

2012 lakkyara

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XBRL could potentially improve efficiency of shareholder voting

Voting by institutional investors is seen as a promising means of monitoring corporate governance and enhancing investee companies' value, but institutional investors face time and cost constraints in exercising their voting rights. Greater use of electronic disclosure of corporate information should improve the efficiency of shareholder voting and facilitate decision-making on important shareholder resolutions.

Shareholder voting by institutional investors has recently been garnering considerable attention. One factor behind this attention is that rules regarding mandatory disclosure of asset management companies' voting decisions were revised in 2010. Other contributing factors include expectations that institutional investors will fulfill a societal role as overseers of corporate governance and a growing propensity among institutional investors to act in the aim of enhancing the corporate value of their long-term portfolio holdings.

Currently, however, shareholder voting in Japan is hindered by a number of practical difficulties. Additionally, institutional investors are subject to cost and time constraints in exercising their voting rights. Shareholder voting has consequently yet to live up to its promise as an effective instrument of corporate governance. In this paper, I summarize the practical challenges that institutional investors face in terms of voting and propose solutions to these challenges.

Current state of shareholder voting and issues to be addressed

There are three main practical impediments to shareholder voting in Japan. First, electronic voting is not yet widespread. Voting is consequently time-consuming, resulting in tight time constraints. Second, companies' annual general meetings (AGM) of shareholders tend to be heavily clustered on certain dates, limiting the time and resources that institutional investors can devote to individual companies. Third, Japanese companies typically put many shareholder resolutions on the agenda at their AGMs. Some of these resolutions require shareholders to make decisions based on thorough knowledge of the company's circumstances.

I will first explain the current shareholder voting process and the sources from which shareholders can obtain information needed to vote. Currently, companies send shareholders proxy materials, including the text of shareholder resolutions to be voted on at their AGMs, after filing their earning digests with the stock exchanges. In addition to the resolutions, the proxy materials also include reports to shareholders (on the status of operations in general, status of individual businesses, capital investment, risk management, major subsidiaries' status, workforce status, status of directors and corporate auditors, dividends, financial statements, independent auditor's report, and matters related to corporate governance and the company's shares).

In Japan, many companies and institutional investors do not yet have platforms for electronically exchanging voting-related information¹⁾. Instead, they still send and receive information on shareholder resolutions and voting decisions by mail. Asset management companies are generally slow to receive proxy materials because the materials are first sent to the nominal shareholder, typically a trust bank, and then forwarded to the institutional investor. In the case of funds that invest overseas, proxy materials are forwarded by overseas custodians and take up to 10 days to reach the asset management company. Japanese companies have recently been expediting distribution of proxy materials by releasing them in PDF format via the Tokyo Stock Exchange's TDnet timely disclosure system and the FSA's EDINET disclosure system. Nonetheless, if an electronic voting platform is not available, institutional investors still must allow for transit time to return their completed voting documents to the company, limiting the time available for them to deliberate on shareholder resolutions based on the voluminous information contained in proxy materials. However, electronic voting is unlikely to soon gain widespread prevalence, largely due to cost

factors. This is the first issue that needs to be addressed.

The second issue is the timing of AGMs. In Japan, 68%²⁾ of companies have a March fiscal year-end and most of these companies hold their AGMs in late June. Institutional investors consequently must cast votes for numerous companies' shareholder resolutions at the same time. This schedule imposes a heavy burden on asset management companies.

Additionally, Japanese companies tend to have more shareholder resolutions on their AGM agendas than their counterparts in the US and other countries. Their shareholder resolutions also often require sophisticated judgment. In the case of resolutions regarding appropriation of retained earnings, for example, shareholders should take into consideration historical data in addition to information contained in proxy materials when assessing whether using retained earnings to fund long-term investments instead of paying dividends is likely to lead to long-term appreciation in shareholder value. However, making such decisions quantitatively by obtaining the requisite data and utilizing analytical software is of course time-consuming and costly. This is the third issue.

Needed infrastructure

What do institutional investors need to make optimal voting decisions within tight time constraints without incurring undue costs? One possible approach is to gather data on shareholder resolutions' content and portfolio companies' current status, pre-sort resolutions between those that can be voted on automatically and those whose subject matter requires discretionary judgment, and set aside sufficient time to conduct due diligence on the latter.

Many asset management companies disclose their voting policies on their websites. In most cases, asset management companies are able to make voting decisions based on information publicly disclosed by investee companies, such as their earnings performance in recent years and whether they have nonexecutive directors, anti-takeover defenses, and retained earnings appropriation

policies. The information required to make such decisions is currently available from EDINET and TDnet³⁾. Since 2008, both EDINET and TDnet require the financial statement portion of companies' disclosure filings to be prepared in XBRL⁴⁾ format. Sales and other financial statement information can be directly obtained as data from such filings. The Tokyo Stock Exchange has installed a system that automatically prepares XBRL data whenever a listed company files a corporate governance report. By virtue of this system, information on anti-takeover defenses and nonexecutive directors is also available as data.

The FSA plans to upgrade EDINET by 2013. The upgrade will expand the scope of available XBRL data beyond annual securities filings' financial statement content. Additionally, the FSA plans to require reports of large shareholdings and information on share buybacks and other such matters to also be filed in XBRL format. Such information will thus also become available as data.

Proxy materials are currently filed in PDF format but compiling them in XBRL format is technically feasible given that their content is very similar to annual securities reports. If proxy materials become subject to XBRL filing requirements in the future, corporate information would become available in a uniform data architecture from the proxy materials stage onward. Such data architecture should enable institutional investors to automatically compare identically labeled data from past shareholder resolutions and financial statements and identify resolutions that they wish to vote in favor of. This approach should help institutional investors free up sufficient time to make deliberate decisions on shareholder resolutions that require further scrutiny.

Benefits of improving voting efficiency

Building appropriate infrastructure also has the potential to help institutional investors exercise their voting rights more effectively. For example, in the case of an asset management company that passively manages funds that hold upwards of 1,000 different stocks, if 70% of its investee companies send out proxy materials at around same time and each one contains multiple shareholder



resolutions, adequately reviewing all of the resolutions would be extremely time-consuming and costly. The asset management company would face a dilemma. On one hand, as a long-term investor, it rightfully wants to vote in a manner conducive to enhancement of shareholder value. On the other hand, minimizing fund-management expenses is another important priority. If the infrastructure described above were available, asset management companies could screen for stocks that meet certain risk criteria, thoroughly review the state of their management and their policies, and decide whether to vote for or against shareholder resolutions endorsed by management.

In recent years, considerable progress has been made in establishing disclosure-related infrastructure. I would like to see more active discussion among concerned parties regarding how to best utilize this infrastructure. I hope that societal infrastructure that helps investors evaluate companies and exercise their voting rights more efficiently is developed further and gains widespread recognition.

Note

- 1) Voting platforms are information systems that enable institutional investors that are beneficial, not registered, shareholders to electronically obtain the text of shareholder resolutions online and submit voting instructions.
- 2) Of 3,724 listed companies as of February 2012, 2,540 (68%) have a fiscal year that ends on March 31.
- 3) After completion of the AGM, reports contained in the text of shareholder resolutions are reprinted largely verbatim in annual securities filings and published on EDINET together with external auditor reports, AGM proxy materials, and notices of voting results.
- 4) XBRL (eXtensible Business Reporting Language) is an XML-based language standardized to facilitate preparation, distribution, and use of information for financial reporting purposes.

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