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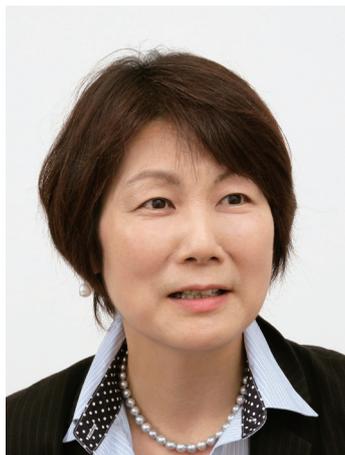
The role of investor relations in enhancing business value

- Interview with Yoshiko Sato by Sadakazu Osaki -

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Executive Summary

The Japanese government is promoting the importance of active engagement between companies and investors amid a series of governance reforms, most notably including the Corporate Governance Code and Stewardship Code. Does such engagement differ from investor relations (IR) as currently practiced by Japanese companies? NRI's Sadakazu Osaki spoke with Yoshiko Sato, Executive Managing Director of the Japan Investor Relations Association, about IR's value and IR best practices going forward.



Yoshiko Sato

*Executive Managing Director
Japan Investor Relations Association*

Joined Nikkei Inc. in 1985, working largely in its Advertising Bureau's Financial Advertising Department. Seconded to JIRA in March 1993. Promoted to senior researcher in March 1999 and head of research in 2003. Appointed Executive Managing Director in June 2015. Author of multiple books on IR strategy. Member of FSA's Certified Public Accountant and Auditing Oversight Board.

Sadakazu Osaki

Head of Research, Center for Strategic Management and Innovation, Nomura Research Institute

Joined Nomura Research Institute in 1986. Graduated University College London (LL.M.) in 1990. Appointed director of Capital Markets Research Department in 1999. Appointed Head of Research in Center for Strategic Management and Innovation in April 2008. Currently a visiting professor at the University of Tokyo. Member of Financial System Council and Council for Regulatory Reform. His many books include Seminar on Financial Instruments and Exchange Law (2013; jointly authored with Zenichi Shishido).



IR is reciprocal communication

Sadakazu Osaki: How long have you been with the Japan Investor Relations Association (JIRA)?

Yoshiko Sato: More than 23 years. I was involved in establishing JIRA in 1993.

Osaki: Back then, many Japanese corporate executives and investors had never even heard of IR. While few today are unaware of IR, I suspect many still don't know what JIRA does.



Sato: JIRA is made up mainly of publicly traded corporations. We currently have 567 member companies, some 90% of which are publicly traded. Other members include IR service providers and securities firms. JIRA engages in four main activities. First, we conduct seminars and training programs for IR professionals. Second, we provide networking opportunities for the IR community. Third, we run an annual awards program to recognize companies that aspire to excellence in IR. We also consult with companies regarding how we select award winners.

Fourth, we conduct surveys and other research on topics of keen interest to the IR community.

Osaki: How should companies approach IR?

Sato: IR is generally regarded as PR targeted at investors. Such a mindset is what I call narrowly defined IR. From a broader perspective, IR aims to enhance companies' value through listening to investors and incorporating their input into corporate management. Such a value-additive function is integral to IR in my opinion. For companies, IR has two facets.

The first is getting capital markets to fully value a company in light of its future prospects. Second, IR can play a key role in enhancing a company's value also. For example, the CEO of a B2B company with extensive overseas operations told me that he had a premonition that the Chinese economy was at risk of slowing. His underlings, however, were all reporting that all was well in China. But when the CEO

met with investors knowledgeable about the global economy and industry trends, many expressed concerns about China. Upon further investigation, he found that Chinese demand had indeed weakened. By virtue of this knowledge, the company was able to take corrective action earlier than it otherwise would have.

Osaki: Does the current push to reform corporate governance through compliance with the Stewardship Code and Corporate Governance Code send a message that companies should engage more actively in IR?

Sato: Yes, I think so. Dialogue between a company and investors is fruitful when the company is receptive to investor input gleaned from IR activities, clarifies its own position and continues to conduct IR activities through consistent information disclosure.

From investors' standpoint, however, I think it's important to adopt a somewhat different approach to new initiatives than to ongoing activities. For example, the topic of enhancing a company's value going forward has hitherto been addressed mainly in terms of operating performance and/or business strategies. With the advent of the Governance Code, the time has come to talk about how governance itself adds value. I would like to see dialogue on such matters incorporated into IR activities.

Osaki: The message is that that IR is communication initiated by companies whereas stewardship activities are lobbying of companies' management by institutional investors.

Sato: Some institutional investors make proposals to encourage investee companies to enhance their value and gain market recognition for doing so. Such proposals might include measures to better quantify a company's latent value or adoption of an EVA [economic value added] framework to explain reform initiatives at earnings briefings. I consider dialogue to be one example of IR.



Osaki: Investors take the initiative to make such proposals after investing in a company. By doing so, they are in effect acting as unpaid consultants from the company's standpoint.

Sato: Yes, some CEOs have told me that investors with which they regularly speak often suggest good ideas because they understand the company's weaknesses. Of course, companies cannot benefit certain investors at the expense of others. They have to be careful to act in the interests of all shareholders.

Osaki: If an investor's proposal results in a successful outcome, both the company and investors would benefit, the latter through their investment returns. While active engagement between companies and investors is on the rise, overseas institutional investors in particular complain that shareholder general meetings in Japan are tightly clustered within a short timeframe and proxy materials often don't arrive early enough. Has there been any improvement on these fronts recently?



Sato: Companies that send out proxy materials earlier and/or make them available on their websites have increased considerably. I feel many companies are committed to ensuring that their shareholders receive voting information early enough. Additionally, some companies have started visiting institutional investors several months in advance of, instead of shortly before, their shareholder general meetings.

Proxy advisory firms should be more flexible

Sato: According to a JIRA survey regarding IR activities related to shareholder general meetings, about 40% of the respondents companies visit proxy advisory firms or are considering doing so.

Osaki: Proxy advisory firms are controversial. In particular, they have been criticized for making voting recommendations by mechanically applying quantitative criteria. What would you like to see from proxy advisory firms going forward? Overseas investors with large Japanese stockholdings seem to be heavily dependent on proxy advisory firms' recommendations.

Sato: Given differences between individual companies' operating environments and other circumstances, proxy advisory firms should ideally make company-specific instead of one-size-fits-all recommendations.

Osaki: If they did, it would be important for companies to engage in direct dialogue with not only investors but also proxy advisory firms.

Sato: I agree but I've heard of many cases where companies met with proxy advisory firms to no avail or attempted to set up meetings but were rebuffed due to time constraints, partly because almost all shareholder general meetings in Japan are scheduled within such a narrow time window. Some companies have therefore decided to bypass proxy advisory firms in favor of meeting directly with overseas investors.

Osaki: That's smart, considering that investors don't always follow proxy advisory firms' voting recommendations.

Sato: I've heard of cases where such meetings with investors have in fact paid off.

Analysts' proper role

Osaki: The FSA has recently penalized investment bank analysts for giving investors nonpublic information on companies' yet-to-be-released earnings reports and/or using such information for solicitation purposes. The securities industry has taken these infractions very seriously, with the Japan Securities Dealers Association (JSDA) issuing proposed guidelines for analysts. What's your opinion on this matter?



Sato: Many companies have strong reservations about disclosing nonpublic earnings-preview information to analysts. Since around 2013, we have been receiving inquiries from member companies about whether such disclosures are permissible and how to

respond to analysts' questions.

Osaki: Is such previewing of earnings reports a recent development or has it been around for a long time?



Sato: It was never much of a concern until a few years ago. I'm not sure exactly why analysts started approaching companies for earnings preview information, but their objective is apparently to update their earnings forecasts before the quiet period to lessen the shock of any major downward revisions.

Osaki: Companies definitely don't like such downward revisions but they prefer to maintain relatively drama-free, long-term relationships with analysts. So they have reluctantly complied with analysts' requests for earnings preview information.

Sato: That's right. While no one would disagree with the earnings previews' intent of lessening shocks, companies were unsettled by mysterious movements in their share prices after they had disclosed earnings preview information to analysts. So, in a certain sense, companies are presumably pleased that the new JSDA's guidelines will reduce or perhaps completely eliminate analysts' requests for earnings preview information.

Osaki: If analysts voluntarily comply with the JSDA guidelines, companies should have fewer worries about answering analysts' questions.

Sato: But one issue raised by the investment banks penalized by the FSA is that they have a duty to maintain the confidentiality of so-called corporate information [i.e., material, nonpublic information on a publicly traded company's operations or finances that, if known, would influence an investor's investment decisions] but companies are not sure what information should be designated as corporate information.

Osaki: That's a tough one to deal with. Given that corporate information is a concept that originated in securities industry regulations, I doubt it's feasible to require all

publicly traded companies to explicitly identify corporate information.

However, a Financial System Council working group is discussing adoption of a fair disclosure rule to prohibit selective disclosure of potentially market-moving nonpublic information.

Sato: I believe fair disclosure regulations should be approached with caution. It's true that if material nonpublic information regarding a company falls into the hands of a select few analysts or whoever, there's currently no law that would compel the company to publicly disclose the information. I'm aware that some say that a rule like the US's Regulation FD is needed but in Japan, unlike in the US, no company has ever intentionally disclosed material information in the aim of prompting revision of consensus forecasts. Secondly, the risk of market-moving information leaks would decrease if analysts change how they gather information. Thirdly, if such a regulation were adopted, it could impede dialogue about enhancing companies' long-term value.

Osaki: I agree. In Japan, public disclosure is such a technically defined concept that nonpublic information is broad in scope. In an extreme case, a company might forbid its IR staff from saying anything not already published on its website, in which case meaningful dialogue with investors would grind to a halt.

Sato: If companies' communication with investors were restricted to publicly disclosed information, investors may not be able to gain sufficiently in-depth knowledge of companies. I think it's best not to impose a rigid public disclosure rule.

Even the US's Regulation FD reportedly permits companies to disclose nonpublic information that allows analysts to piece together a "mosaic of information" (non-material information that collectively has substantial analytic value). Such an approach helps investors gain a deep understanding of companies in accord with the Stewardship Code's intent. It's important for companies to be free to disclose such information.

Osaki: Overly restrictive regulations on corporate disclosure would hinder analysts' constructive activity of publishing new insights by assembling mosaics of information.

Sato: Exactly. An analyst's job is not to gather insider information and pass it on to clients. Analysts need to get back to their rightful role.

Osaki: Such behavior by analysts is ultimately driven by clients. If analysts stop providing material nonpublic information to clients, their companies would lose those clients who expect such information from analysts. As a result, there'd be fewer people caught up in short-term share price movements. Such an outcome would by no means be a bad thing from the standpoint of the market as a whole.

Sato: The more diversity among liquidity providers, the better from a liquidity standpoint. So we can't disparage such short-term traders who seek an informational edge, but such traders have undeniably had too much influence up to now.

Securities firms inevitably place priority on clients that generate the most order flow because they don't earn profits from clients that don't trade much. It's a difficult situation unless securities firms radically change their business models. Whether sell-side analysts are needed is a separate question. Without them, however, the general public, particularly individual investors, would have one less source of investment information.

Osaki: Some companies want individual investors to own their stocks as long-term shareholders.

Sato: Individual investors play an important role even in terms of market depth.

Osaki: Do companies have IR initiatives targeted directly at individual investors?

Sato: Many companies send newsletters to individual shareholders after their shareholders general meetings and/or hold briefing/meet-and-greet gatherings for them. Fewer companies hold briefings for individual investors in general. Given the large number of individual investors, most companies pursue efficient outreach to the individual investor community through their websites.

Osaki: Yes, it's hard to gauge the payoff from courting individual investors. Even if a company conducts IR targeted at individual investors, they still may not buy the company's stock.

Sato: Individual investors are said to be the investor group for which IR's results are hardest to measure. Smaller companies can derive noticeable benefit from an increase in individual shareholders or increased trading volume but large companies cannot

quantitatively verify the benefits of having more individual shareholders, though they may sense that their stock has a bit more downside support than previously.

However, with the current population of shareholders getting older, it's important for companies to conduct IR with the next generation of shareholders in mind.

Now that the public is gradually becoming more interested in investing in stocks in the wake of NISAs' [tax-advantaged Nippon Individual Savings Accounts'] advent, companies should promote themselves to new investors more actively.

Osaki: Thank you for a very informative conversation.



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