September 5, 2016

Cross share holdings

Summary
Cross share holdings are still a big issue in Japan, as the cancelation of shares and return on shareholders equity remain slower to improve. This report shows this evidence clearly, using analysis of 500 companies of core research universe as of August 2016. Average ROE and CG scores for 50 largest cross share holdings/sales companies were lower than those for overall 500 companies. A half of 50 companies are banks and those holdings have not really decreased for a year. Due to accountability to shareholders, companies should disclose cost/benefit on the holdings that put downward pressure on ROE by earning only dividends.

Cross share holdings under discussion for decades

Cross share holdings are a local issue that has been discussed on the improvement of return on shareholders equity (ROE) for many years. However this issue has not been solved yet, as many companies in Japan hold a large amount of shares as non-trading purpose shares in the balance sheet. It is well known that ROE of Japanese companies remains lower at 7.8% and far behind of US companies at 12% in FY2015. Such a lower ROE is mainly due to lower profit margin and lower asset utilization. While cross share holdings decrease at slower pace and many companies state that the holdings would help earnings enhance for long term view due to tightened relationship with business partners, ROE slipped 0.4ppt for FY2015.

Analysis on core research universe 500 companies

Examining cross share holdings for major companies based on our CG core research universe of 500 companies (mainly composites of JPX400 Index), these companies still maintain relatively large holdings compared with the business. The simple average of 500 companies in dollar vale of non-trading purpose share holdings to sales (revenue) was 10.8% for FY2015. Assuming asset turnover of approximately 1.0, the assets of cross share holdings would account for 10% of the total assets. The 10% of the balance sheet will earn dividend yield at 2% per annum and result in decreasing return on total assets, as the holdings are likely to hold for a long term. A company holds 10% of share holdings in the balance sheet will only earn ROE at 4% (=2%/50%) from the share holdings asset, if the company employs 50% financial leverage to the total assets. This would decrease return on shareholders value as an entire company.

The next chart shows relationship between cross share holdings and ROE for 50 largest holdings companies that own larger amount of shares against sales for FY2015. Median of ROE for the 50 largest cross-share holding companies was 5.9% for the year, whereas median of share holdings/sales was 46%. Only 6 companies could generate more than 10% of ROE for the year, holding non-trading purpose shares at 30% compared with sales on average, which was lower than median of 46% for 50 largest holding companies. This analysis apparently shows larger cross share holdings are likely to put under pressure on return on equity.

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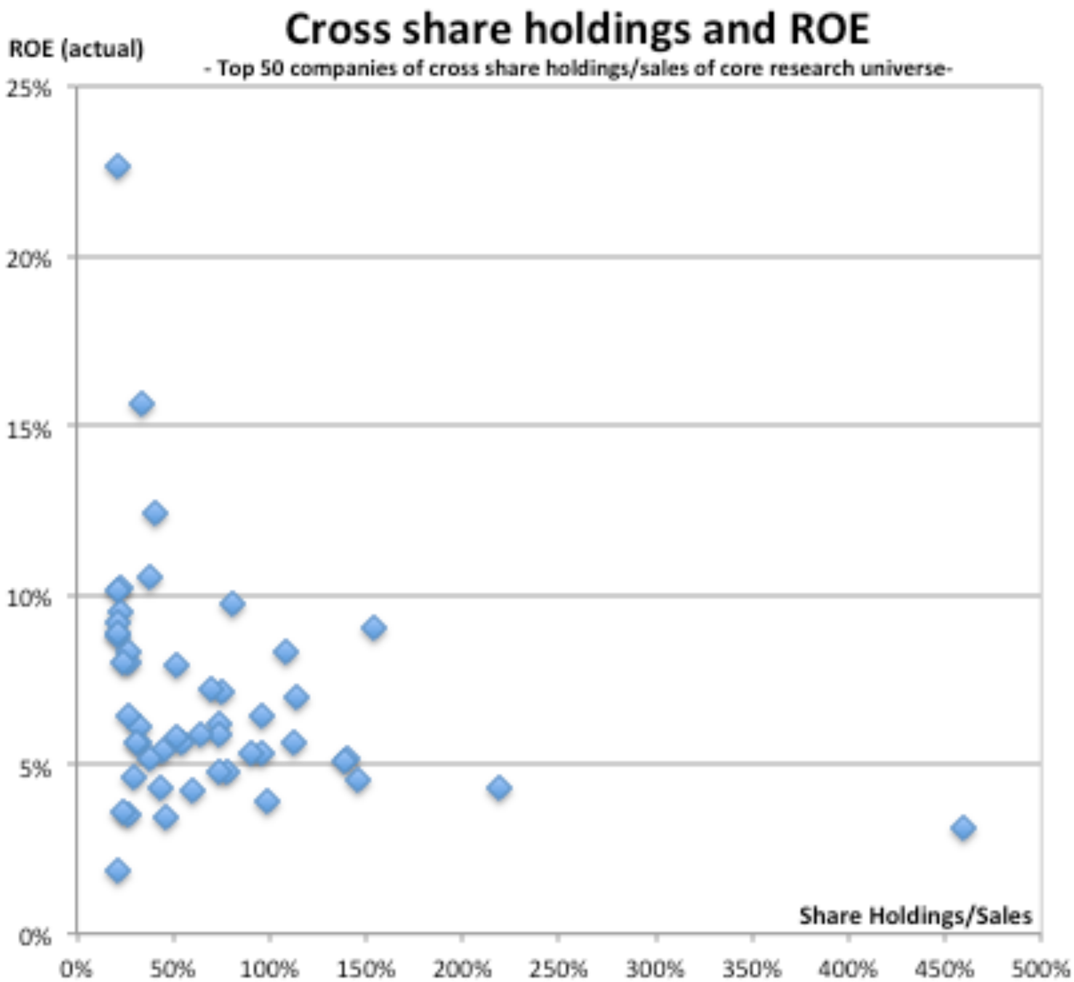

Slower cancelation of cross share holdings

The following 50 largest share holding companies against sales shows the holdings are decreasing at slower pace than expectations since 'Corporate Governance Code' was effective in June 2015. Only 7.8% for simple average of 50 companies decreased the share holding value from FY2014 to FY2015, whereas TOPIX Index fell 12.7% from March 2015 to March 2016, as most of the holdings were valued at the end of March in the fiscal year end. The cancelation seems to be slower pace, as only 18 of 50 companies decreased the holdings more than 12.7% for the period, although the change should be examined more carefully in one by one. This shows slower cancelation of holdings. Additionally, as expected, a half of the 50 companies are banks. This means it is still a big issue.

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JP Sec #	Company Name	Sales (JPY mil)	Share Holdings (excluding Trading purpose, JPY mil)				ROE (actual)	CG Score	CG Rating
			FY2015 (JPY mil)	Share holdings/Sales	FY2014 (JPY mil)	chg (FY2015-FY2014)			
8369	Bank of Kyoto	112,689	517,558	459.3%	602,979	-14.2%	3.1%	50.7%	B-
8385	Iyo Bank	119,348	260,756	218.5%	295,966	-11.9%	4.3%	55.0%	B-
8595	JAFCO	41,155	63,482	154.3%	68,885	-7.8%	9.0%	50.7%	B-
8359	Hachijuni Bank	181,203	264,651	146.1%	322,722	-18.0%	4.5%	57.6%	B-
8333	Joyo Bank	163,314	229,740	140.7%	259,309	-11.4%	5.2%	63.2%	B
8355	SHIZUOKA BANK	223,613	310,222	138.7%	346,297	-10.4%	5.1%	61.8%	B
8309	Sumitomo Mitsui Trust Holdings	1,198,904	1,364,983	113.9%	1,542,740	-11.5%	7.0%	66.7%	B
8334	Gunma Bank	136,220	152,649	112.1%	175,043	-12.8%	5.6%	54.1%	B-
8411	Mizuho Financial Grou	3,215,274	3,489,146	108.5%	4,136,842	-15.7%	8.3%	65.9%	B
8356	Juroku Bank	114,544	113,296	98.9%	135,364	-16.3%	3.9%	54.8%	B-
8331	Chiba Bank	228,693	220,262	96.3%	251,569	-12.4%	6.4%	57.3%	B-
8377	Hokuhoku Finantial Group	192,584	183,844	95.5%	180,607	1.8%	5.3%	55.7%	B-
4528	ONO PHARMACEUTICAL	160,284	145,153	90.6%	157,115	-7.6%	5.3%	57.8%	B-
8308	Resona Holdings	817,408	663,158	81.1%	712,358	-6.9%	9.7%	72.9%	B+
8524	North Pacific Bank	149,791	116,469	77.8%	116,480	0.0%	4.8%	53.7%	B-
8379	Hiroshima Bank	134,366	100,244	74.6%	116,220	-13.7%	7.1%	54.4%	B-
8306	Mitsubishi UFJ Financial Group	5,714,419	4,229,148	74.0%	4,951,678	-14.6%	6.2%	63.5%	B
8327	NISHI-NIPPON CITY BANK	154,905	113,597	73.3%	115,387	-1.6%	5.9%	57.0%	B-
6971	KYOCERA	1,479,627	1,084,117	73.3%	1,017,944	6.5%	4.8%	56.8%	B-
8316	Sumitomo Mitsui Financial Group	4,772,100	3,338,397	70.0%	3,952,419	-15.5%	7.2%	56.3%	B-
7186	Concordia Financial Group	334,500	214,214	64.0%	230,844	7.6%	5.9%	63.4%	B
7180	Kyushu Financial Group	131,224	79,584	60.6%	103,841	-23.4%	4.2%	57.7%	B-
8418	Yamaguchi Financial Group	165,504	90,258	54.5%	107,907	-16.4%	5.6%	59.2%	B-
8766	Tokio Marine Holdings	4,400,000	2,307,154	52.4%	2,884,938	-20.0%	7.9%	70.6%	B+
8354	Fukuoka Financial Group	236,707	123,346	52.1%	126,538	-2.5%	5.8%	49.1%	C+
8630	NKSJ Holdings	3,270,000	1,513,365	46.3%	1,883,220	-19.6%	3.4%	70.4%	B+
8544	Keiyo Bank	70,526	31,451	44.6%	39,033	-19.4%	5.4%	57.2%	B-
8600	TOMONY Holdings	60,962	26,123	42.9%	27,895	-6.4%	4.3%	51.6%	B-
8358	Suruga Bank	139,430	56,282	40.4%	61,360	-8.3%	12.4%	62.7%	B
8725	MS&AD Insurance	4,700,000	1,757,786	37.4%	2,253,641	-22.0%	5.2%	73.1%	B+
8830	Sumitomo Realty&Development	792,000	295,388	37.3%	306,807	-3.7%	10.5%	38.2%	C
8697	Japan Exchange Group	101,000	34,436	34.1%	37,055	-7.1%	15.6%	82.9%	A-
9404	Nippon Television Network	360,000	116,688	32.4%	125,287	-6.9%	5.6%	46.1%	C+
8253	Credit Saison	269,919	86,366	32.0%	89,433	-3.4%	6.1%	59.1%	B-
8804	Tokyo Tatemono	260,012	81,275	31.3%	81,640	-0.4%	5.6%	53.5%	B-
7173	Tokyo Financial Group	79,583	23,851	30.0%	30,125	-20.8%	4.6%	52.3%	B-
8801	Mitsui Fudosan	1,540,000	424,095	27.5%	457,886	-7.4%	6.4%	59.0%	B-
4581	TAISHO PHARMACEUTICAL HOLDIN	290,135	78,068	26.9%	82,126	-4.9%	3.5%	46.8%	C+
4530	HISAMITSU PHARMACEUTICAL	161,852	43,367	26.8%	43,737	-0.8%	8.0%	43.0%	C+
6201	TOYOTA INDUSTRIES	2,228,944	593,859	26.6%	695,974	-14.7%	8.3%	43.0%	C+
4676	FUJI MEDIA HOLDINGS	640,572	154,161	24.1%	169,527	-9.1%	3.6%	54.3%	B-
8795	T&D Holdings	2,380,000	568,498	23.9%	629,927	-9.8%	8.0%	54.5%	B-
4403	NOF	170,460	39,592	23.2%	41,594	-4.8%	10.2%	46.4%	C+
8601	Daiwa Securities Group	653,711	150,841	23.1%	159,155	-5.2%	9.5%	66.0%	B
4536	SANTEN PHARMACEUTICAL	195,291	42,969	22.0%	33,334	28.9%	22.6%	76.5%	B+
2267	YAKULT HONSHA	390,412	85,456	21.9%	78,401	9.0%	8.8%	53.8%	B-
7951	YAMAHA	435,477	95,066	21.8%	143,064	-33.6%	10.1%	72.4%	B+
5232	Sumitomo Osaka Cement	234,192	50,875	21.7%	61,043	-16.7%	9.2%	56.4%	B-
4569	KYORIN	119,483	25,847	21.6%	19,846	30.2%	8.9%	56.6%	B-
5214	Nippon Electric Glass	251,177	53,629	21.4%	47,038	14.0%	1.9%	46.7%	C+

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Cross share holdings and CG scores

Our CG scores focus on a goal of a corporation, maximizing shareholders value for a long term, and should include the degree of cross share holdings in the rating process, as large amount of share holdings would deteriorate return on shareholders value. Thus, higher ratio in holdings/sales would be lower CG scores accordingly. Average CG score for all 500 companies was 61.5 as of August 2016, whereas that for 50 largest holding/sales companies was 57.9. Average CG score for largest companies was 3.6 points lower than overall average score.

Conclusion

On the above analysis, cross share holdings are simply harmful for return on shareholders value, as ROE for the 50 largest holdings companies was 3.7ppt lower than that for overall 500 companies. Just earnings from dividend from the holding shares generate lower return and decrease return on total assets or return on shareholders equity. If a tightened relationship with business partners through the holdings generated much higher return on business as companies state, cost and benefit must be disclosed to shareholders. However, we have only seen it on the 'Corporate Governance Report' that many companies state cost and benefit or risk and return of holdings is examined more than a year in the company. Until now, they have not fulfilled sufficient accountability on it. The cross holding cancelation should accelerate more quickly, if not.

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