Peter Tasker
01 APRIL 2022

Arcus

PRIMED FOR ACTION: JAPAN'S NEW MARKET STRUCTURE

Summary

- Despite some watering down of initial plans, the new stock market structure does exert new discipline on listed companies.
- Specifically, the criteria for listing and maintaining a listing are now unified, which was not the case before.
- So companies will have to meet requirements on free float and liquidity on a continuous basis or face demotion.
- This is the latest move in the steady accretive process of Japanese corporate governance. It has secured buy-in from all significant stakeholders.
- The individual steps may seem small, but the change through time is extraordinary.

April 4th will see the Tokyo stock market's biggest shake-up in sixty years. Replacing the familiar structure of the TOPIX ("Tokyo Stock Price Index") First Section, the TOPIX Second Section, the JASDAQ ("Japan Association of Securities Dealers Automated Quotation") and Mothers markets, three new faces will appear.

The Prime Section, consisting of 1,841 names, is intended for blue chip companies that have passed onerous governance and disclosure requirements, as well as having a floating share proportion of at least 35%.

The Standard Section is less exacting, which is why 337 of the 2,185 members of the TOPIX First Section have opted for it. Altogether, it will contain 1,477 names.

The Growth Section, intended for younger, more dynamic companies, will start with 459 members.

The TOPIX Index, like the Nikkei 225 Index, will continue to exist, but it is likely that over time Prime will take over as the standard bearer of Japanese equities. Indeed, that is why the change-over has been so tortuous and controversial.

The original proposal was for a much smaller membership, along the lines of the S&P 500 ("The Standard and Poor's 500"), but many company managements feared that demotion to a "lesser" Section would have significant effect on their business, due to loss of credibility in the eyes of lenders, suppliers and potential hires.

Intense lobbying has led to a much larger Prime Section, which has led to a certain amount of cynicism amongst market participants. In particular, companies have been allowed up to seven years to meet the new, tougher criteria if they file a credible improvement plan with the TSE ("Tokyo Stock Exchange"). 296 companies have taken advantage of that option.

Yet, as noted above, even more companies have decided to drop down from Prime to the Standard section which suggest that the bar has indeed been raised. Managements seem to believe that failure to come up with a convincing road map could lead to the disgrace of compulsory demotion, which would be a worse fate than voluntary membership of Standard from the get-go.

The most radical change from the old system, which applies to all three of the new Sections, is that the new criteria must be met every year, not just at the time of listing, as was the case before. For example, stocks on the Mothers exchange were required to have a free float of at least 25% when they listed, but from then on only needed to clear 5%. The same goes for the minimum market capitalisation requirement, which should make managements a great deal more sensitive to shareholders' interests.

The fact that 84% of Prime names (meaning 1,545 stocks) have fully accepted the tight new rules, with their permanent and very real threat of demotion can only be a good thing. Yet there is still plenty of room for improvement. As JAPEX ("Japan Exchange Group Inc.") CEO ("Chief Executive Officer") Akira Kiyota was quoted as saying in the Nikkei newspaper ("The Nihon Keizai Shimbun"), April 4th, the date on which the new structure will be introduced, is "not the end, but the beginning."