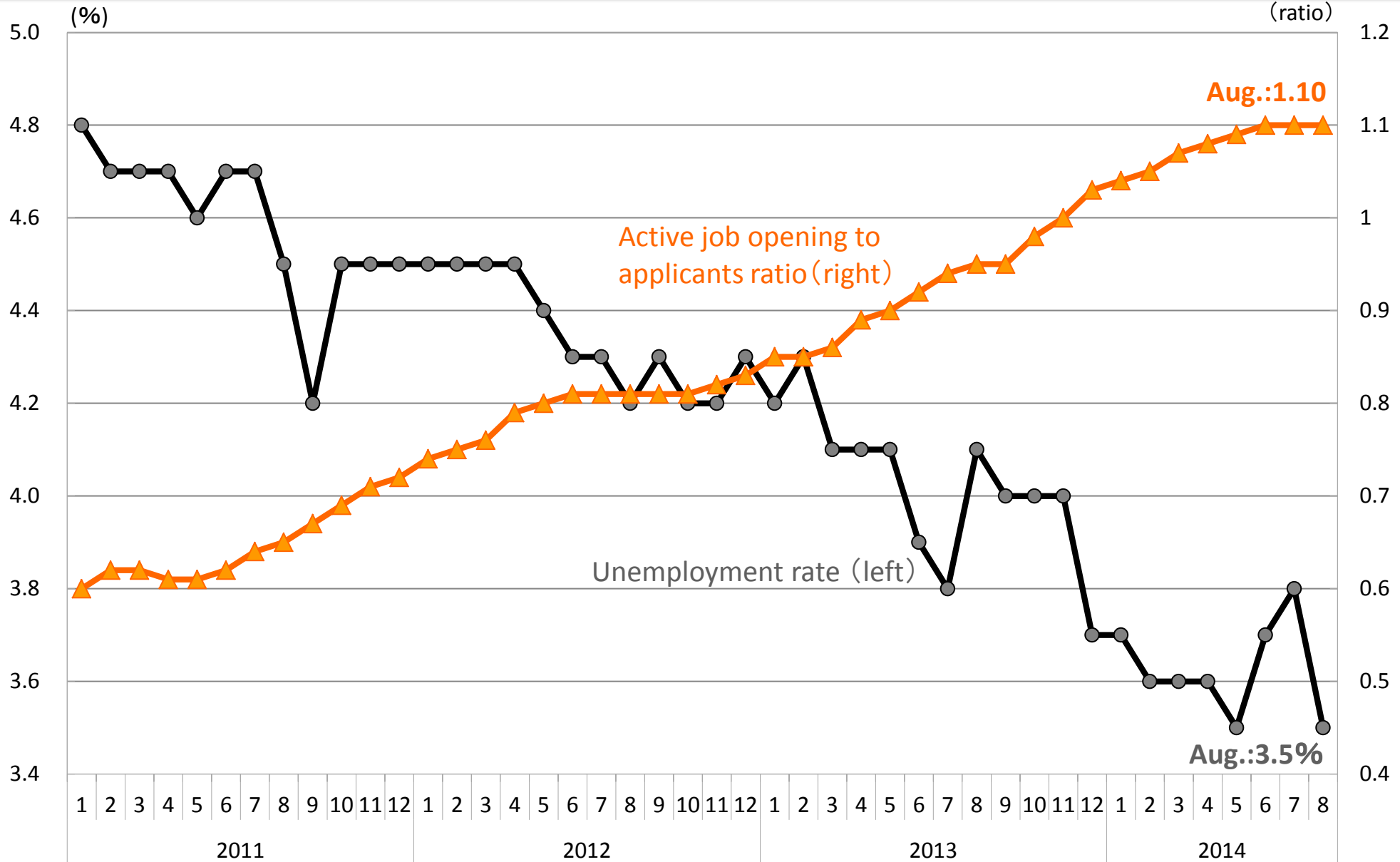
Dividends on stocks are increasing



Wages are gaining momentum further.



Tight labor market



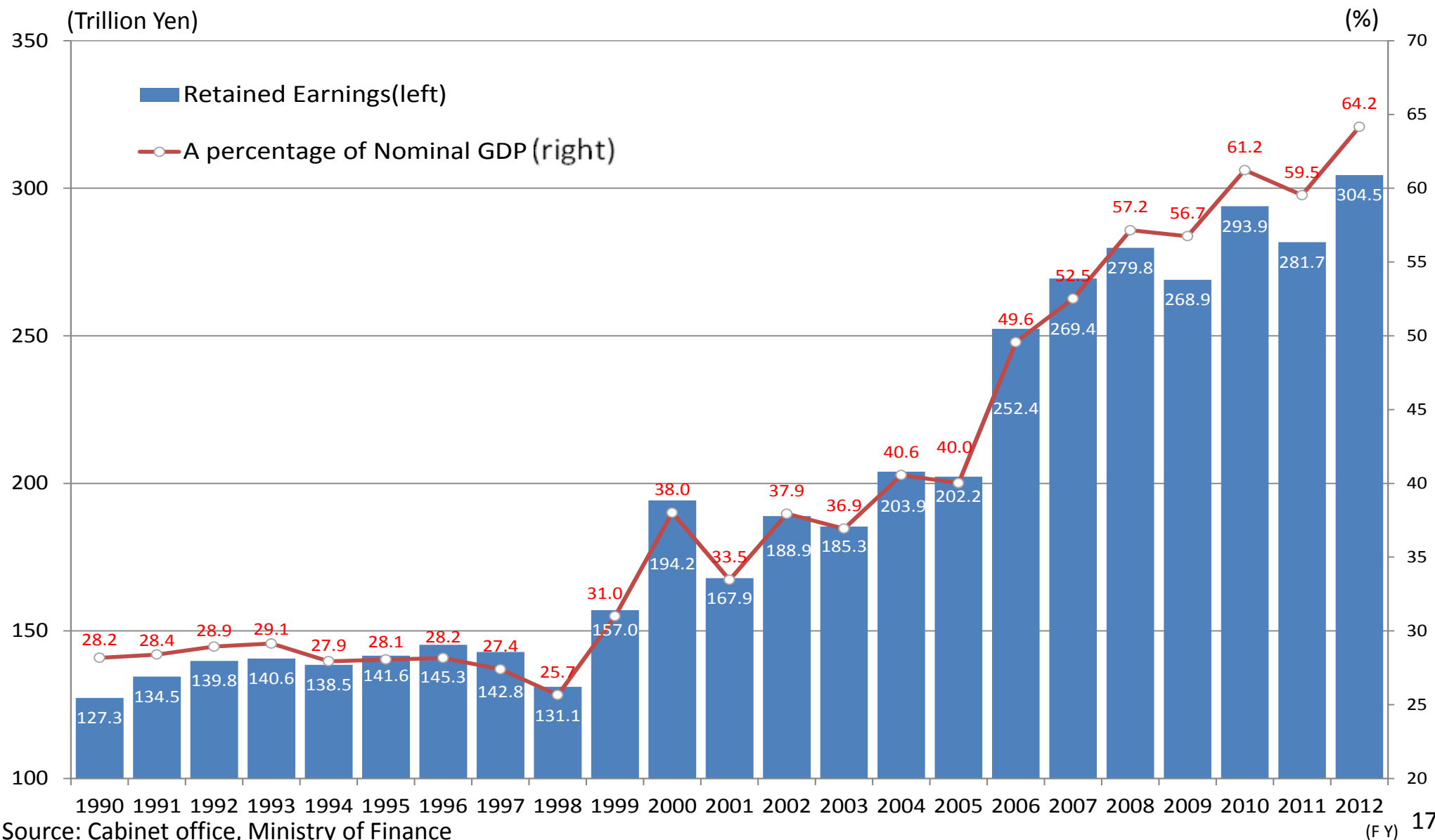
Aug.:3.5%

Aug.:1.10

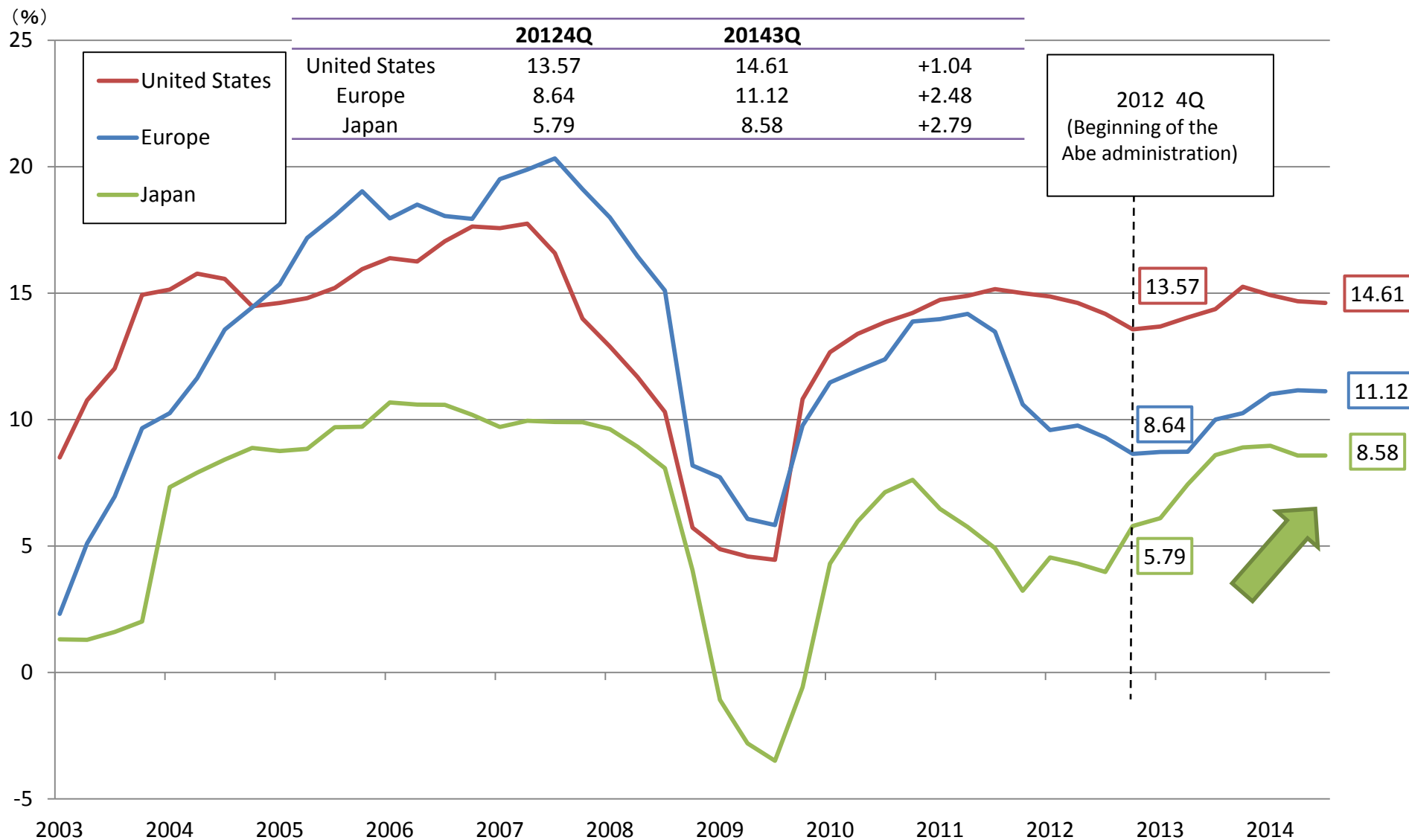
Unemployment rate (left)

Active job opening to applicants ratio (right)

Retained earnings are still rising



Japan's ROE is lower than Europe and the U.S.

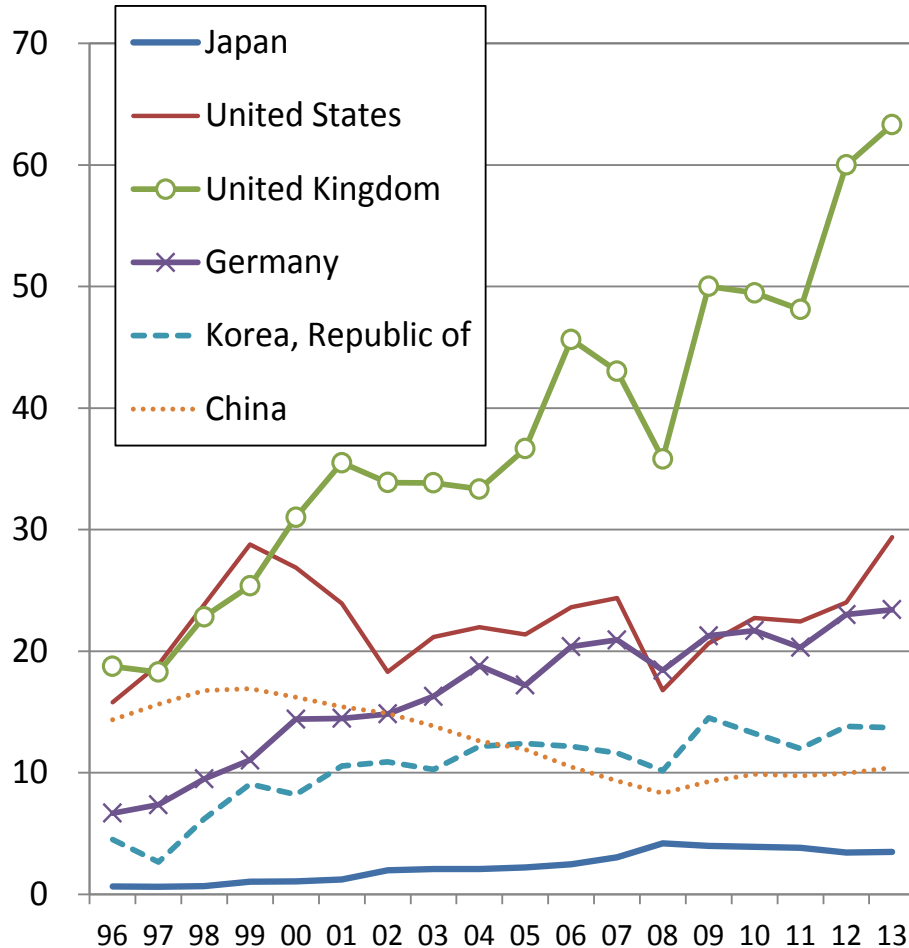


Japan needs to attract much more FDI.

⇒It is crucial to create business-friendly environment.

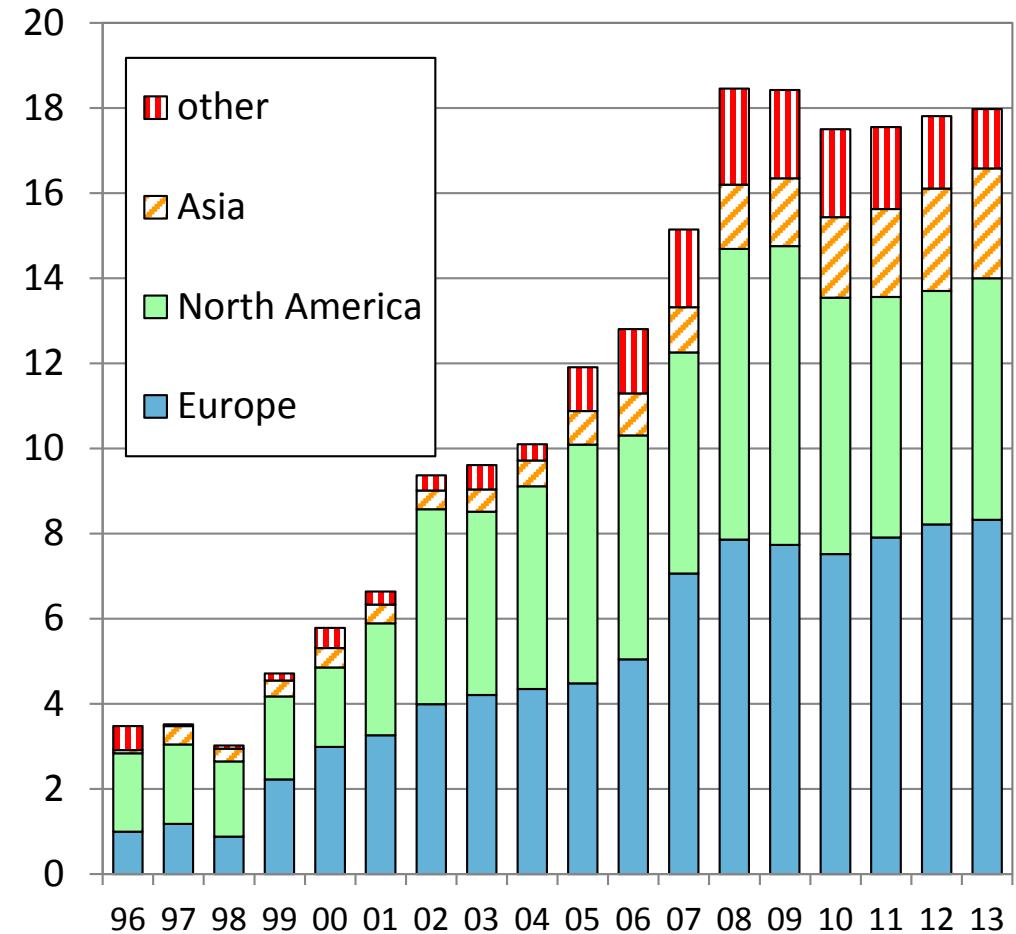
Inward Foreign Direct Investment balance

(%, Ratio to GDP)



Foreign Direct Investment balance in Japan

(Trillion Yen)



Required Growth of the Number of Jobs and Labor Productivity to achieve the real GDP Growth Rate of 2%

	FY1980-2013	FY2014-2040		
	(actual)	(estimate)		
		I	II	III
		Base Case Scenario	Enhance the Labor Force Participation Rate	No Increase in the Rate of Labor Productivity
Real GDP Growth Rate (%)	2.1%	2.0%	2.0%	2.0%
(annual)				
Growth Rate of Labor Productivity (%)	1.7%	2.9%	2.3%	1.7%
(annual)				
Growth Rate of the Number of the Employed Persons (%)	0.4%	-0.9%	-0.3%	0.3%
(annual)				
Increase in the Number of the Employed Persons (Million)	8.0	-14.0	-5.0	6.0
(annual)				

(Notes)

I . Base Case Scenario: Assumed that the labor force participation rates by age groups and gender groups will be unchanged from 2013 levels.

II . Enhance the Labor Force Participation Rate: Assumed that ①By 2040, labor force participation rate of women (25 to 59 years old) will rise at the same level of Sweden in 2010. ②By 2040, labor force participation rate of elderly (60 to 64 years old) will rise at the same level of age group of 55 to 59 years old in current , and labor force participation rate of age group of 65 and over will increase in the same pace with age group of 60 to 64.

III . No Increase in Rate of Labor Productivity: Assumed that there will be no change in the rate of labor productivity, compared with the average growth rate of labor productivity by FY1980 to 2013 .

(Source) Cabinet Office, Ministry of Internal Affairs and Communications, National Institute of Population and Social Security Research, etc.

Key Points of Japanese Growth Strategy and Fiscal Consolidation

1. Regaining the “earning power” (productivity and profitability)

- Corporate governance, Provision of risk capital & Corporate Tax
- National Strategic Special Zones
- GPIF reform
- Creation of new markets (healthcare and agriculture)

2. Enhancing human resources

- Mitigating the impact of aging population
- Labor market reform
- Foreign workers
- Promoting women's participation

3. Fiscal consolidation

- Fiscal consolidation targets
- Social security reform
- Consumption tax rate hike to 10%

1. Regaining the “earning power” of the Japanese Economy

① Japan will raise its productivity and profitability

1) Strengthening corporate governance for pro-growth corporate decisions

- Outside directors, the Stewardship Code, and JPX-Nikkei 400
- “Corporate Governance Code” by mid 2015.

2) Supporting environment for pro-growth business activities

- Creating an environment that makes more entries and exits happen
---institutional and financial vehicles to support restructuring and M&A.

② Japan will make changes for a more business-friendly environment

1) Pro-growth corporate tax reform

- Aim to reduce effective corporate tax rate from current 35% to below 30%. We will start the first phase of reduction from the next fiscal year.

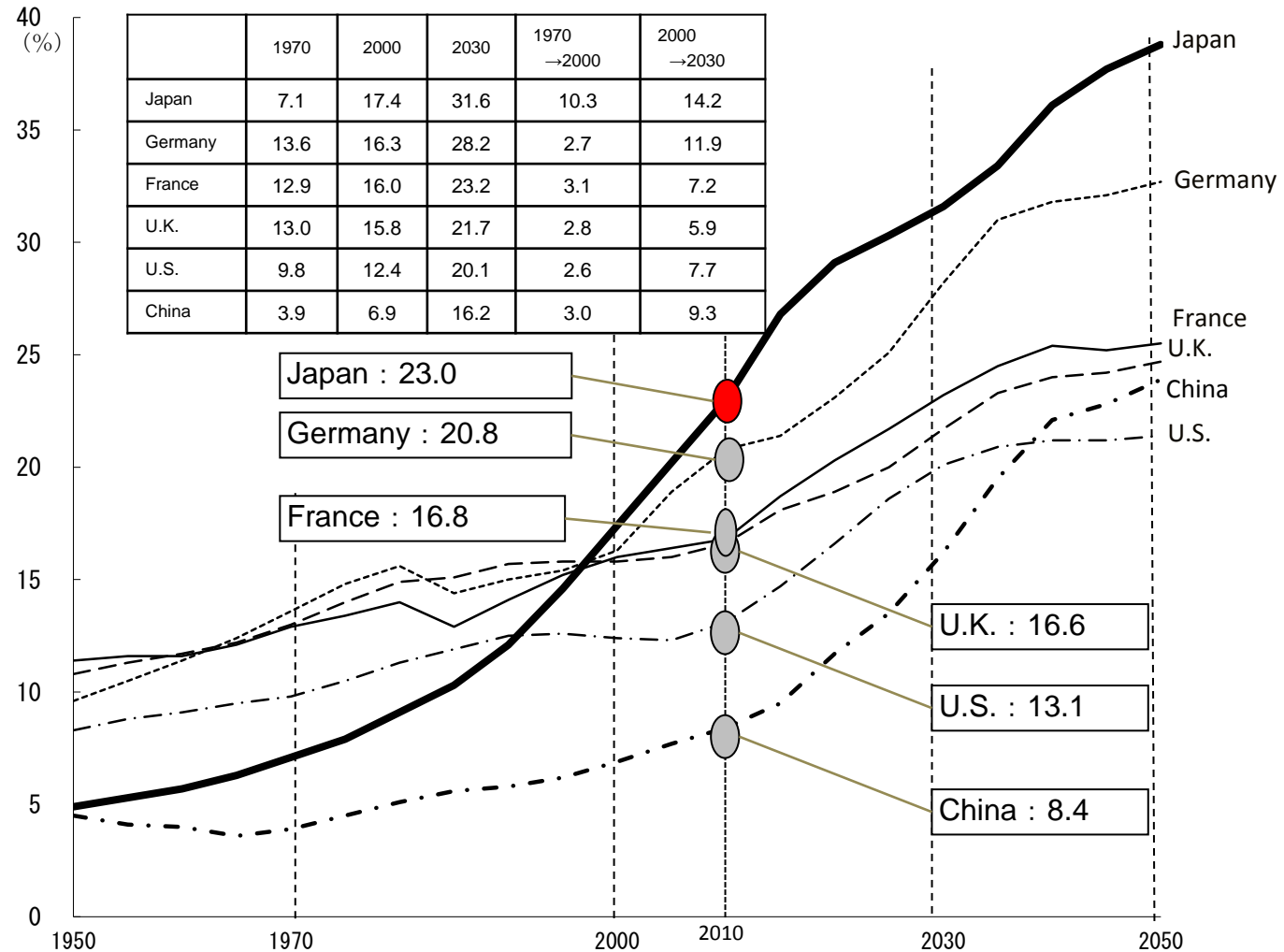
2) Electricity business reform & agriculture reform

2. Enhancing human resources

- *A new initiative has been kick-started to raise the birth rate and stop the trend of declining population from local level.*
- The birth rate in Tokyo is only 1.1, while the national average is around 1.4.
- Aging population: To maintain a stable population of around 100 million in 50 years, innovative countermeasures against the falling birth rates, including focused assistance for third and subsequent children, will be implemented.
- In July, 2014, Prime Minister Abe instructed relevant ministers to work together to reinvigorate local communities, local people and local businesses, with the main objective of stopping the declining trend of population
- “The long-term vision” will be drawn up by year-end.

Birth rate is declining and aging population progresses.

Ratio of People Older than 65 years to the Total Population



(Source) Japan 1950-2010: "National Census" (Ministry of Internal Affairs and Communications)
 2011-2050: "Japanese Future Demographic Projections" (National Institute of Population and Social Security Research) (January, 2012)
 Other countries: "World Population Prospects: the 2012 Revision" (United Nations)

(CY)

2. Enhancing human resources

- *Japan will carry out labor market reform and promote more participation of women and foreign people to mitigate the impact of demographic change.*
- **Labor market reform** : Building a more flexible employment system.
 - A new wage system (“**white-collar exemption**”) focusing more on the performance than the working hours will be introduced.
- **Establishing friendly environment for foreign workers**
 - The training programs for foreign workers will be expanded (time period, etc.) in the construction and shipbuilding sectors.
 - Action will be taken to bring foreign housekeepers in NSSZs.

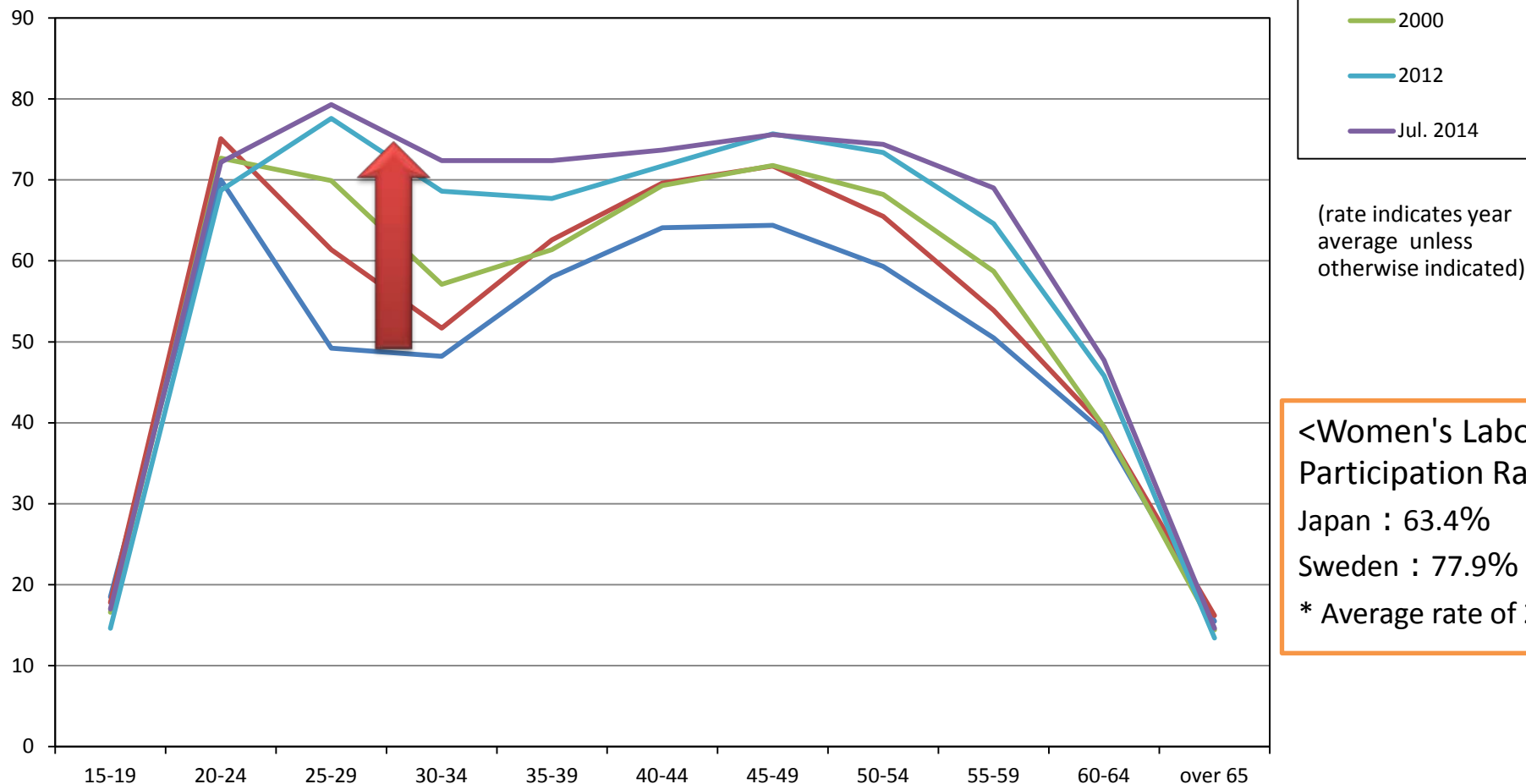
2. Enhancing human resources

● Assisting women wishing to work

- After-school programs for school-age children will be expanded, to accommodate additional 300,000 by end-FY2019
- Modifying tax and pension rules that currently favor stay-at-home wives over working women will be discussed at the Council on Economic and Fiscal Policy.
- The government set a target that “30% share of leading positions will be taken by women by 2020.” Components and action plans of new legislation will be worked out by end-FY2014.

Women's Participation in the Labor Market

Women's Labor Force Participation Rate



<Women's Labor Force Participation Rate >
Japan : 63.4%
Sweden : 77.9%
* Average rate of 2012

3. Fiscal consolidation

- **Fiscal consolidation targets :**

The FY2015 target is to halve the primary deficit. We will discuss a clear trajectory to **achieving primary surplus by FY 2020** expeditiously following the formulation of the FY 2015 budget.

- **Social security :**

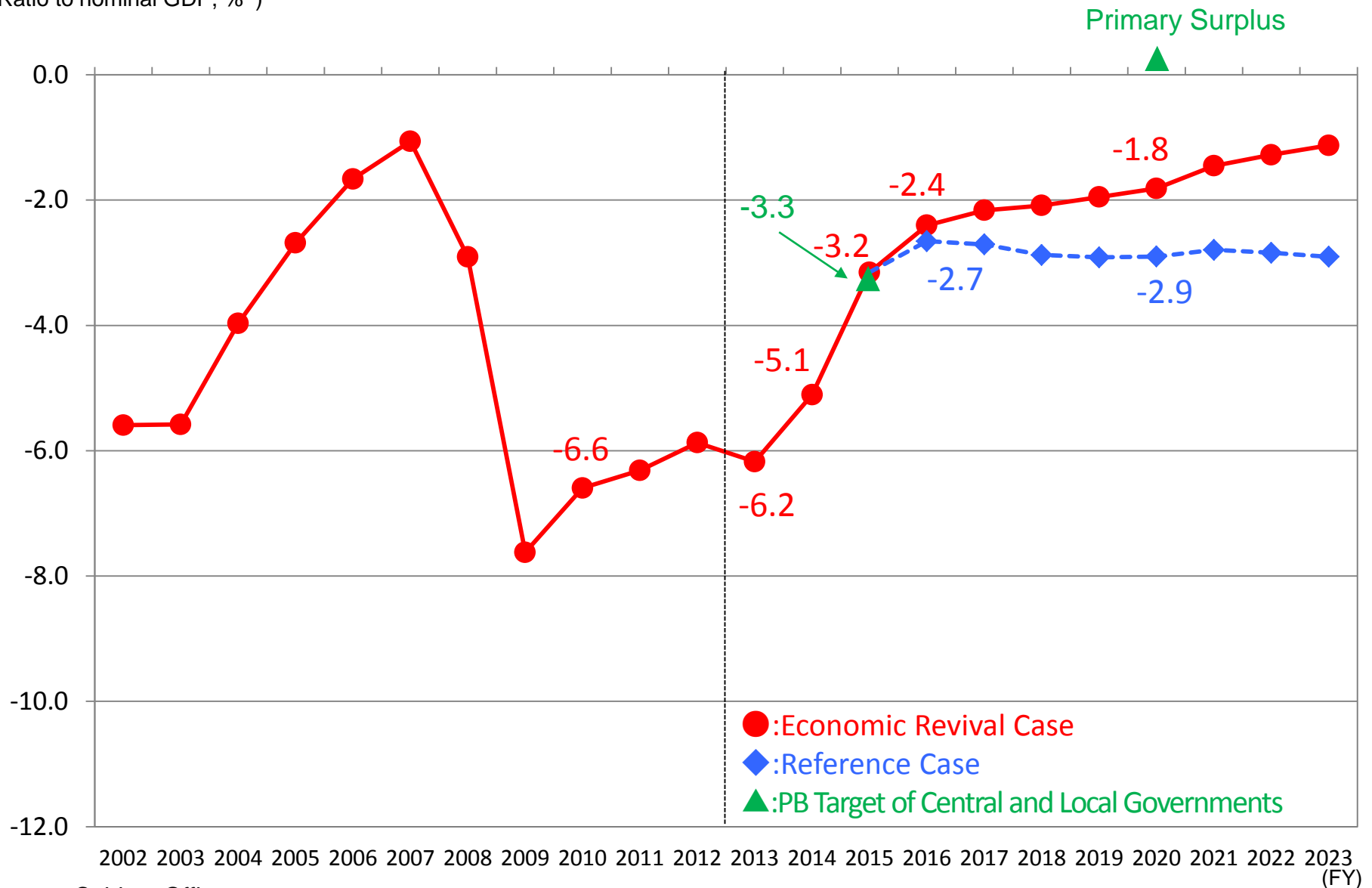
To address the rising social security expenses, individual financial burdens should reflect individual financial ability to pay, to ensure “fairness” across and within generations.

- **Consumption tax rate hike to 10% :**

A decision whether to **raise the consumption tax rate from 8% to 10%** will be made by the end of 2014.

Primary Balance of the Central and Local Governments

(Ratio to nominal GDP, %)



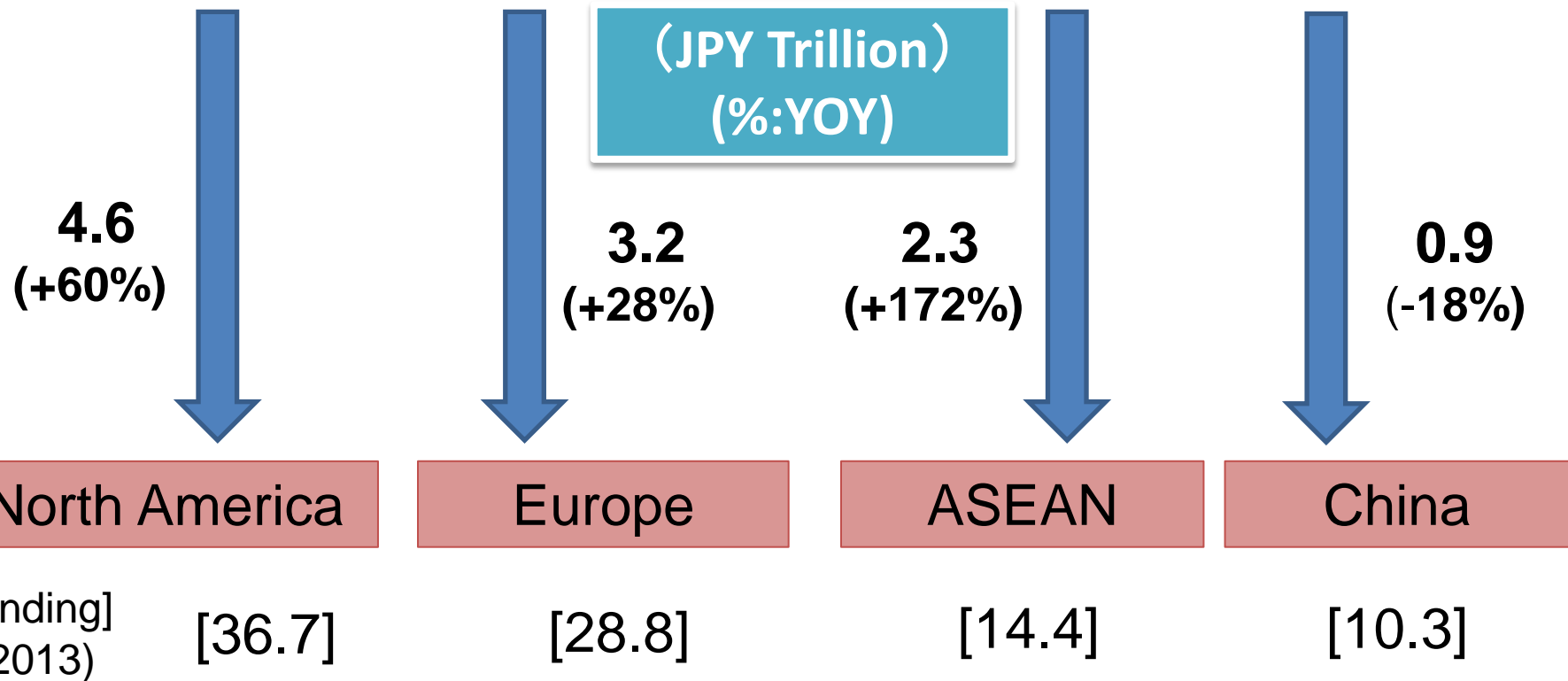
Source: Cabinet Office

Proactive Corporate Moves

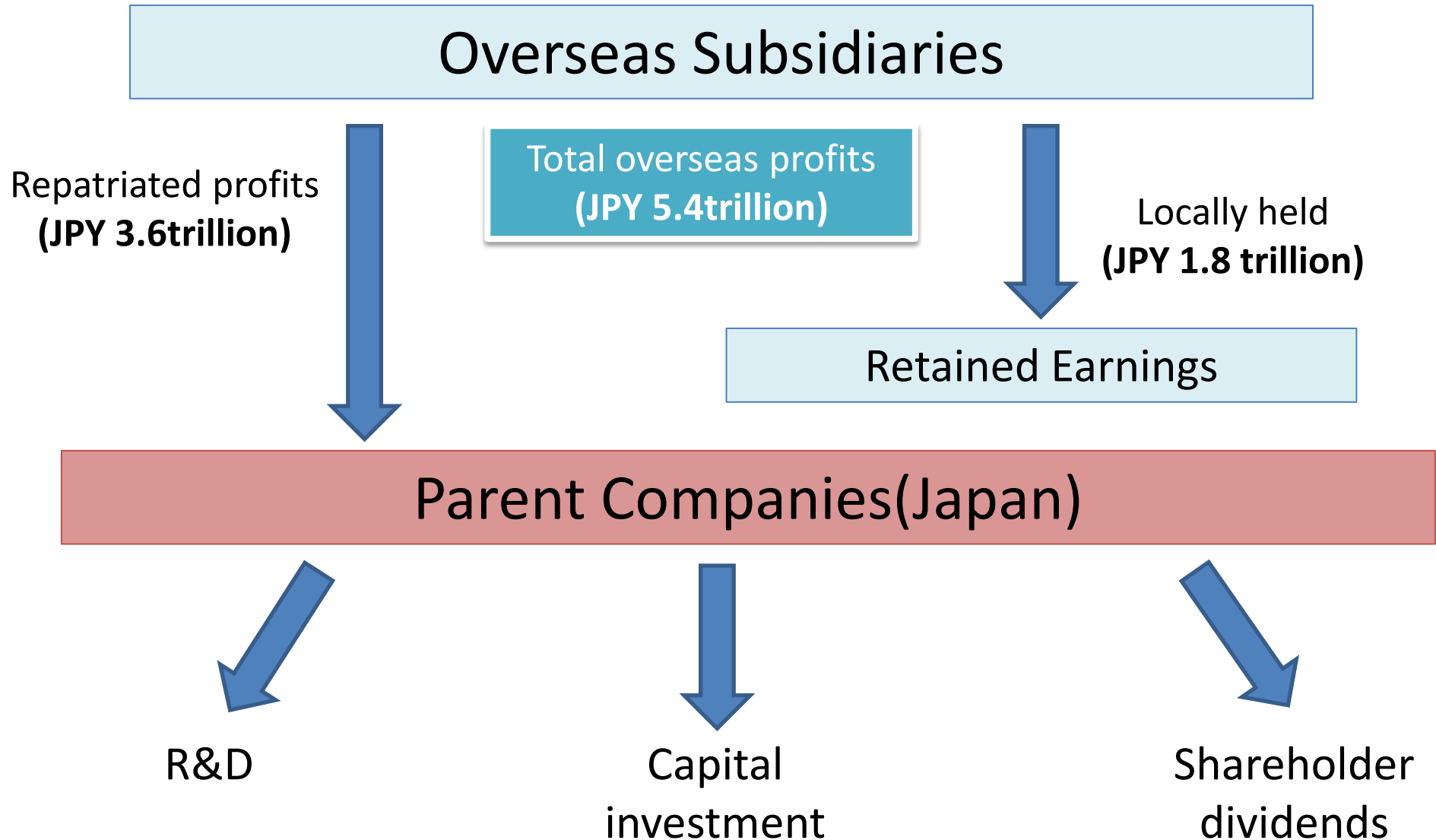
- **Abenomics** has triggered already deep-rooted changes in the economy.
 1. **Japanese corporations are now ready to take more risks**, rather than hoarding cash, building a foundation for higher profitability.
 2. Tighter labor market has led to **new emerging changes, including a shift to regular (full-time) employees and higher labor participation by women and elderly people**, partially offsetting the impact of the aging population.
- **The switch to inflationary environment** has changed the mindset of Japanese corporations for **higher productivity and profitability**.
- **Actual changes**: Japanese corporations now
 - 1) expand business in foreign markets; and
 - 2) borrow more from banks, including SMEs.
 - 3) Invest in human capital.

1. Expanding business in foreign markets

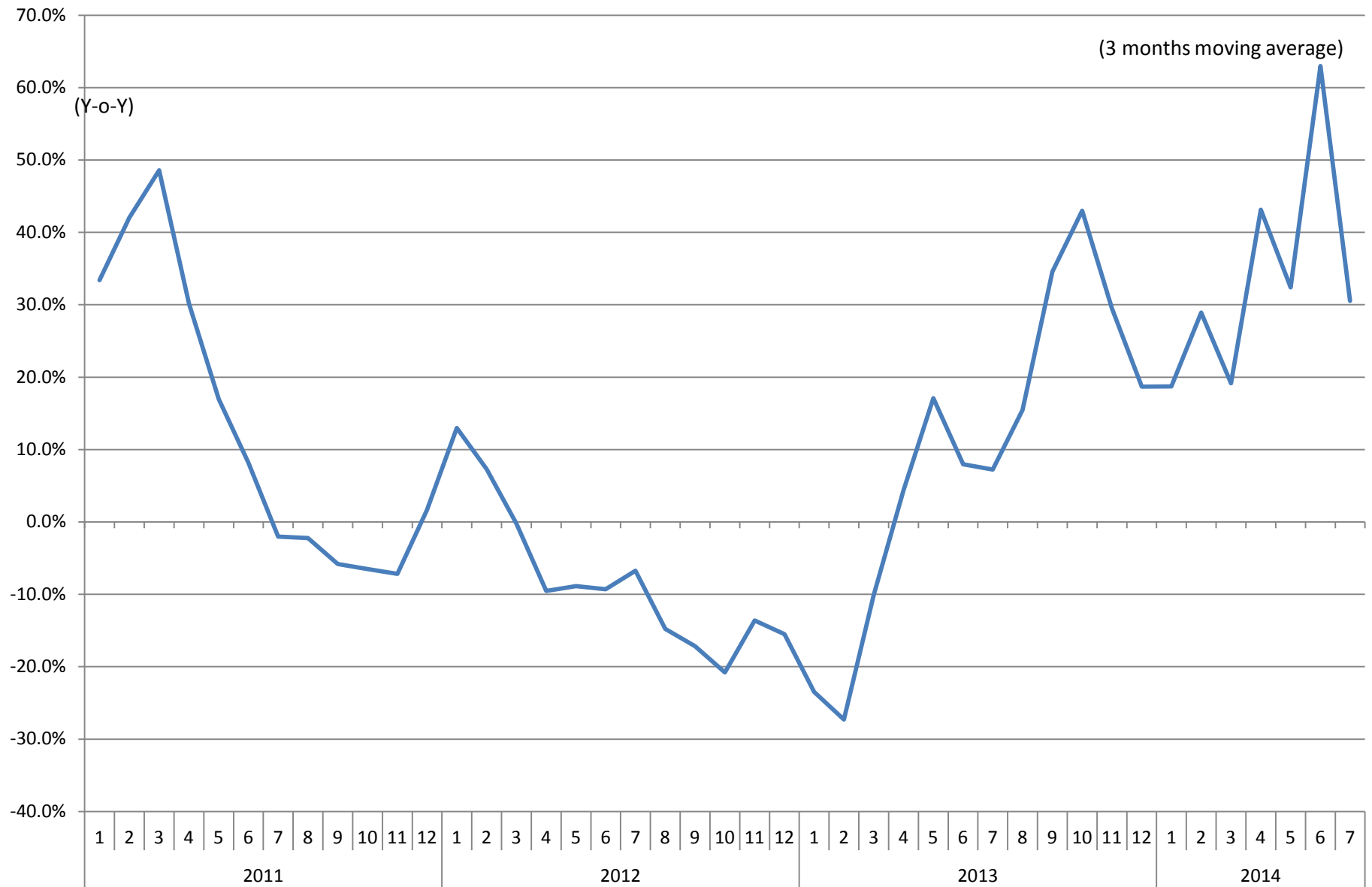
FDI outflows from Japan (total: JPY 9.6 trillion (CY2012)⇒13.4 trillion (CY2013))



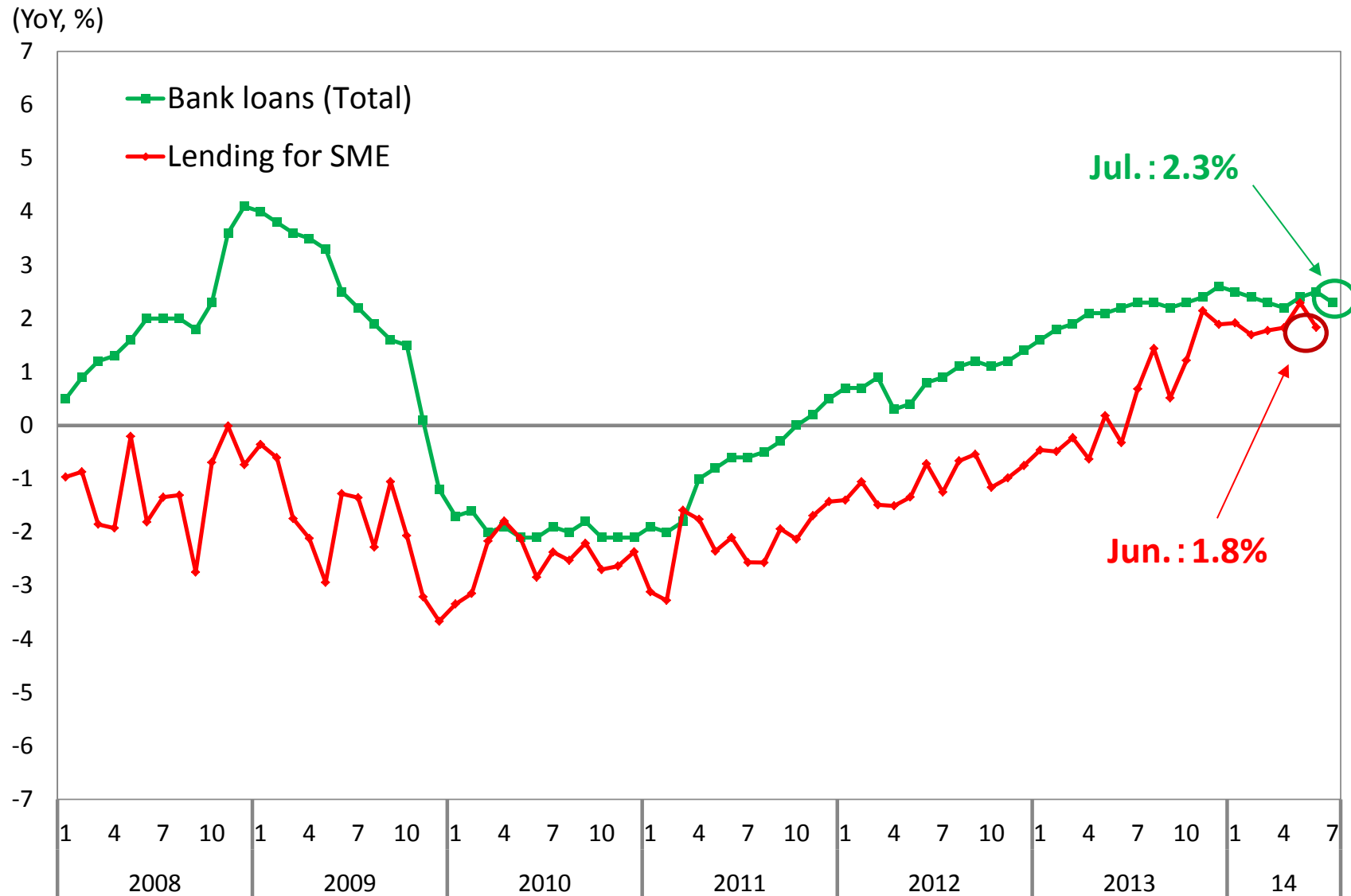
Japanese companies repatriate more overseas profits



Orders received for machinery from overseas



2. Borrowing more from banks

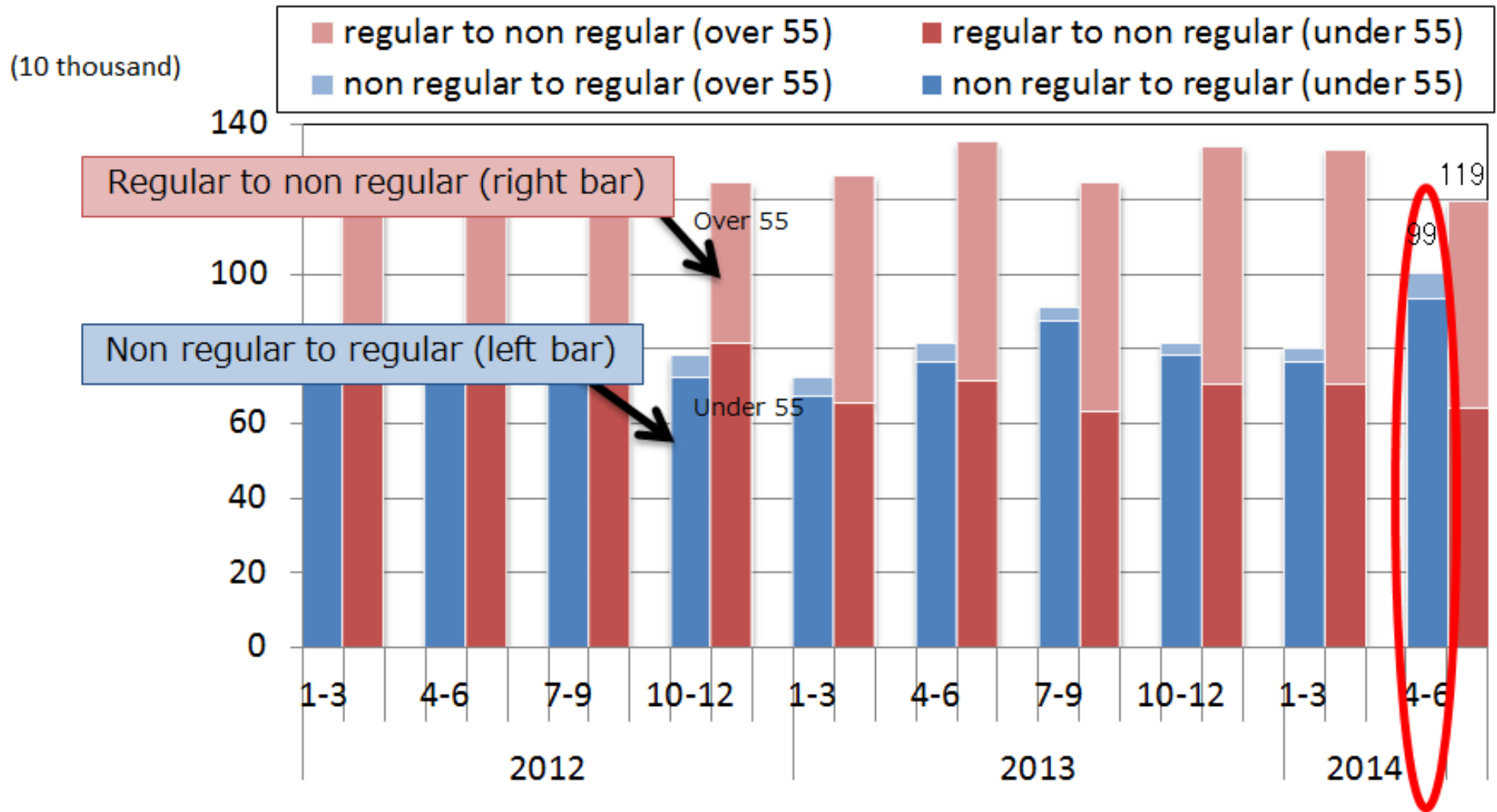


3. Investing in human capital

- Under the favorable economic climate and tighter labor market,
- More investment to enhance professional skills of staff
- Widespread moves to switch contract workers to full-time
 - ✓ ANA: All the newly employed flight attendants have been full-time. (Currently 3,200 out of 5,000 are full-time.)
 - ✓ Starbucks: All the 800 contract workers have been converted to regular employees.
 - ✓ BTMU: Job terms for temporary workers can be extended to age 60 if they so wish.

Shift to regular employment

Employers who have changed their job in 3 years



Source: Ministry of Internal Affairs and Communications

More Reforms, More Growth

- Continued reforms in line with a constantly evolving Growth Strategy are essential.
- The aim of the revision of “Japan Revitalization Strategy” is to provide basic guidance for remaining tasks, focusing on the 10 key reforms.

