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Why Japanese Boards of Directors Should be Held to Gender Diversity Standards of the West

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Abstract

Mounting research indicates that gender diversity on boards is correlated with superior financial performance and governance oversight. Gender diversity fosters innovation, improved risk oversight, and a greater focus on workforce diversity issues. As board gender diversity has become a global issue, and governments, exchanges, and investors around the world have taken significant actions, Japan remains behind on board gender diversity. Historically, Japan was only held to local market standards. The rationale for not expecting Japan to rise to higher global standards included a lack of female talent and culture. However, this historical rationale is no longer valid. The concerns expressed over lack of female talent are no different than those heard when Norway instituted 40 percent gender quotas in 2003 and when California instituted gender quotas in 2018. If the definition of a qualified director is expanded and global boundaries are eliminated, then Japan has sufficient female candidates to fill board positions. For these reasons, certain leading investors and proxy advisors have changed their proxy voting policies to require Japanese companies to have at least one woman on the board. Higher standards for gender board diversity are necessary to shift ingrained cultural gender stereotypes, maximize the usage of talent, and harness the merits of board diversity.

Why Japanese Boards of Directors Should be Held to Gender Diversity Standards of the West

Japan Is Severely Behind the Global Movement for Board Diversity

As gender board diversity has become a global issue, we can ask whether Japan should be held to local market standards or to board gender diversity standards of the West. With the Fourth Basic Plan for Gender Equality, established in December 2015, the Japanese government set a target for 10 percent of board seats at public companies to be held by women.[1] At that time, women held less than 3 percent of board positions. The current percentage of seats held by women has reached 6.2 percent as of July 2020.[2] This is an improvement, but Japan is still woefully behind Russell 3000 companies, the three thousand largest U.S.-traded stocks where women currently hold 22.6 percent of seats, and most of Europe, where women hold 30 percent to 40 percent of seats in most jurisdictions.[3] Europe's lead is notably the result of quota systems. The Japan Corporate Governance Code (the Code) recommends that boards achieve diversity and specifies gender and international experience as examples of diversity. As the Code is "comply or explain" and the diversity recommendation has not been specific to gender diversity, progress has been slower than targeted. As a result, in 2021, Japan is severely behind most markets in board diversity.

Should global investors continue to exempt Japan from meeting a minimum level of female candidates on the board? It has long been understood that Japan's corporate boards operate differently, and Western style governance standards (e.g., majority board independence) could not be expected. Similarly, investors have thought board gender diversity would be hard to achieve for Japan. Reasons included the fact that few women had risen in the corporate ranks due to both logistical challenges as well as cultural expectations. Prior to discussing these concerns, it is important to review why gender diversity on boards is important and how research is driving investors' voting and decisions.

1 "Appointment of Women to Board Positions," in *Women and Men in Japan 2020* (Gender Equality Bureau Cabinet Office, March 6, 2020), 31, https://www.gender.go.jp/english_contents/pr_act/pub/pamphlet/women-and-men20/index.html.

2 Female Board Member Data Site (Japanese), Gender Equality Bureau Cabinet Office, accessed March 21, 2021, https://www.gender.go.jp/policy/mieruka/company/yakuin.html.

3 2020 Women on Boards, "2020 Women on Boards Gender Diversity Index" (summary sheet), 2, https://5050wob.com/wp-content/uploads/2021/02/2020-Gender-Diversity-Index-Report-FINAL.pdf; Meggin Thwing Eastman, Damion Rallis, and Gaia Mazzucchelli, "The Tipping Point: Women on Boards and Financial Performance" (MSCI, December 2016), 20, https://www.msci.com/documents/10199/fd1f8228-cc07-4789-acee-3f9ed97ee8bb.

Gender Board Diversity is Correlated with Stronger Financial Performance and Governance

The board gender diversity issue has moved beyond one of fairness and equality to one of performance and economic sustainability. A mounting body of evidence shows that companies with more diverse boards have better financial performance and stronger governance than companies without board diversity. In the U.S., Nasdaq recently submitted a proposal to the SEC with new proposed listing requirements related to board diversity.[4] In that proposal, Nasdaq cited several studies from Credit Suisse, MSCI, and Catalyst, with each study reporting relatively higher performance, as measured by return on equity or EPS, by companies with one or more women on the board compared to peer groups that did not have the same level of female representation.[5] Not all studies have shown the relationship between financial performance and board diversity, but many have accepted that there is a correlation. Theories on what causes the improved performance include better decision making, greater innovation, and increased ability to attract and retain talent.

Further research demonstrates stronger governance and oversight for companies with women board directors. These studies, also referenced in the Nasdaq proposal, indicate correlations with higher quality of financial reporting and internal controls, fewer financial reporting restatements, and decreased likelihood of securities fraud.[6] Cognitive diversity is a further explanation as to why companies with diverse boards perform better and have stronger governance. Cognitive diversity arises when people with different values, experience, and knowledge are brought together. While gender differences may not always bring cognitive diversity to a board, it is much more common for women joining boards in Japan to bring different experiences and knowledge, having worked at foreign companies, international entities, as entrepreneurs, or in academia.

Foreign Investors and Proxy Advisors Take Action

In recent years, many large investors and pension funds noted this research on performance and began to directly engage with investee companies that lacked women on their boards. Investors make buy-and-sell decisions on the stocks they hold and have the power to exercise voting rights for or against the election of directors at the annual meeting of shareholders (AGM in Japan).

For decades, Japan has been treated differently by proxy advisors, who provide research and

[4] See SR-NASDAQ-2020-081, the proposal to advance board diversity filed with the Nasdaq Listing Center on December 11, 2020, available at https://listingcenter.nasdaq.com/assets/rulebook/nasdaq/filings/SR-NASDAQ-2020-081.pdf.

[5] Ibid., 18.

[6] Ibid., 9.

voting recommendations for asset managers and asset owners.[7] Both proxy advisors and investors have different voting policies for different countries or regions. In certain situations, imposing standards acceptable in one region might be ineffective, if not futile, if applied in other regions. Proxy advisors review and revise their policies by region each year based on investor sentiment and other factors, such as regulatory changes.

While several years ago Glass Lewis, one of the largest proxy advisors, did not have a gender board policy for Japan, Glass Lewis currently has a gender diversity policy applicable to companies listed on the First and Second sections of the Tokyo Stock Exchange. Specifically, if one of these companies does not have any incumbent or proposed female members, Glass Lewis will recommend investors vote against the chair of the company, the most senior executive of the company, or the nominating committee chair, depending on the structure of the company. Glass Lewis considers other information included in a company's disclosure, such as the rationale for not having any female board members, in making its final vote recommendation.[8] Institutional Shareholder Services (ISS), the largest proxy advisor, does not have a policy on board gender diversity in Japan even though it has gender diversity policies for most other regions and countries.[9]

Large global investors are also beginning to change their standards for Japan. One example is State Street Global Advisors. State Street is well known for its Fearless Girl campaign, which was launched in 2017. This policy was extended to Japan in 2018 and is effective in 2021.[10] Goldman Sachs is another example of an asset manager deciding to include Japan in its global policy. Goldman Sachs' Japan policy specifically reads, "Vote AGAINST the Nominating Committee if the board does not have at least one woman director. For Japanese boards with statutory auditors or audit committee structure, but no nominating committee, vote AGAINST top executives."[11]

7 Institutional Shareholder Services (ISS) and Glass Lewis are the two largest proxy advisory firms.

8 Kevin Gibb, Naoko Ueno, and Dimitri Zagoroff, eds., "2020 Proxy Season Preview: Japan" (Glass Lewis, May 2020), 4, https://www.glasslewis.com/wp-content/uploads/2020/05/Japan-Season-Preview.pdf.

9 "JAPAN Proxy Voting Guidelines Benchmark Policy Recommendations" (Institutional Shareholder Services, November 19, 2020), 4, https://www.issgovernance.com/file/policy/active/asiapacific/Japan-Voting-Guidelines.pdf.

10 Lyuba Goltser, "State Street Escalates Policy on Board Gender Diversity and Touts Impact of Its 'Fearless Girl' Campaign," *Governance & Securities Watch,* October 10, 2018, https://governance.weil.com/insights/state-street-escalates/.

11 "Policy, Procedures and Guidelines for GSAM Global Proxy Voting 2020" (Goldman Sachs, March 2020), 24, https://www.gsam.com/content/dam/gsam/pdfs/us/en/miscellaneous/voting_proxy_policy.pdf.

Rationale for Excluding Japan from Global Standards is Not Compelling

While certain investors are firm on gender board policies for Japan, many others continue to exclude Japan from these voting policies. The Japanese government has yet to institute a quota for gender. The Corporate Governance Code, which is "comply or explain," does not specifically recommend a minimum level of gender diversity. Rationale for excluding Japan has included (1) a lack of qualified female candidates, (2) ingrained cultural and historical gender stereotypes that make placing women on boards ineffective, (3) the view that voting against a CEO for a gender issue is extreme, and (4) the belief that investors need to focus on other governance issues, such as board independence. Each of these points is discussed below.

If Japanese companies expand the criteria of a qualified board member to women entrepreneurs and senior Japanese/non-Japanese women in Japanese/non-Japanese companies, whether residing inside or outside of Japan, then the talent pool of qualified candidates would greatly expand.[12] Similar concerns were heard in 2003 in Norway, when the country instituted a 40 percent board gender quota. Similar concerns were also heard in 2018, when California became the first state to sign legislation, Senate Bill 826 (Women on Boards), to put in place gender quotas for companies headquartered in California.[13] In both situations, companies were able to identify qualified candidates. The characteristics of the female board members did diverge from the traditional CEO or C-suite roles, and for many of these women, it was their first time serving on a board.[14] However, they brought significant talent and expertise from different sectors.

Japan cannot be excluded due to cultural barriers. Glass Lewis notes "that gender role expectations ingrained throughout Japanese society have impeded the progress of gender diversity in corporate Japan."[15] Japan's cultural bias requires a stronger urgency to address the issue. Placing women on boards as a result of quotas or other pressures can change attitudes towards board diversity, which is far preferable to waiting for attitudes to change so that more women can be

[12] Related to last point of country of residence (residing inside of Japan/outside of Japan), virtual board meeting participation during COVID-19 was accepted by all countries, including Japan. Thus, if occasional virtual attendance is permitted, candidates who may previously not have been considered due to challenges with attending all board meetings and special meetings in person in Japan may now be considered.

[13] "Women on Boards" (Senate Bill 826), California Secretary of State, last accessed March 21, 2021, https://www.sos.ca.gov/business-programs/women-boards.

[14] Cathrine Selerstad, Morten Huse, and Silvija Seres, "Lessons from Norway in Getting Women onto Corporate Boards," The Conversation, March 6, 2015, https://theconversation.com/lessons-from-norway-in-getting-women-onto-corporate-boards-38338.

[15] Gibb, Ueno, and Zagoroff, eds., "2020 Proxy Season Preview: Japan," 6.

appointed. Even amidst cultural bias, a woman equipped with the proper skillset and knowledge can impact challenging boards. This is not easy, but this has been accomplished in other countries, resulting in a shift in gender bias. Many women who serve on European or U.S. boards are no longer viewed as "female board directors" but simply "board directors."

Investors may hesitate to put in place a gender board policy for Japan because of the lack of nominating committees in Japan. More specifically, investor voting policies specify which board directors will be the recipient of AGAINST votes if certain standards are not met. Board diversity is often the responsibility of the nominating committee, and the nominating committee chair or members may be held accountable. If there is no nominating committee, the vote is typically against a CEO or Board Chair. Concerns with voting against the CEO or Chairman should bring attention to the governance risk of not having formal independent nominating committees rather than allowing this structural deficiency to impede the promotion of gender diversity.

Finally, certain investors might want to prioritize other governance issues, such as director independence, over diversity. While board independence is certainly a concern, board independence has risen in recent years and should no longer be used as reason to avoid focusing on gender diversity. In fact, the two are not mutually exclusive as most women directors serve as independent directors.

Changing Attitudes

Japan has demonstrated changing attitudes towards the tolerability of gender bias. While almost unimaginable in prior decades, in February 2021, Yoshiro Mori, a former prime minister of Japan, stepped down as president of the Olympic Committee after making offensive comments about women speaking too much in meetings and claiming they competed to speak the longest.[16] The comments were met with extreme criticism from around the globe and thousands of volunteers resigned. His successor, Seiko Hashimoto, has commented that the organizers of the Tokyo Olympics will promote gender equality as high a priority as efforts to ensure a coronavirus-free Games.[17] Certainly, investors, regulators, and exchanges can elevate the priority of promoting gender diversity on boards and hold Japan to higher gender diversity standards.

[16] Motoko Rich, "Tokyo Olympics Chief Resigns Over Sexist Comments," *New York Times,* February 11, 2021, https://www.nytimes.com/2021/02/11/world/asia/yoshiro-mori-tokyo-olympics-resigns.html.

[17] "Tokyo 2020 Chief Says Gender Equality Efforts as Important as Virus Containment," *Nikkei Asia,* February 25, 2021, https://asia.nikkei.com/Spotlight/Tokyo-2020-Olympics/Tokyo-2020-chief-says-gender-equality-efforts-as-important-as-virus-containment.

Author Biography

Tracy Gopal taught English in Japan as an ALT on the Japan Exchange and Teaching (JET) Program from 1992 to 1993 in the towns of Maibara and Ohmi in Shiga Prefecture. She holds a BA in Economics from the University of Michigan, Ann Arbor, where she graduated summa cum laude and Phi Beta Kappa. At the University of Michigan, she took extensive coursework in Japanese. She earned her MBA from the Fuqua School of Business at Duke University. She earned the CFA Charterholder designation in 2002. Following an extensive career in transactions and governance with EY and ISS, she founded Third Arrow Strategies, a corporate governance consulting firm. In 2021, Tracy will officially launch the Third Arrow Strategies Japan Board Diversity Network, a membership organization committed to raising the percentage of female board directors in Japan.

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