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Trade, Labor and EU Law Perspectives

Japan's All-Too-Long List of Public Companies – A Return to the Past?

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1. New Classification List of Public Companies for Foreign Investment Review

On May 8, the Japanese authorities published a list of publicly-listed companies that are subject to prior examination for direct investments by foreign investors under the newly amended Foreign Exchange and Foreign Trade Act (the "**FEFTA**"). The subject companies are classified into three categories: (A) companies engaging in 12 sensitive industries ("core sectors" including electricity, gas, cyber security and telecommunications) from a national security perspective, (B) companies engaging in less sensitive sectors among certain designated industries, and, (C) companies engaging in non-designated sectors that are only subject to post-investment reporting requirements. When any foreign investor acquires more than 1% of the total shares of any company in category (A), prior notification to, and subsequent review by, the government authorities is required. However, this procedure may be waived for some passive investments under certain conditions, such as cases where the investor is a foreign financial institution that makes a certain non-control commitment, or in cases where ordinary investors or accredited sovereign wealth funds (and public pension funds) are investing in less than 10% of the total shares with a stricter non-control commitment. Such exemptions are not available for non-Japanese SOEs in any case.

The list was published in response to the recent amendment of the FEFTA, effective in May. As a result of this amendment, the thresholds for acquiring shares of listed companies engaging in core sectors to be subject to prior governmental examination were drastically lowered from 10% to 1% of all shares. Due to the complexity and difficulty of determining whether the investee engages in business in core sectors, there is substantial need for such a list to ensure the predictability of foreign investors' actions (however, the list is not a part of any law or regulation, and thus reliance on it will not be formally protected).

2. Too Long a List?

Surprisingly enough, 518 public listed Japanese companies, or 13.6% (or about 40% on a corporate value basis) of all listed companies, are classified in category (A) – companies conducting business in core sectors. In the process of compiling the list, the authorities conducted a survey of all listed companies on whether they are engaged in core sectors. Some critics, however, say that "anti-activist' sentiment may permeate such process. At first glance, some oddities may be found among those 518 companies. For example, a public listed company that mainly operates resort hotels and golf courses is classified into this most sensitive category (A), which has some overseas media outlets questioning why a resort hotel company is classified into the same category as a large industrial manufacturer of military products. However, the "business purpose" (range of business) section of the company's commercial registration includes not only the management of hotels and golf courses but also 28 businesses in total including information processing services, data communication systems-related business, and natural power generation, which is likely the reason for the classification.

3. Third Axis — Public Interest Capitalism

From a different perspective, however, the length of the list may not necessarily be a negative. To explain, traditionally, the management of Japanese companies has tended to emphasize long-term employment, maintenance of stable relationships with business partners, and return of interests to society. In recent years, however, under the influence of the shareholder-oriented capitalism of the United States, shareholders' short-term interests, such as stock prices and short-term ROE, have become more important, and have taken on the form of "good medicine" to remedy the common weaknesses of Japanese companies in terms of their transparency, mobility, and ability to respond to change. Contrastingly, however, such influence might also have negative effect of destroying Japan's traditional "good old" corporate culture.

George Hara, a successful Japanese investor based in the United States has warned about this issue since the early 2000s. He advocated a "Public Interest Capitalism" that emphasizes long-term and sustainable growth, and fair returns to employees, business partners and social communities. This view has found support among some major Japanese listed companies and start-up ventures. Mr. Hara preaches the value of long-term and sustainable growth, and raises an alert over management styles that are inclined toward the short-term interests of shareholders. Public Interest Capitalism anticipated the ESG movement, which has only relatively recently begun to be emphasized worldwide. http://www.allianceforum.org/en/capitalism/

Of course, Public Interest Capitalism is not directly related to national security, which is the major reason for the recent tightening of foreign investment in Japan. However, the two concepts may share commonalities as they serve to check or control "excessive capitalism." From this perspective, the all-too-long list with many oddities at first glance may serve its purpose after all.

The revitalization of global investment is the lifeline of the world economy, and therefore appropriate cross-border transactions should be strongly promoted in the future. At the same time, however, the need to control that lifeline has to be increased in several ways. Japan cannot return to "protectionism" as it used to be. However, the "New Normal" will likely be drastically different from the simple and open "activist-friendly" capitalist economy that we had enjoyed up until very recently. The key to Japan's future survival will be to find the right balance among investment promotion, national security, and the public interest, and how best to do that.

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