# Mizuho Custody Newsletter

**August 2024 | Japan**

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## I. Market News

### 1. BOJ's rate hike may make Japanese companies more disciplined

At the Monetary Policy Meeting on March 19, 2024, the Bank of Japan (BOJ) decided to lift the negative interest rate policy. This marks the first policy interest rate hike in the recent 17 years. The abolition of yield curve control (YCC) was also announced then, putting an end to the unprecedented monetary easing that began in 2013.

BOJ decided at the meeting held on July 31, 2024, to raise the policy interest rate further to 0.25%. Some market participants and analysts anticipate the next rate hike making it to 0.50%. The governance structure and balance sheets of Japanese companies have become much better than ever, and backed by their strong business performance, pay hike has reached the levels seen 30 years ago. As many analysts have recognized a virtuous cycle of wage increases and rising prices, we can now safely say that Japan has finally got out of deflation.

"We will intensify the “selection and concentration” of our business portfolio. We are going to sell-off low-prioritized businesses." On July 31, the day the BOJ decided the additional rate hike, the CEO of a leading office equipment manufacturer emphasized its strategy, asked at a press conference how the company would deal with rising interest rates.

The company has approximately JPY 150 billion (circa USD 1billion) in short-term debts, and the interest rate hike in July would force them to pay JPY 100 million to 200 million (circa USD 680 thousand to 1,360 thousand) more as interest. In April, the company sold its U.S. subsidiary engaged in development of medicines and plans to lay off 2,400 employees by the end of March 2025.

Domestic listed companies have recorded record-high profits for three consecutive years and thus they are resilient to interest rate hike in a narrow range. However, according to a survey conducted on 90,000 companies, including small and medium-sized enterprises, it turned out that about 7% of those companies would go into the red if borrowing rates were to rise by 1%. During the long-lasted period of ultra-low interest rates, companies have procrastinated to review their unprofitable business sections. Facing the real world with positive interest rates, companies are now urged to further improve efficiency of their business.

The executive vice president of a leading power company says, "If borrowing rates rose by 1% based on the interest level in FY 2023, it would have a negative impact of approximately JPY 19 billion (circa USD 130 million) on our operating profit." In July, the company announced to sell off its care service business subsidiary to a drugstore chain. By divesting non-core business, the company aims to concentrate its resources on core business.

"As discipline of interest rate came back to normal, Japanese industries are entering into an era of restructuring," says an executive of an investment fund. The Price-to-Book Ratio (PBR) improvement campaign initiated by the Tokyo Stock Exchange (TSE) has prompted listed companies to sell off unprofitable business divisions. The BOJ's policy interest rate hike will further spur this trend. The executive of the fund company reveals, "We have currently 300 M&A deals under consideration since major companies are planning to sell their subsidiaries."

The BOJ's rate hike brings competition to "lenders" as well. On July 31, the day of the BOJ’s decision on an additional rate hike was announced, the three domestic mega banks announced that they would raise the interest rate on ordinary savings accounts from 0.02% to 0.1%. Shortly thereafter, a major online banking service companies announced that it would raise to 0.15%. The competition to attract deposits just began then.

At the meeting in July, the BOJ also announced a concrete plan to reduce its purchase of Japanese government bonds (JGBs). As the redemption amount will exceed the purchase amount, the BOJ's holdings of JGBs will naturally decline.

BOJ aims JGB market to work more efficiently than in the past. Since starting the extraordinary monetary easing in 2013, BOJ has rapidly increased its exposure on JGBs. BOJ holds nearly half of the outstanding balance at this point, and from now private financial institutions and foreign investors is expected to buy and hold more JGBs.

In a world with positive interest rates, companies will have to pay more borrowing costs, which may force some companies with low profitability to get out. On the other hand, by getting out of the prolonged easing policy, Japanese companies are encouraged to strive for productivity improvements, which lead market participants to expect their business to grow medium- to long-term.

*Compiled from Nikkei Shimbun and Mizuho research*
*Please refer to the below link for the announcement from BOJ:*
https://www.boj.or.jp/en/mopo/mpmdeci/mpr_2024/k240731a.pdf

## 2. MOF selected twelve brokers to promote JGBs overseas

At the monetary policy meeting held in July, the Bank of Japan (BOJ) announced to reduce the purchasing amount of Japanese government bond (JGB). To secure new JGBs buyers, the Ministry of Finance (MOF) is going to enhance investor relations (IR) for government funds and other overseas investors, in collaboration with securities firms. MOF will also search other potential JGB buyers, including domestic banks and individual investors.

At the end of July, MOF established the "JGB・GX Promoter" system. It designated 12 securities firms, both Japanese and Non-Japanese, from the JGB market special participants (Primary Dealers). Primary Dealers are financial institutions that play a key role to ensure stable absorption and distribution of JGBs in the market.

The designated securities firms are expected to initiate caravans with the MOF to major investors such as central banks and sovereign wealth funds in the United States, Europe, Asia, and the Middle East, to hold IR events. They are also assuming the role of promoting sales of GX (Green Transformation) bonds, which have been issued since February, both in Japan and overseas.

BOJ is currently purchasing about JPY 6 trillion (circa USD 40.8 billion) worth of bonds per month, and the bank now holds 47.4% of JGBs issued as of the end of March. At the monetary policy meeting in July, the BOJ announced a plan to gradually reduce its JGB purchases, aiming to reduce monthly purchasing amount to JPY 3 trillion, which is about a half of its current purchases, by March 2026.

MOF is finalizing its JGB issuance plans taking BOJ's purchase reduction plan into account. MOF believes private financial institutions to be core holders of JGBs. MOF is now considering to issue government bonds with short maturities more than those with long ones to alleviate their concern toward interest rate risk, to make them feel more comfortable for buying more JGBs.

However, it seems that financial institutions have very limited capacity for this purpose. As of the end of March, the holding ratio was 13.5% for banks and 16.3% for life and non-life insurance companies. Due to the financial regulations that require financial institutions to control the amount of interest rate risk up to a certain level, it is not practical for these institutions to share the entire portion the BOJ currently holds.

MOF also looks at domestic individual investors as important potential buyers, but their holding ratio is just at 1.1%. It does not seem practical that individual investors to be “major JGB holders” anytime soon.

As of the end of March, the holding ratio by oversea investors was 13.7%. In June, MOF's panel of experts pointed out that the thing was to create an environment that allows various types of overseas investors to join the market."

In the auction for 10-year JGBs issued in early July, the coupon rate, which is the interest rate applicable to holders annually, was set at 1.1%, marking the first time in 12 years that it exceeded 1%, up from 0.8% in June. The government expects that if interest rates continue to rise in the process of normalization of monetary policy by the BOJ, that would attract more overseas investors to JGBs.

It is hard to predict how much more foreign investors would purchase JGBs in the future. Although it is still going up, the yield on JGBs appears less attractive than that of U.S. 10-year Treasury bonds, which now exceed 4%. Japan's government debt exceeds twice the gross domestic product (GDP), which keeps Japan's long-term sovereign credit rating lower than that of the United States or Germany, in spite that Japan is the largest creditor nation.

Some market watchers are concerned that interest rates rise would result in more interest payments by the government. According to the MOF's estimates based on the FY2024 budget proposal, under the scenario where the assumed interest rate for 10-year JGBs go up from 1.9% in FY2024 to 2.4% in FY2027, to the government would have to pay JPY 15.3 trillion (circa USD 104 billion) for interest in FY2027, which is 1.6 times of the amount in FY2024.

It is important for Japanese government to establish market confidence in JGBs, if it intends to attract overseas investors to be stable JGB holders. The panel of experts asserts that it is necessary to be more conscious of how Japan's economic and fiscal management has been viewed by the market, including overseas investors. Overseas IR could be a forum to face concerns of overseas investors on Japan’s fiscal situation and economic policies and to demonstrate its ideas and strategies.

*Compiled from Nikkei Shimbun and Mizuho research.*
*The names of the promoters can be found at MOF’s below website:*
https://www.mof.go.jp/english/policy/jgbs/IR/promoter.html

### 3. Corporate reform pressured by foreign shareholders

According to the Shareownership Survey published by the Japan Exchange Group (JPX), the foreign ownership ratio of Japanese stocks in fiscal year 2023 went up by 1.7 percentage points from the previous year, reaching a record high of 31.8%. Many of the issues that contributed to this uptrend have strengthened shareholder returns through dividend increases and share buybacks.

Investors moved money into companies that manage with consciousness of capital costs through dialogues with foreign investors, leading the Nikkei Stock Average to reach a record high for the first time in 34 years in this July. A fund manager at a domestic asset management company stated that many Japanese companies began to return their retained earnings to shareholders had been taken as a positive sign by foreign investors."

In fiscal year 2023, foreign investors bought Japanese stocks on net basis by JPY 7.69 trillion (circa USD 52.3 billion), the second highest level since fiscal year 2013 (JPY 9.53 trillion / circa USD 64.8 billion). Among the industries that attracted foreign investors, the top sectors included shipping (up 4.9 points), pharmaceuticals (up 4.3 points), and "other products" (up 4.1 points), which includes gaming companies.

Nikkei Shimbun, a leading Japanese financial daily, ranked 1,125 companies whose fiscal year-ends in March listed on the TSE Prime, in terms of how much their foreign ownership ratios increased, that could be compared with the previous year. The research found that the foreign ownership ratio increased in 745 companies, which accounts for about two-thirds of the total. The top company, which sells surgical supplies, saw its foreign ownership ratio rise by 14 points to 49.2%.

The company increased its annual dividend for the fiscal year ending March 2024 by JPY 9 per share to JPY 80 per share. Although its net profit dropped by 35% compared to FY2023, it raised its dividend payout ratio from about 40% to 70%. It is believed that a foreign activist fund has influenced the issuer’s decision. According to a report submitted by the issuer, the activist fund based in the U.S., together with related funds, held 9% of the company as of this

February. In July, the funds increased their stake to 16%.

Cases similar to the above were found with other issuers whose foreign ownership ratio increased in companies as foreign activist funds became their major shareholders. A major shutter manufacturing company disclosed that a U.S.-based activist fund held more than 5% of its shares in October 2023. A company handling surveying equipment had a fund based in U.S. as it new shareholder in May 2023.

Many market participants now believe that activist funds bring discipline and a sense of tension to management, which may sometimes lead the companies' shares to be properly evaluated in the market. A strategist at a Japanese think tank says, "By modelling other companies, senior management of companies would be more willing to work on reforming their own consciousness of their stock price, which would eventually lead the market to higher level."

Activist funds have been increasing their voices not just in Japan but globally. From January to June, the number of proposals and demands made to companies was a record high of 147 for the same period in the past. This year, activist funds made proposals that strike at the core of management, such as sell-off of unprofitable businesses or the overhaul of management teams, rather than traditional demands for more dividends and share buybacks. Pressure from the market on company management is likely to intensify further.

According to a major UK-based financial group, the number of proposals and demands from activist funds between January and June increased by 10% year-on-year to 147, surpassing the record of 143 of the same period in 2018. By region, the United States saw a 15% increase to 61 cases, while the Asia-Pacific region, including Japan (which had 14 cases for the entire year of 2023), doubled to 50 cases.

Looking at the proposals and demands submitted between January and June by content, those related to the broad category of "M&A (mergers and acquisitions)," including sell-off of unprofitable businesses, and those demanding "board reform," such as dismissal of directors, each accounted for 36% of the total, sharing the top category.

A consultant at a Japanese think tank says, "In the past, activism had largely focused on demands related to shareholder returns and governance." He further mentions, "As more funds began adopting activist strategies, they have been trying to differentiate themselves from competitors with specific proposals related to business and brand strategies."

The activist funds that entered the Japanese market doubled to 72 as of May 2023, compared to those of five years ago. This increase is due to the favorable corporate performance that makes investors believe the stock price appreciation more likely, as well as the fact that many companies are actively engaging in governance reforms and to return more to shareholder at the request of TSE.

In Japan, some activists are making proposals on specific business strategy. A Hong Kong-based fund pressured a major detergent and toiletry manufacturer to further refine its brands and strengthen its advertising and promotional activities.

The representative of the Japanese branch of a UK fund says, "Companies have become more open to having dialogue with activist funds. Both sides tend to avoid long-lasting conflicts that often end up using high costs and cause much workloads."

Stock prices may surge soon after activist funds' holdings are disclosed, but that will not last long unless the company would proceed reforms that look convincing to the market, in case the company had not accept the proposals and demands from the activist fund. Activist funds should also submit proposals that enhances corporate value, with convincing sound to other shareholders.

*Compiled from Nikkei Shimbun, and Mizuho research.*

### 4. Parent-subsidiary listing to get less common in the market

The practice of both a parent company and its subsidiary being listed, known as "parent-subsidiary listing," is rarely found in the Western markets, and said it has been believed to be a practice unique to Japan. Parent-subsidiary listings increased during the 2000s to diversify companies' financing sources. However, many analysts came to be aware that the parent company's interests tend to be put first when the parent deals with its subsidiary, which could result in harming the interests of the minority shareholders of the subsidiary (shareholders other than the parent company).

The number of parent-subsidiary listings has been declining recently. In the fiscal year 2023, the number of cases dropped by 10% from the previous year to 190 companies, which is half of its peak in FY 2006. One of the major convenience store chains in Japan, which was a subsidiary of a major trading company, was delisted on July 24. The parent-subsidiary listing has been strongly criticized by investors due to concerns about potential conflict of interests between the parent company and the subsidiary. Since December 2023, Tokyo Stock Exchange (TSE) has been requesting listed companies whose subsidiaries are also listed to disclose the rationale of the practices and to present how they would protect minority shareholders.

A research institute of a major securities company group conducted a survey on listed companies held by parent companies that are also listed, across all stock exchanges. The survey found that in FY 2023, such companies fell below 200 in number for the first time in 30 years, since fiscal year 1993. Many of them went private through TOB (Tender Offer Bid) by its parent companies.

In 2023, another domestic trading company paid approximately JPY 380 billion (circa USD 2.5 billion) to acquire its listed system subsidiary in which it had a 60% stake, into its wholly-owned subsidiary. Furthermore, a major electronics company launched TOBs on two of its listed subsidiaries, reducing the number of its listed subsidiaries from four to two.

Some companies are trying to push their listed subsidiaries out of its group by lowering its equity stake in the subsidiaries. This is based on their negative outlook that no synergistic effects could be expected even if the company would stay in the group. A researcher from the previously mentioned research institute says, "The processes and methods of dissolving “parent-subsidiary listings” have been diversifying."

A major automobile manufacturer sold 80% of shares of its listed subsidiary to an Indian company after having made the subsidiary wholly owned by it. The two companies carried out the deal in anticipation of the electrification of vehicles and for revision part of their capital relationships. A major ink manufacturer sold its shares, about 55% ownership, of a listed chemical manufacturing company to a subsidiary of an American investment firm.

Reviewing parent-subsidiary listings often involves other shareholders of the listed subsidiaries. A software development company listed on the Prime Market accepted a request of an overseas activist investor and made four of its listed subsidiaries into wholly-owned subsidiaries by paying about JPY 41 billion (circa USD 280 million). Afterwards, the parent company also chose to go private.

A major recruit agency initially planned to sell over half of the shares of a listed welfare services outsourcing company to an emerging medical services company. However, after receiving a proposal from a major life insurance company to acquire the shares, it accepted this offer and sold the shares to the life insurance company.

The trend of dissolving parent-subsidiary listings is expected to continue in FY 2024 as well. A major electronics manufacturer plans to sell a semiconductor packaging manufacturer, in which it holds majority stake, to a consortium orchestrated by a government fund. Other than the government fund, a major printing company and a chemical company will acquire all shares for a total of about JPY 700 billion (circa USD 4.7 billion).

The major trading company mentioned earlier decided to jointly manage its convenience store chain with a major telecommunications company. The telecom company invested about JPY 500 billion (circa USD 3.4 billion) to acquire 50% of the convenience store's shares, and the convenience store chain was delisted. A major textile manufacturer sold its shares of a listed subsidiary that operates an electronic comic distribution business, in which it had a 60% stake, to an American investment fund for about JPY 275 billion (circa USD 1.87 billion).

Next focus may be how the rest of listed subsidiaries would act or be treated. Some companies still hold a number of listed subsidiaries, including a leading domestic retailer, a major internet-related company, a leading steel company, and a major fitness gym chain.

Among them, the retailer has 16 listed subsidiaries, the biggest number in Japanese companies. The company mentions several reasons for keeping its subsidiaries listed, such as introducing discipline from the capital markets, synergistic effects within the group, and reduction of financial burden. Furthermore, it states that it would respect independence of its listed subsidiaries and would not engage in any actions that might violate the principle of shareholder equality."

There are some unusual situations, where the market capitalization of a subsidiary exceeds that of its parent company. The previously mentioned internet-related company has a listed subsidiary that provides electronic payment services, but the market capitalizations of the parent and subsidiary have reversed. Many investors are dissatisfied about the situation as they see it as inefficient capital relationship.

A researcher at a domestic think tank points out, "Parent company and its subsidiary sometimes contradict whether to integrate the listed subsidiary into the parent company or to make it independent." Companies should revisit where their own strengths lie and establish or refine their strategies for enhancing the corporate value of the group as a whole.

*Compiled from Nikkei Shimbun and Mizuho research.*

## II. New Equities Listing Approvals

| Listing Date | Name of Company | ISIN Code | MKT |
|---|---|---|---|
| Aug-13 | Asumi HD Inc. | JP3119830002 | P |
| Aug-29 | Hillstone Inc. | JP3796120008 | P |
| Sep-25 | ROXX, inc. | JP3984210009 | G |
| Sep-26 | KIDS STAR Inc. | JP3240450001 | G |
| Sep-26 | ASUA Inc. | JP3119640005 | G |
| Sep-26 | INGS inc. | JP3152680009 | G |
| Sep-27 | Ai ROBOTICS INC. | JP3160060004 | G |
| Oct-01 | Shimadaya Corporation | JP3356550008 | S |
| Sep-26 -Oct-02 | Growth X Partners, Inc. | JP3274290000 | 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

Click for up-to-date FOL information:

https://www.jasdec.com/en/description/less/for_pubinfo/for_pubinfo.html

Please visit our Custody homepage on the Web at:

https://www.mizuhogroup.com/bank/what-we-do/custody