

Gapponshugi in an ESG World

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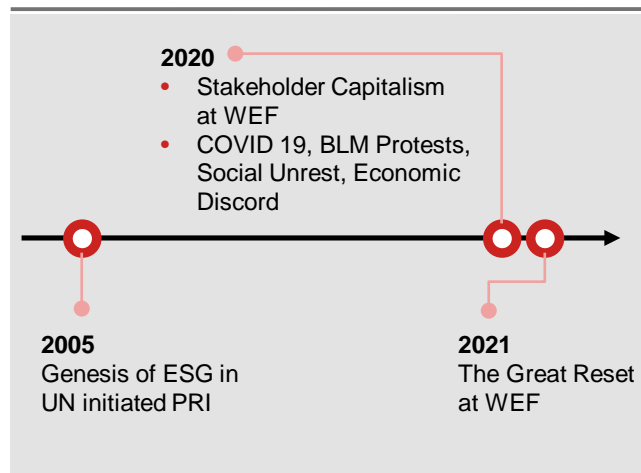
June 2021

See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Any authors named on this report are research analysts unless otherwise indicated.

ESG Investing: The future starts here

Timeline



ESG: the new normal?

| | 2019 | 2020 | Change |
|--|------|------|--------|
| Investors considering ESG | 55% | 89% | ▲ |
| Investors complying with regulation | 56% | 84% | ▲ |
| Plans integrating ESG into investment policy | 68% | 88% | ▲ |
| Plans developing a set of ESG beliefs | 19% | 55% | ▲ |

The key reason for considering ESG risks remains the need to comply with regulation, accompanied by an increase in plans integrating ESG into their investment policy and developing a suite of related policies as a result.

Source: Mercer European Asset Allocation Insights 2020

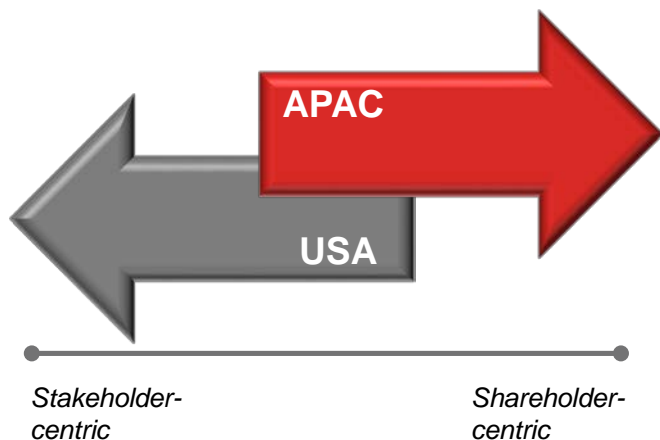
Governance, beliefs and policy

| | |
|--|-----|
| Does the plan's investment policy make reference to ESG issue? | 88% |
| Has the plan developed a set of ESG/responsible investment beliefs? | 55% |
| Does the plan have a standalone ESG/responsible investment policy? | 14% |
| Does the plan have dedicated resource focused on responsible investment? | 8% |
| Does the plan have a responsible investment committee? | 5% |

The number of plans that have explicitly created and formalized ESG beliefs has increased significantly, up from 19% last year to 55% this year.

Source: Mercer European Asset Allocation Insights 2020

ESG: East meets West



Social Aspects at Forefront

| | Affected in 2017 | Will affect in 2022 |
|---|------------------|---------------------|
| ESG issues impact on share prices | | |
| Governance | 58% | 65% |
| Environmental | 23% | 52% |
| Social | 23% | 46% |
| ESG issues impact on corporate bond yields/spreads | | |
| Governance | 41% | 53% |
| Environmental | 15% | 40% |
| Social | 15% | 35% |

ESG: APAC Outlook

Japan

Most advanced in APAC; GPIF leading change; best dividend growth of any major equity market in last five years.

China

HK-listed companies obliged to give full disclosure on ESG-related activities. Shanghai and Shenzhen are expected to follow.

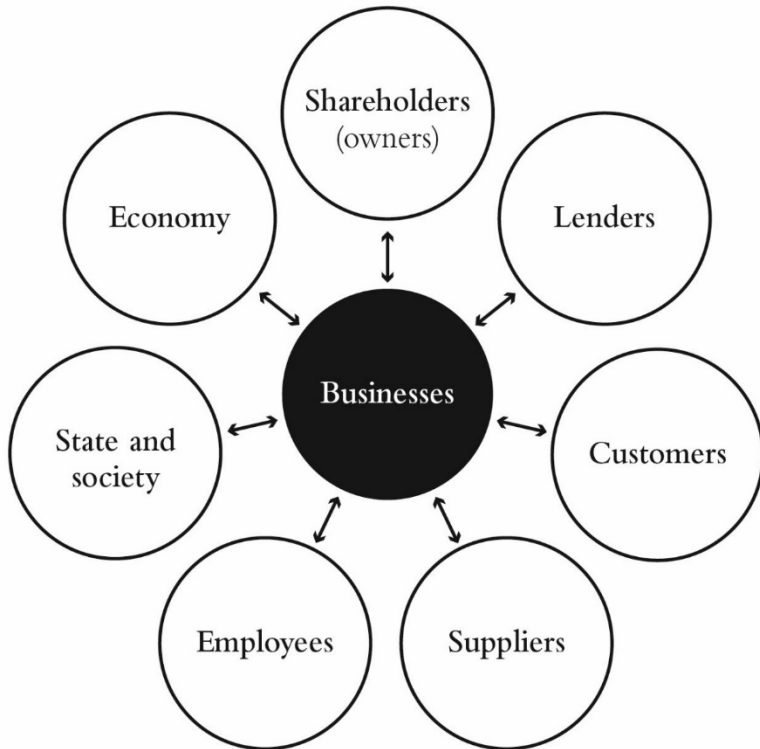
Korea

NPS announcement in September that it seeks to incorporate ESG criteria into its domestic equity and bond portfolios.

Taiwan

Board composition of leading index constituents is more international than regional peers.

Stakeholder Capitalism: Lessons from Japan



Ian Maitland & Mitsuhiro Umezo (2006)

“Japan appeared to have invented a more humane form of capitalism without having to sacrifice efficiency and productivity”

“Many Americans looked to Japan for an alternative to the raw capitalism practiced in the United States and liked what they saw”

Carl Kester (1991)

“Japanese managers are agents of the entire coalition of stakeholders rather than the shareholders or any other single group”

Eric Orts (1992)

Japanese company is “a coalition of stakeholders – suppliers, lenders, customers, shareholders – holding a complex blend of senior and junior, short-term and long-term, conditional and unconditional, implicit and explicit claims against the company”

Sanford Jacoby (2000)

Japanese variant of capitalism “balances the interests of multiple stakeholders: employees. Creditors, trading partners, and finally shareholders”

Ronald Dore (2000)

In Japan “the rights of owners....are seen to be very properly circumscribed by the rights of other stakeholders – employees, customers, suppliers and sub-contractors, creditors, local communities etc”

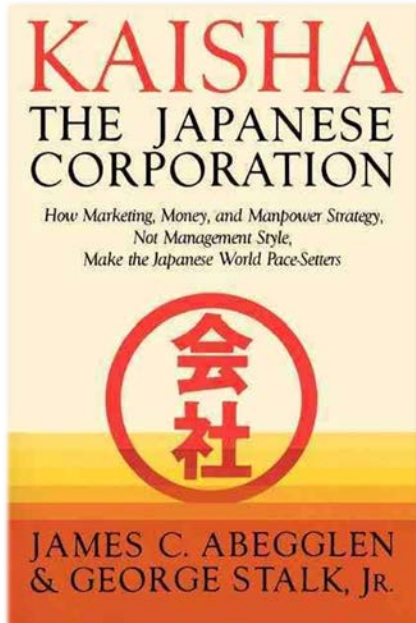
Fukuyama (1995)

Japanese company is a community “whose members are willing to subordinate their private interests for the sake of larger goals of the community”

“The Japanese system operates in stark contrast to Western-style capitalism. It’s genesis lies in a 1970 article in the New York Times. The Friedman doctrine, also called shareholder theory or stockholder theory, is a normative theory of business ethics advanced by economist Milton Friedman which holds that a firm’s sole responsibility is to its shareholders.”

Gapponshugi: Ethical Capitalism

Reading List



Kaisha: The Japanese Corporation

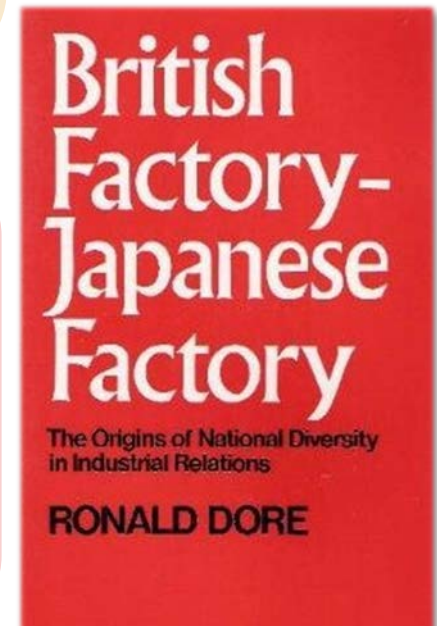
Whose company is it?

- The constituency of the Kaisha board members are other career employees of the company.
- Corporate objectives of US and Japanese management were polarized at date of publication.
- US management prioritized share price as second of nine objectives.
- Japanese management placed this last.
- One out of six of the major Kaisha executives have been executives of the company's union.
- *"Union and the Kaisha are co-terminous"*

British Factory/Japanese Factory

The Enterprise as a Community

- Compared working practices/employment systems at English Electric Company with Hitachi Company in 1972.
- Hitachi's spending on non-salary benefits equivalent to 8.5% of labor costs. British equivalent just 2.5%.
- In 1969, 15 of 20 Hitachi directors joined the company straight from full time education.
- In 1967, 6 of 16 English Electric Company directors were NEDs with no previous interest in the company.
- In reference to British factory.
- *"By and large, once one is outside the factory gates one is a citizen"*



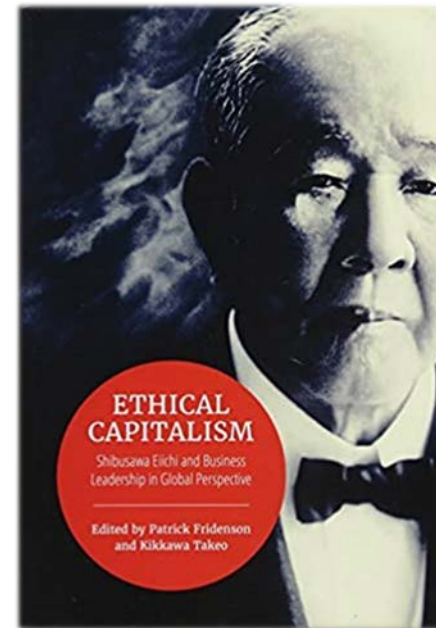
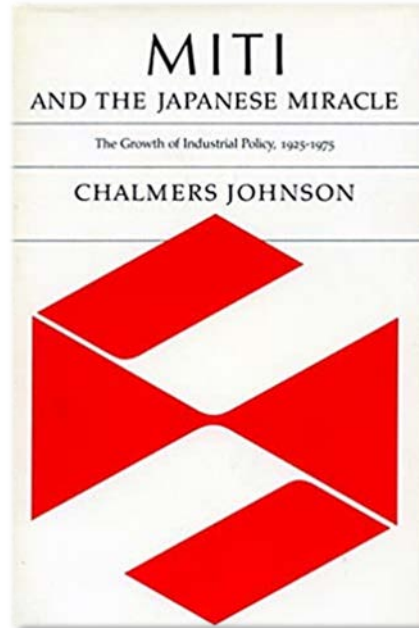
Gapponshugi: Ethical Capitalism (*cont'd*)

Reading List

MITI and the Japanese Miracle

Administrative Guidance

- MITI had been engaged in both the transfer of knowledge among enterprises and facilitated the share of best practice from one enterprise to another.
- Guidelines and policies entailed loans to targeted industries to lessen reliance on capital markets.
- Longer term views as opposed to quarterly revenue or annual metrics could be prioritized.
- MITI abetted by Japanese lifetime employment systems, enterprise unionism and the seniority based wage system.
- *“In some of its forms administrative guidance is indistinguishable from a formal legal order by the government”*

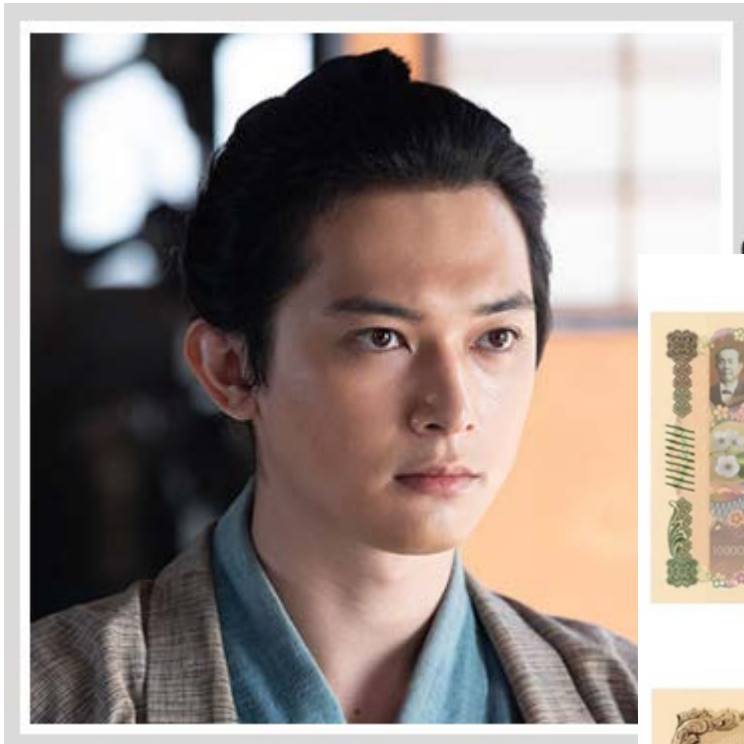


Ethical Capitalism

The Crisis of Capitalism and the Gapponshugi of Shibusawa Eiichi

- As Head of Dai-Ichi bank, Shibusawa championed Gapponshugi capitalism as an alternative means of societal and economic organization.
- Shibusawa's Gapponshugi model was the diametric opposite of the zaibatsu model associated with closed family-centred conglomerates.
- Often strong religious and spiritual values were the principal justification that led business leaders to advocate corporate responsibility.
- Top management may become very wealthy individually, but if most of society suffers in poverty, his own happiness will not last.
- *“Shibusawa introduced the concept of gapponshugi to describe a specific type of corporation based on manpower, capital, technology, information and intellectual network”*

“Seiten wo Tsuke” – “Reach for the blue sky”



表



裏



- NHK showing a 45 part drama series about the life and work of Shibusawa-san.
- Seiten wo Tsuke started on Sunday 14 February 2021 and runs for twelve months.
- Shibusawa-san will feature on the new ¥10000 note which will enter circulation in 2024.
- Yoshizawa Ryo, a well-known Japanese actor plays the role of Shibusawa-san. Many other famous actors play support roles.

Japan Equities: Dividend safety

Janus Henderson Global Dividend Index, May 2020

| Region (USD bn) | 2016 | % chg | 2017 | % chg | 2018 | % chg | 2019 | % chg |
|------------------------|----------------|-------------|----------------|-------------|----------------|-------------|----------------|-------------|
| Emerging Markets | 88.7 | -22.3% | 105.1 | 18.6% | 126.9 | 20.7% | 140.0 | 10.4% |
| Europe ex UK | 223.2 | 4.6% | 225.1 | 0.8% | 256.6 | 14.0% | 251.4 | -2.0% |
| Japan | 64.7 | 23.2% | 70.0 | 8.1% | 79.1 | 13.0% | 85.7 | 8.4% |
| North America | 445.0 | 0.9% | 475.7 | 6.9% | 509.7 | 7.2% | 534.7 | 4.9% |
| Asia Pacific | 117.8 | 3.5% | 141.6 | 20.2% | 150.4 | 6.3% | 147.7 | -1.8% |
| UK | 93.0 | -3.3% | 95.7 | 2.9% | 99.6 | 4.1% | 105.8 | 6.2% |
| Total | 1,032.4 | 0.1% | 1,113.2 | 7.8% | 1,222.4 | 9.8% | 1,265.3 | 3.5% |
| Divs outside top 1,200 | 131.0 | 0.1% | 141.2 | 7.8% | 155.1 | 9.8% | 160.5 | 3.5% |
| Grand total | 1,163.4 | 0.1% | 1,254.4 | 7.8% | 1,377.4 | 9.8% | 1,425.8 | 3.5% |

Source: Janus Henderson

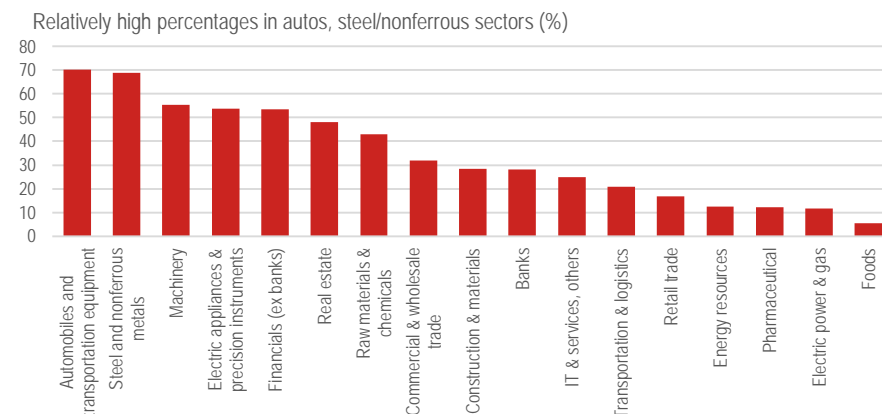
- GHDI Japan index ended the decade at 237.4, the fastest growing region in the world, up 137% on a headline basis.
- Japanese dividends have soared 173% in ten years, reflecting a growing willingness among Japanese companies to pay a higher ratio of profits to shareholders.
- 2019 was the fifth consecutive year of world-beating growth for Japanese dividends, though at 6.3% the underlying increase was the slowest in this period.
- Almost three quarters of Japanese companies raised their dividends last year.

For details, see [Investing for income: Look East note](#), dated June 2020

Japan: Recent results reassure on dividends

- Japanese banks have maintained dividends, despite downward earnings guidance from Mitsubishi and Mizuho.
- *“Some investors may be concerned about downside risks to dividends, but we see limited risk of this, at least for FY19 and FY20 as the common equity Tier 1 ratio at the three megabanks has remained around 12-16% ...the management of the banks in question is now more committed to long-term dividend upside”*
Ken Takamiya, Nomura, 16 March 2020
- *“We like the way that Suzuki Motor increased 20/3 DPS by ¥11 versus its previous projection to ¥85 by paying a commemorative dividend to mark 100 years in business even though profits fell sharply in 20/3 and the 21/3 earnings outlook is uncertain too.”*
Masataka Kunigimoto, Nomura, 26 May 2020

Japan: Dividend cuts in 2008



Note: Universe is TOPIX constituents as of end-March 2008. The chart shows the percentage of companies in each sector where FY08 DPS was lower than FY07 DPS. Sector classification is based on TOPIX 17 sectors. Source: Nomura, based on Bloomberg, company data

“We believe that Japan is likely to significantly outgrow other developed markets in dividends in 2020. This comes at a time when dividends paid by European companies could fall by 30% this year and 15% in the US”

Source: Financial Times, 18 May 2020

Japan's Income Favorites: Key metrics

Nomura Research: Most popular dividend names

| Ticker | Name | Market Value (USD mn) | Net Debt/ (Net cash) 2019 (USD mn) | Last Ann. Div (USD mn) | Dividend Cover (x) | ND/ EBITDA | Div Yield 2020E (%) | 2010-2019 DPS CAGR (%) |
|----------------|-----------------------------------|-----------------------|------------------------------------|------------------------|--------------------|------------|---------------------|------------------------|
| 9432 JP | Nippon Telegraph & Telephone Corp | 87,834 | 34,451 | 3,263.5 | 2.9 | 1.06 | 4.2 | 13.6% |
| 9433 JP | KDDI Corporation | 65,926 | 12,813 | 2,363.8 | 1.4 | 0.48 | 4.0 | 19.4% |
| 7267 JP | Honda Motor Co., Ltd. | 42,524 | 44,438 | 1,810.0 | 13.7 | 5.32 | 3.9 | 8.4% |
| 8316 JP | Sumitomo Mitsui Financial Group | 36,254 | na | 2,352.4 | 243.6 | na | 6.5 | 7.4% |
| 8766 JP | Tokio Marine Holdings, Inc. | 28,923 | na | 1,423.8 | 5.3 | na | 5.0 | 18.2% |
| 8001 JP | Itochu Corporation | 32,516 | 31,831 | 1,228.2 | 4.7 | 3.10 | 4.0 | 18.4% |
| 9984 JP | SoftBank Group Corp. | 89,582 | 105,600 | 7,725.3 | 4.0 | 5.98 | 1.0 | 37.5% |
| 4452 JP | Kao Corp. | 38,439 | (194) | 555.1 | 3.9 | (0.33) | 1.6 | 9.4% |
| 7751 JP | Canon Inc. | 26,433 | 924 | 1,573.1 | 2.6 | 0.11 | 7.3 | 3.3% |
| Average | | 49,825 | | | 31.4 | | 4.17 | 15.1% |

- We estimate that KDDI's dividend payout ratio will grow from 40.5% in 3/19 to 44.7% in 3/23. This will see DPS grow from ¥105 to ¥140.
- *"We now view KDDI as one of the most promising stocks in the telecommunications sector....."*
Daisaku Masuno, Nomura, 26 May 2020
- Nomura expects NTT to grow its dividend from ¥90 in 3/19 to ¥110 in 3/23 which implies a growth in payout ratio from 40.9% to 43.1%.
- *"NTT is projecting a ¥5 hike to DPS for 21/3 despite concerns about the impact of COVID-19."*
Daisaku Masuno, Nomura 26 may 2020
- Nomura expects Itochu's DPS to grow from ¥83 in 19/3 to ¥92 in 23/3.
- *"We like this proactive attitude toward dividend hikes and share buybacks at a time of concern about shareholder returns amid the downturn in business conditions."*
Yasuhiro Narita, Nomura, 22 May 2020

"Kao places priority on providing shareholders with stable, continuous dividends. Kao has raised annual dividends to 130 yen per share for the fiscal year ended December 31, 2019, the 30th consecutive increase in dividends" Kao website.
Nomura expects an annual dividend increment of ¥10 per annum through to December 22.

Appendix A-1

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As at 31 March 2021.

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