

Equity Market Reactions to Japan's First Corporate Governance Code

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This version: May 2019

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This study examines equity market reactions to Japan's first national corporate governance code implemented in 2015. By investigating how stock prices reacted to: 1) a series of regulatory events leading to the implementation of the code, and 2) to comply-or-explain reports disclosed by Japanese firms for the first time as part of the code's mandatory disclosure, we find evidence showing the code's net positive impact on shareholder wealth. Our cross-sectional analyses suggest that 1) the net positive impact was driven by the majority of firms traded in Tokyo except high-disclosure-firms and that 2) firms exempted largely from the code's obligations also exhibited an increase in their shareholder wealth, signalling a spill-over effect of the code. Furthermore, we find that comply-or-explain reports are value relevant, and some of the code's 73 principles are associated with price decline of firms following their reports of deviation.

Keywords: disclosure, corporate governance, shareholder wealth, capital markets, event study, Japan

JEL classification codes: G3, G14, G30, G34, G38

1. Introduction

There continues to be changes around the globe made to regulations setting the mandatory disclosure requirements for publicly-traded firms, with a recent trend being adding non-financial information to the list of mandatory disclosure. In 2016 the advisory committee of the U.S. Securities and Exchange Commission called for modification of disclosure rules to add more qualitative factors to reporting requirements for U.S. firms. Japan introduced a mandatory disclosure of comply-or-explain governance reports in 2015, while the European Union set a disclosure requirement of non-financial information for large firms starting in their financial year 2017.

An increased demand for non-financial information comes after regulators and business leaders started to place stronger emphasis on the importance of environmental, social and governance (ESG) aspects of business. In the investment community, leading asset managers such as Japan's Government Pension Investment Fund (GPIF) and California's Public Employees' Retirement System (CalPERS) are increasing investments in firms with superior ESG behaviour. Surveys show that by 2015, three-quarters of investment professionals evaluate ESG information when making investment decisions (PwC 2014; CFA Institute 2015).

Compiling mandatory disclosure can take up resources and costs of public firms, while investors are increasingly swamped by a flood of corporate information coming from various different channels, including social media. Given that attention is a limited resource for any investor, it poses an empirical question whether an additional disclosure requirement, particularly on 'soft' non-financial information, helps investors make better decisions, or improves the efficiency of capital markets. As non-financial information had long been provided to investors as part of firms' voluntary disclosure, it may well be the case that the introduction of a new a mandatory rule requiring public firms to disclose non-financial information has little consequence in capital markets. It could also damage shareholder wealth if additional information costs incurred by the new disclosure regime are greater than its benefits.

Under a voluntary disclosure framework, investigating the impact of disclosing non-financial information on capital markets suffered from a self-selection bias. Japan's first corporate governance

code implemented with a mandatory disclosure rule of governance information provides an opportunity to develop a study based on an argument that changes made to firms' information environments are exogenous.

While there is extensive literature on the mandatory disclosure of financial information, studies focusing specifically on mandatory disclosure of non-financial information are relatively undeveloped. However, interest in disclosing non-financial information has been rising, and studies have presented mixed conclusions on whether adding a new non-financial mandatory disclosure regime benefits shareholder wealth.

By employing event study methods, this research provides evidence showing a net positive impact on shareholder wealth by mandatory disclosure of non-financial information provided by more than 3,000 companies traded on Tokyo Stock Exchange (TSE) in a relatively short period of time.

This paper also adds to the literature empirical evidence on a positive economic implication of a corporate-governance act. Specifically, it offers evidence showing a net positive effect for shareholders measured in stock returns throughout two test periods; a series of regulatory events leading to the introduction of the code and a series of publications of comply-or-explain reports during the year starting 1st of June 2015, when the code and its mandatory disclosure rule took effect.

While many prior studies examine stock returns during several legislative events to capture investors' expectations of the market-wide net effects of a regulation, this paper goes a step further by also examining stock returns in the first year of implementation. In this research's setting, investors were able to confirm whether the high-quality governance recommended by the code was being implemented in a specific firm when the firm published its first comply-or-explain report. The investors could then better assess the implications of the code on the firm, and take actions should they adjust their expectations formed before reviewing the firm's governance disclosure.

We find a statistically significant market-wide effect of plus 0.02 percent, suggesting that investors anticipate improvements in governance arrangements, transparency and investor confidence to outweigh the compliance and disclosure costs of the code. The positive effect is driven by the majority of firms listed on TSE, except those whose governance disclosure practices were evaluated

highly by Bloomberg at the time when the code took effect. TSE's secondary markets that are not fully exposed to the code and its disclosure regime also exhibited a net positive return behaviour despite the code's limited impact on their corporate information environment. This paper also examines how the new disclosure regime impacted shares of well-disclosed firms and poorly-disclosed firms. Reports of deviations from several of the code's 73 principles are negatively associated with return behaviour of TSE stocks, suggesting there exists a market pressure urging firms to adhere to these principles.

The remainder of the paper is organized as follows: Section 2 reviews the related literature and develops our hypotheses; section 3 describes the event history of Japan's corporate governance code, data and empirical methods; section 4 presents test results and the last section summarises findings.

2. Related literature and hypotheses

Prior works on mandatory disclosure of non-financial information include those that examined market consequences of the Sarbanes-Oxley Act (SOX), adopted in the U.S. in 2002. A group of studies document positive abnormal returns around the legislative events of SOX (Akhigbe & Martin, 2006; Jain & Rezaee, 2006; Li, Pincus, & Rego, 2008). On the other hand, another group of studies documents evidence showing net negative effects of SOX (Litvak, 2007; Zhang, 2007): The evidence on economic implications of SOX is therefore mixed and inconclusive.

Among the reasons for the conflicting findings may be that SOX applies to the vast majority of U.S. public firms, making it hard to find a natural control group of unaffected U.S. public firms. It is also difficult to isolate SOX effects from unrelated concurrent events as SOX-related events are often clustered in time (Leuz & Wysocki, 2016). To investigate the causal relationship between SOX and stock reactions, SOX-unexposed foreign firms are used by Litvank (2007) and Zhang (2007). Researchers have also exploited cross-sectional differences to distinguish firms that need to make large changes to adhere to SOX requirements from firms that were already compliant with the requirements as part of their identification strategies. (Li et al, 2008; Zhang, 2007; Litvank, 2007)

There are two different routes shown by prior studies on how the code may cause consequences in the equity market. Firstly, the literature argues that disclosing information can reduce information asymmetries between inside managers and outside investors. By making more internal information available to the public, the risk of estimating a firm's value over uncertain parameters can be reduced, leading to lowering the required rate of return on equity (Barry & Brown, 1985; S. Brown, 1979). On the other hand, the stakeholder theory provides a framework for arguing that not only financial information but also non-financial information on a firm's social behaviour influences the firm's value (Harrison & Freeman, 1999). In this context, corporate governance can be viewed as a mechanism to protect investors against expropriation by insiders (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2000). Therefore, information on governance arrangements is value-relevant because investors demand a higher risk premium for investment in a firm reporting poor governance arrangements, and vice versa.

Investors' anticipation of the code's net effect can be captured by examining equity-market reactions before and after the implementation of the code because investors' expectation on the net effect is priced in firm values during two stages: Firstly at the time when the code's drafts were made public, and secondly at the time a firm publishes its comply-or-explain report. An investor may take an action immediately after seeing a draft of the code at one of regulatory events anticipating net benefits of the code on a particular firm. The investor may then become disappointed in seeing the firm's report, showing lower-than-expected degree of adherence to the code, or lower-than expected quality of narrative information, and make an adjustment to their portfolio.

A net positive change in stock price throughout the code's legislative process and first-time disclosure of comply-or-explain reports ('the announcement events'), would indicate that investors anticipate benefits from the code through improvements in governance arrangements, transparency and investor confidence to outweigh the compliance and disclosure costs of the code. A net negative change in stock price would suggest investors anticipate net costs of the code. Hence, our first hypothesis:

H1: The equity market's net reaction to the announcement events is significantly different from zero: A net positive change indicates investors' anticipation that the code is net beneficial to shareholder wealth, whilst a net negative change indicates that investors anticipate a net cost effect of the code.

The literature suggests that equity reactions would be absent under certain conditions. Among the conditions is a lack of credibility of the disclosed information (de Jong, DeJong, Mertens, & Wasley, 2005). We presume that this is not the case for Japan's corporate governance as although comply-or-explain reports aren't audited, the reports are distributed by TSE's Timely Disclosure Network (TDNET) which is open to the public. Once disclosed on TDNET, the information content cannot be erased or altered by the disclosing firm. It is anticipated that a firm will make its best efforts to submit only credible information to TDNET because of the limited control over the content on TDNET.

Another condition leading to an absence of stock reactions is when code recommendations are too easy to follow and thus deemed 'useless' by investors (Goncharov, Werner, & Zimmermann, 2006). We argue that this is the case for firms listed on TSE's secondary-market section that are exempted from 68 out of the 73 principles of the code.

Japan's corporate governance code consists of five General Principles (GP) and 68 Principles and Supplementary Principles (SP), as shown in the Appendix. The five GPs offer nothing more than a general outline of the very basic spirit of the code, without calling for any specific action.

For instance, GP-1 calls for 'appropriate measures' to be adopted by companies to 'fully secure shareholder rights' but doesn't say what are recommended as 'appropriate measures'. 'Appropriate measures' are specified by the 7 principles and 9 supplementary principles listed under GP-1. Among them is SP 1-2-4 recommending the creation of an electronic voting infrastructure to allow overseas investors to exercise their voting rights online without physically attending a general shareholder meeting.

Appointing two or more non-executive directors and adoption of performance-based remuneration for management are also part of specific recommendations of the 68 Principles and SPs.

The recommendations to provide narrative explanations on a wide range of management policies, including cross-shareholdings, related party transactions, and how to evaluate the board's effectiveness are also set by Principles and SPs. Firms listed on TSE's main-market section are obliged to report their policies on each and all of 73 principles of the code in a comply-or-explain report. On the other hand, firms listed on TSE's secondary-market section only need disclose their policies on the 5 General Principles. Almost all secondary-market firms reported full compliance in the first year of the code, while about half of main-market firms reported one or more deviations.

Based on the assumption that the 5 General Principles of Japan's corporate governance code are value irrelevant, we form a subgroup consisting of secondary-market firms ('exempted' firms) and another comprised of main-market firms that are fully exposed to the code ('exposed' firms). We presume that there exists a cross-sectional variation in the stock behaviour that can be attributed to whether a firm is fully exposed to the code or largely exempted from the code.

We then use Bloomberg's corporate governance disclosure scores (G-score) as of June 1, 2015, when the code and its disclosure rule took effect, to divide sample firms into groups ranked by the ratings. A 'transparent' firm with a relatively high G-score would likely see little benefit or cost from the new mandatory disclosure rule implemented with the code, because it had already provided high-quality information on its governance practices voluntarily. Therefore, their shares may show little or no reaction to the announcement events.

On the other hand, an 'opaque' firm with a relatively low G-score, whose governance information was poorly disclosed before the code, would likely face some significant compliance costs and benefits. In the case of opaque firms, investors' anticipation could be either positive or negative. They may foresee compliance and disclosure costs of the code to outweigh its benefits for those firms, leading to a negative share reaction. If they anticipate otherwise, share reactions of opaque firms could be positive.

Next, we examine whether comply-or-explain reports deliver information useful to investors. Since 1st of June, 2015, TSE-listed firms started to publish comply-or-explain reports on a date they chose, often following TSE's guideline to set the publication date within six months from holding an

annual general shareholders' meeting. Each firm's report publication dates was not known to the public beforehand.

As discussed earlier, investor anticipations about the net effects of the code formed during the pre-implementation regulatory process may be adjusted when firms publish comply-or-explain reports. Such adjustments in prices should be observed for the disclosure event of exposed firms, but not for the disclosure events of exempted firms. Furthermore, these return behaviours can be either positive or negative in direction, depending on the information conveyed by each report. Investors may become disappointed by a report showing a lower-than-expected degree of adherence to the code, resulting in a negative stock returns. Investors can also be impressed by a report showing high-quality governance arrangements, leading to a positive share return. Therefore, we examine the absolute values of stock returns associated with each disclosure to capture market responses regardless of the direction of effects. We state our second hypothesis as:

H2: The equity market's average of absolute reactions to comply-or-explain reports is significantly different from zero.

Lastly, we presume that there exists market pressure for firms to comply with the code in the form of price decline following a report of deviation from code recommendations. Prior studies report that equity markets react positively to announcements of compliance with best practices recommended by a code (Fernandez-Rodriguez, Gomez-Anson, & Cuervo-Garcia, 2004; Goncharov et al., 2006). Therefore our third hypothesis is:

H3: There exists a significant negative association between a report of deviation from code principles and the share price of the firm reporting the deviation.

3. Research Design

a. Data

Sample firms were selected according to the following criteria: 1) From a pool of domestic stocks listed on TSE as of March 2018, 2) Equity Contribution Securities and ETFs were dropped,

and 3) acquired firms, delisted firms and firms listed since April 2014 were excluded. The selection process resulted in a group of 3,007 individual firms trading their shares on TSE throughout the test period of this study. Table 1 presents the result of this selection process.

Of the 3,007 firms, 2,245 firms traded on the TSE's main markets are fully exposed to the code. 762 firms traded on the TSE's secondary markets are exempted from the 68 'useful' principles of the code (Table 2). The secondary-market firms tend to be small local businesses, as summarised in Table 3 and Table 4.

>>Table 1, 2, 3, 4<<

G-scores rated as of June 2015 were collected using Bloomberg. The scores ranged from 5.3 to 67.9 in a scale of 100, with a median value of 46.4, as shown in Figure 2. A total of 1,908 sample firms have a G-score rated as of June 1, 2015, when the code took effect. 1,842 firms were traded on TSE's main markets, with the median value of their G-scores standing at 46.4, as shown in Figure 1 and Table 5.

G-scores are part of Bloomberg's ESG data product launched globally in 2009. Bloomberg assign its ESG ratings to companies that are adopted by global equity indices. Additionally, it also assigns its ratings to a company upon its data user's request, if the company has over \$30 million in market value and its quantitative ESG data are publicly available. The average G-score of Japanese companies was 45.5, compared to a 50.6 average of U.S. firms and a 55.5 average of U.K. companies, rated as of January 2018.

>>Figure1, Table 5<<

Daily closing stock prices and market values of sample firms were obtained from Datastream, while other financial data were obtained from the Worldscope Global Database. Information on listing and delisting, market sections, industry breakdowns and code principles were obtained from TSE's website.

Data on comply-or-explain reports were manually collected using Bloomberg, which gathers and stores disclosure documents distributed by TDNET. The information includes: 1) The date and time the firm disclosed its first comply-or-explain report, 2) the number of non-compliance

explanations listed in the report and 3) whether any announcement was made on the same trading day as the publication of its first comply-or-explain report through TDNET. A trading date, in this study, ends at 3 p.m. when the TSE closes daily trading. Figure 2 presents the distribution of dates of first-time comply-or-explain reports.

b. Event history

This section explains a series of regulatory events that took place in 2014 and 2015 related to the introduction of Japan's first corporate governance code.

The code was introduced in June 2015, as part of Prime Minister Abe's economic revival plan. It adopted a comply-or-explain mechanism, which allows companies to choose between compliance and non-compliance with the principles of the code. Whilst adherence to the code is voluntary, firms are required to publish annually a comply-or-explain report articulating how they applied each and all of the 73 provisions and principles of the code. In the case of non-compliance, the firm must explain why it chose to deviate from the code.

The code was aimed at playing both a normative role and a descriptive role. The normative role was to set a clear and comprehensive governance standard that can win recognition from investors worldwide. The second objective of the code was to make Japanese governance practices more transparent and understandable. The code's mandatory disclosure rule requires firms to provide narrative explanations on their capital policies, arrangements over cross-shareholdings and related-party transactions, and procedures for appointing directors and their remuneration. In other words, the descriptive role is designed to enhance transparency of, and investor confidence in Japanese management style.

On 14 June, 2014, the prime minister's office drafted the "Japan Revitalization Strategy Revised in 2014 – Japan's Challenge for the Future" (Japan Revitalization Strategy 2014), which stated that a corporate governance code would be introduced by June 2015. The economic plan included various other initiatives that could potentially impact private businesses, such as the reform plan for investment policies of public pension funds, a plan for facilitating venture financing

businesses, promotions of innovations in robotic technologies and setting up of more nursery schools to help working mothers.

Japan Revitalization Strategy 2014, which stated that the Tokyo Stock Exchange would draft the Corporate Governance Code, was officially approved at a cabinet meeting on 24 June 2014. The economic plan, along with the scheduled introduction of the code, attracted the attention of all major Japanese newspapers.

However, Japan Revitalization Strategy 2014 was not the first attempt to introduce a plan for Japan's first corporate governance code. The ruling Liberal Democratic Party had released its "Japan Revival Vision" on 23 May 2014 about three weeks before Abe's Japan Revitalization Strategy 2014, which included an introduction of a national corporate governance code, deregulations to promote venture businesses and empowerment of women, all of which overlapped with Abe's Revitalization Strategy. Although the LDP's Revival Vision wasn't widely covered in the media, we include the event in our event-study analysis as it revealed the leading political party's intention to carry out corporate governance reform. After Abe's administration appointed a new central bank governor who promoted quantitative easing, anticipation had grown for reforms in the corporate sector to pave the way for Japan to overcome deflation and weak consumer confidence.

On 7 August, 2014, the Council of Experts Concerning the Corporate Governance Code (the Council) was jointly set up by Japan's Financial Services Agency and TSE. The council held nine meetings until publishing the final draft of the code on 5 March, 2015. Minutes and materials of the Council's nine meetings were posted on the Financial Services Agency's website in both Japanese and English shortly after each meeting closed. The dates of the nine council meetings are included in our analysis.

The first five meetings reviewed corporate governance codes of the U.K., Germany and France, as well as the Organisation for Economic Co-operation and Development (OECD)'s corporate governance principles. The five meetings provided a basic idea about what may be included in Japan's code.

The first draft of the code was presented at the sixth meeting held on 12 November 2014 in a 22-page document. Additions and modifications were made to the draft at subsequent meetings, on 25 of November and 12 of December. In the ninth meeting on 5 March 2015, the council published its final proposal titled “Japan’s Corporate Governance Code – Final Proposal – Seeking sustainable Corporate Growth and Increased Corporate Value over the Mid- to Long-Term”. The code was implemented on 1 June, 2015, by the Tokyo Stock Exchange by revising its listing and disclosure rules.

In summary, we identify 12 regulatory events corresponding to the dates when a plan to introduce a national governance code and the contents of the code was released to the public. The dates in the chronological order are as follows: May 23, 2014 (LDP’s Japan Revival Vision), 14 June (Abe’s Japan Revitalization Strategy draft), 24 June (Cabinet approval of Japan Revitalization Strategy), 7 August (the Council’s first meeting), 4 September (the Council’s second meeting), 30 September (the Council’s third meeting), 20 October (the Council’s fourth meeting), 31 October (the Council’s fifth meeting), 12 November (the code’s first draft revealed by the Council), 25 November (the second draft revealed by the Council), 12 of December (the third draft revealed by the Council) and 5th of March 2015 (the final proposal revealed by the Council). None of these events were anticipated beforehand.¹ Table 6 summarises above 12 events.

>>Table 6<<

For the post-implementation disclosure analysis, an event is set for each firm corresponding to the date when the firm’s first comply-or-explain report was published (‘disclosure date’). The disclosure dates vary between firms, as shown in Figure 1. A typical Japanese firm closes its financial year at the end of March and holds an annual general shareholders’ meeting late June. Following TSE’s disclosure guideline, such a company would submit its comply-or-explain report by the end of the year, coinciding with the chart’s peak on 18th December, 2015.

¹ We found no media report that revealed any of above key events before a formal announcement was made Using Factiva’s news search, we investigated news articles of four Japanese major news agencies: the Nihon Keizai Shimbun, the Asahi Shimbun, the Mainichi Shimbun and the Yomiuri Shimbun.

21 percent of main-market firms (474 companies) reported full compliance with all 73 principles of the code, while 79 percent (1,788 companies) reported at least one reason for non-compliance with some principles, according to TSE's survey published in September 2016.

>>Figure 2<<

c. Empirical method

For each event, we compute daily abnormal returns (AR) using the below equation.

$$AR_{jt} = R_{j,t} - R_f - \beta_1(R_{m,t} - R_f) - \beta_2SMB_t - \beta_3HML_t \quad (1)$$

Where $R_{j,t}$ is the daily return of a stock j at t , the ratio of the closing price at (t) to the closing price at $(t-1)$, adjusted for any capital actions. AR is the portion of the stock's daily return that cannot be explained by the Fama-French three-factor model. The three factors are: The excess return of all-stock market over the risk-free rate, $(R_{m,t} - R_f)$; the difference in returns of portfolios of small and large stocks, (SMB_t) ; and that of portfolio of value and growth stocks, (HML_t) . β_1 , β_2 and β_3 are estimated by ordinary least square regression using the data in an estimation window of one year, or 252 trading days.

We use for $R_{m,t}$ the Nikkei All Stock Index, a market value-weighted stock index computed by Nikkei Inc. using all common stocks listed in all stock exchanges in Japan. We obtain SMB_t by subtracting TOPIX100 index from TOPIX Small index. TOPIX100 is computed by TSE using the 100 most liquid and highly market-capitalized stocks on the TSE First Section. TOPIX Small is created by excluding the 500 most liquid and highly market-capitalized stocks traded on the First Section. We subtract TOPIX Growth index from TOPIX Value index to compute HML_t . TOPIX Growth and TOPIX Values are created out of TOPIX constituents using their price-to-book ratios. TOPIX indices are all free-float adjusted market-capitalization weighted indices.

The estimation window used in the regulatory events analysis is the 252-day period preceding the first event date, May 23, 2014, and is common for all sample firms. For the post-implementation

disclosure analysis, an estimation window is set for each firm as the 252-day period preceding the baseline estimation period, which is explained later in this section.

As we are uncertain how quickly the market reacts to each event, the commonly-used event periods of 3 trading days and 5 trading days are used in this study to calculate cumulative abnormal returns (CAR). For each sample firm, CARs are computed for each of its events using the equation below, where L=the number of trading days in the event window, or 3 for 3-day CAR (CAR3) and 5 for 5-day CAR (CAR5). CAR3 is computed for each event using the period one trading day before and after the publication date, or (t-1 to t+1), and CAR5 is computed using the period (t-2 to t+2).

$$\widehat{CAR}_j = \sum_{t=1}^L AR_{jt} \quad (2)$$

In our significance tests, we examine CAR as well as standardized cumulative abnormal returns, SCAR. SCAR is computed as the total value of standardized abnormal returns, SAR, in an event window. SAR, defined as abnormal returns divided by the standard deviation of a firm's abnormal returns during the estimation period, enables us to compare the significance of abnormal share returns between subgroups with different levels of average share volatility. Deflating AR by the standard deviation ensures homogeneity of variance of abnormal return. With SAR, the higher the volatility of a stock, the greater the magnitude of an abnormal return needs to be to reach a certain significance level. Following prior studies (Baginski, Bozzolan, Marra, & Mazzola, 2016; S. J. Brown & Warner, 1985; Bushee, Jung, & Miller, 2011; Cready & Hurtt, 2002; Patell, 1976), we compute SCAR by;

$$\widehat{SCAR}_j = \sum_{t=1}^L SAR_{jt} = \sum_{t=1}^L AR_{jt} / S(AR_j) \quad (3)$$

Where $S(AR)_j$ is the standard deviation of firm j's abnormal returns obtained over the estimation period. Given the standard deviation of SCAR equals one, the test statistic for SCAR is simply;

$$\frac{\overline{SCAR} - 0}{\sigma(SCAR)\sqrt{N}} = \frac{\overline{SCAR}}{\sqrt{N}}$$

(4)

Where \overline{SCAR} is the cross-sectional mean of SCAR, $\sigma(SCAR)$ is the standard deviation of SCAR, and N is the number of observations.

In our analysis of first-time disclosure of comply-or-explain reports, CAR and SCAR are converted into their absolute values because the price impact is expected to be bidirectional. (Bushee et al., 2011; Cready & Hurtt, 2002; Flannery, Hirtle, & Kovner, 2017, Francis, Schipper, & Vincent, 2002)

$$CAR_j = |CAR_j| \quad (5)$$

$$\text{Absolute SCAR}_j = |SCAR_j| \quad (6)$$

Following prior studies, we test the significance of absolute CAR and absolute SCAR by comparing event-period values against pre-event period baseline values by the Wilcoxon matched-pairs signed rank test. The baseline CAR3 is computed by taking the average of 5 values of CAR3, for the period (t-3 to t-5), (t-6 to t-8), (t-9 to t-11), (t-12 to t-15) and (t-15 to t-17). The baseline CAR5 is computed by taking the average of 3 CAR5 values, for the period (t-3 to t-7), (t-8 to t-12) and (t-13 to t-17).

Additionally, to control for ‘contaminating’ announcements, news releases other than comply-or-explain reports occurring within event periods, we create an indicator variable denoting one for such a concurrent disclosure, and zero otherwise..

The net cumulative abnormal return of a stock throughout the regulatory and disclosure events is then obtained by aggregating the CAR for each event. The values of NET_CAR3, the sum of the 13 values of CAR3 computed for each firm, are averaged across the four subgroups: exposed firms, exempted firms, opaque firms and transparent firms. NET_CAR5, NET_SCAR3 and NET_SCAR5 are also computed in a similar manner.

Lastly, we perform cross-sectional analyses using NET_CAR and NET_SCAR to investigate whether there is a market pressure for firms to adhere to specific code principles. The multivariate

regression model below is used for this analysis controlling for firm-specific characteristics of size, capital structure, profitability and G-score. Our focus is on code principles reported as non-compliance and whether they are negatively associated with the total return behaviour of a stock, measured in NET_CAR or NET_SCAR.

$$\text{NET_CAR}_j = \alpha_j + \gamma_1 \text{SIZE}_j + \gamma_2 \text{DE}_j + \gamma_3 \text{ROE}_j + \gamma_4 \text{GSCORE}_j + \gamma_5 \text{CONCURRENT}_j + \sum \gamma_k \text{INDUSTRY}_j + \sum \gamma_l \text{CODE}_j + \varepsilon_j \quad (7)$$

Where NET_CAR_j is computed by totalling cross-sectional average values of CAR3 or CAR5 throughout 12 regulatory events and one disclosure event. SIZE_j is the natural logarithm of firm j's total assets, DE_j is firm j's ratio of debt to total capital and ROE_j is firm j's return on equity, all measured as of June 1, 2015, when the code took effect. GSCORE_j is firm j's Bloomberg G-score, and CONCURRENT_j denotes 1 if there was a concurrent announcement made by firm j on the same day as its disclosure of first-time comply-or-explain report. We also used TSE 33 sector codes to control for industry sector. CODE_j is an indicator variable denoting 1 if the firm j reports a deviation from a code principle, otherwise zero. We excluded from the analysis 25 code principles for which less than 10 firms reported a non-compliance.

The multivariate regression model (2) was also used to analyse SCAR with NET_SCAR_j used as the dependent variable.

4. Results

a. Regulatory-event analysis

Table 7 reports the results of the regulatory-event analysis for all sample firms using the four test variables, CAR3, SCAR3, CAR5 and SACAR5, computed for each of the 12 regulatory events. All the 12 events we identified triggered a price reaction measured either in CAR3 or CAR5. For CAR3, the null hypothesis was rejected in 9 regulatory events with a positive significant value observed for 8 events, and a significant negative value observed for 1 event. The 9 values of CAR3 that are found to

be significantly different from zero total 0.022. A net positive value suggests that throughout the regulatory events, investors anticipated the code to be net beneficial on shareholder wealth. Similarly, a net positive value of 0.017 percent was obtained when using CAR5.

Table 8 presents the results of regulatory-phase analysis on separate portfolios of 4 subgroups: exposed firms, exempted firms, opaque firms and transparent firms. The cross-sectional average of the four test variables were mostly significantly positive for three of the subgroups: the portfolio of exposed firms, exempted firms and opaque firms. By contrast, share reactions of transparent firms were insignificant in most cases; a positive value of CAR3 and SCAR3 were observed for only one of the 12 key regulatory events. 2 and 4 significant values were obtained for CAR5 and SCAR5 respectively, with mixed directions of impact. The results indicate that the market-wide positive CAR was driven by TSE firms other than transparent firms. Whilst investors anticipated Japan's national corporate governance code to be net beneficial on shareholder wealth for the majority of TSE firms, their expectation of the code's effect on transparent firms was mostly insignificant during the pre-implementation phase of the code.

>>Table 7, 8<<

b. Disclosure-event analysis

Figure 3 illustrates that the cross-sectional mean of absolute abnormal returns (AAR) jumps around the disclosure date, denoted as 0 in the horizontal axis. By contrast, the cross-sectional mean of raw abnormal returns, or AR, presented in the same chart doesn't show any apparent change around the disclosure date. A similar trend is observed for absolute SAR (ASAR) and SAR in Figure 4. This shows that the price impact of a comply-or-explain report is bidirectional; some reports cause positive share reactions, while other reports lead to prices declining, cancelling each other's impact. However, price reactions are apparent around the disclosure date when we look at the absolute values of abnormal returns.

Absolute values of CAR3, CAR5, SCAR3 and SCAR5 were tested by the Wilcoxon matched-pairs signed rank test between a baseline period and an event period, as shown in Table 9. All four variables were found to be significantly greater during an event period in comparison with the corresponding baseline values. The results indicate that, even as non-financial information, including governance information, had long been provided to investors as part of firms' voluntary disclosure, the introduction of a new a mandatory rule still caused significant price reactions in the equity market. This suggests that governance information in comply-or-explain reports is relevant to the valuation of firms.

>>Figure 3 & 4, Table 9<<

c. Total cumulative return throughout announcement events

Chart 5 illustrates the distribution patterns of the four total return variables, NET_CAR3, NET_CAR5, NET_SCAR3 and NET_SCAR5. The variables are computed by totalling cross-sectional average values of CAR3, CAR5, SCAR3 and SCAR5 throughout the 13 announcement events (12 regulatory events and the first-time disclosure of comply-or-explain report), spanning the period from May 23, 2014 to May 31, 2016. The four variables are found to be significantly greater than zero, as shown in Table 10. A net positive value suggests that throughout the announcement events, investors anticipated the code to be net beneficial to shareholder wealth.

Table 11 presents the results of total-return analysis on separate portfolios of 4 subgroups: exposed firms, exempted firms, opaque firms and transparent firms. In three of the four subgroups, exposed firms, exempted firms and opaque firms, a significant positive value was obtained for all four total-return variables. By contrast, for the portfolio of transparent firms, a negative value was obtained for each of the four total-return variables; however, they were statistically insignificant. This suggests that investors anticipated the code's effect to be net beneficial for firms traded on TSE except those already were transparent before the code was implemented. The results are consistent with the findings from the regulatory-phase analysis. Whilst investors anticipated Japan's national corporate governance code to be net beneficial on shareholder wealth for the majority of TSE firms, their expectation of the code's effect on transparent firms was insignificant.

The magnitude of the coefficients was largest for exempted firms in each of the four test variables, suggesting that exempted firms drive the net positive effect of market-wide shareholder wealth. This is contrary to our expectation that their excess share returns would be smaller, or could even be insignificant, because of their limited exposure to code obligations. This suggests that even as they are exempted from 68 out of the 73 principles of the code, investors anticipate greater benefits of the code for exempted firms than for exposed firms. One interpretation of this result is that investors anticipate a spillover effect of the code that comply-or-explain reports published by main-market firms will encourage secondary-market firms to improve their governance arrangements and transparency to gain a higher investor confidence.

>>Chart 5, Table 10, Table 11<<

Table 12 and Table 13 present the results of the cross-sectional multivariate analysis on NET_CAR and NET_SCAR. Firm size has a significant negative effect, suggesting that the bigger the firm, the more negative the price reactions were to the regulatory and disclosure events. Reports of deviations from five code principles had a significant negative impact on NET_CAR3, whilst two were significantly positively associated with the variable. For NET_SCAR3, six principles have a significant negative association with the return, whilst two had a significant positive association.

The principles with significant negative associations with NET_SCAR3 are SP2-2-1, P2-4, SP3-1-1, SP 3-2-2, P4-6 and SP4-10-1. SP2-2-1 recommends the board to regularly check whether a code of conduct for employees is widely implemented and whether the corporate culture truly embraces the intent and spirit of the code of conduct. P2-4 calls for ensuring diversity, including active participation of women. SP3-1-1 calls for value-added information disclosure on company objectives, basic views on governance, policies and procedures in determining remuneration and in appointing management and board directors. It also states that disclosure should not be boiler-plate.

SP3-2-2 lists measures to ensure high-quality audits, such as giving external auditors access to management, the internal audit department and directors. It also says a firm should be structured in a way it can respond to any misconduct identified by external auditors.

P4-6 calls for use of non-executive directors. SP4-10-1 recommends firms to seek advice from non-executive directors to ensure the objectivity and accountability of important decisions such as nominations and remuneration of senior management and directors. SP4-12-1 lists measures for ensuring active discussions at board meetings, including distributing materials to directors in advance with supplemental information as needed.

On the other hand, P2-5 and SP4-8-2 had significant positive associations with both SCAR3 and SCAR5. P2-5 recommends establishment of a whistleblowing framework. SP4-8-2 encourages independent directors to appoint the lead independent director to play a key role to facilitate communication with the management.

5. Conclusion

Evidence presented in this paper supports our first hypothesis, which stated that the equity market's net reaction to the announcement events is significantly different from zero. This paper finds a significant positive average stock return indicating investors' anticipation that the code is net beneficial to shareholder wealth. The market-wide net effect was estimated as 0.02 percent in 3-day cumulative abnormal return.

The market-wide positive effect was driven by TSE-listed firms other than those whose disclosure level was already high before the code was introduced. This suggests that the bigger information asymmetries between inside managers and outside investors, the greater the benefit of the code implemented with a mandatory disclosure rule. The finding also suggests that non-financial governance information is value-relevant, and is consistent with the literature arguing that making more internal information available to the public can result in lowering the required rate of return on equity.

Firms traded on TSE's secondary market section, that are exempted largely exempted largely from the code's obligation exhibited an increase in their shareholder wealth despite the code's limited impact on their corporate information environment. This may signal a spillover effect of the code anticipated by investors that comply-or-explain reports published by main-market firms, fully exposed

to the code's requirement, would encourage secondary-market firms to improve their governance arrangements and transparency to gain a higher investor confidence.

Our disclosure analysis found evidence showing that the equity market's average of absolute reactions to comply-or-explain reports is significantly different from zero. The evidence supports our second hypothesis and suggests governance information in comply-or-explain reports is useful to investors even as governance information had long been provided to investors as part of firms' voluntary disclosure.

Our multivariate regression analysis also supported our third hypothesis that showed that there is a significant negative association between a report of deviation from code principles and the share price of the firm reporting the deviation. This indicates that there is a capital market pressure for firms to adhere to some of the code's principles, including P2-4 calling for diversity and active participation of women and SP3-1-1 calling for value-added non-financial information disclosure on company objectives, governance policies and procedures in determining remuneration and in appointing management and board directors. A negative correlation with stock price was also found for principles related to use of non-executive directors. These findings are consistent with the stakeholder theory's view that not-only financial information but also non-financial information matter to investors.

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Appendix A

Table 1. Sample Selection

| Selection criteria | Dropped | Kept |
|--|---------|-------|
| All listed stocks | - | 3,915 |
| Less: ETF and Equity Contribution Securities | -246 | 3,669 |
| Less: Section transfers/delisting/IPO | -662 | 3,007 |

Source: TSE.

Table 2. TSE market segments

| Section | Market | Freq. | Percent |
|-----------------|-----------|-------|---------|
| 1 st | Main | 1,818 | 60.46 |
| 2 nd | Main | 427 | 14.20 |
| JASDAQ | Secondary | 681 | 22.65 |
| Mothers | Secondary | 81 | 2.690 |
| Total | | 3,007 | 100 |

Source: TSE.

Table 3. Industry Breakdown

| Sector name | Freq. | Percent |
|--|-------|---------|
| Automobiles & Transportation Equipment | 112 | 3.72 |
| Banks | 75 | 2.49 |
| Commercial & Wholesale Trade | 287 | 9.54 |
| Construction & Materials | 281 | 9.34 |
| Appliances & precision instruments | 278 | 9.25 |
| Electric Power & Gas | 20 | 0.67 |
| Energy Resources | 17 | 0.57 |
| Financials (Ex Banks) | 69 | 2.29 |
| Foods | 122 | 4.06 |
| IT & Services, Others | 653 | 21.72 |
| Machinery | 212 | 7.05 |
| Pharmaceutical | 58 | 1.93 |
| Raw Materials & Chemicals | 272 | 9.05 |
| Real Estate | 87 | 2.89 |
| Retail Trade | 280 | 9.31 |
| Steel & Nonferrous Metals | 77 | 2.56 |
| Transportation & Logistics | 107 | 3.56 |
| Total | 3,007 | 100.00 |

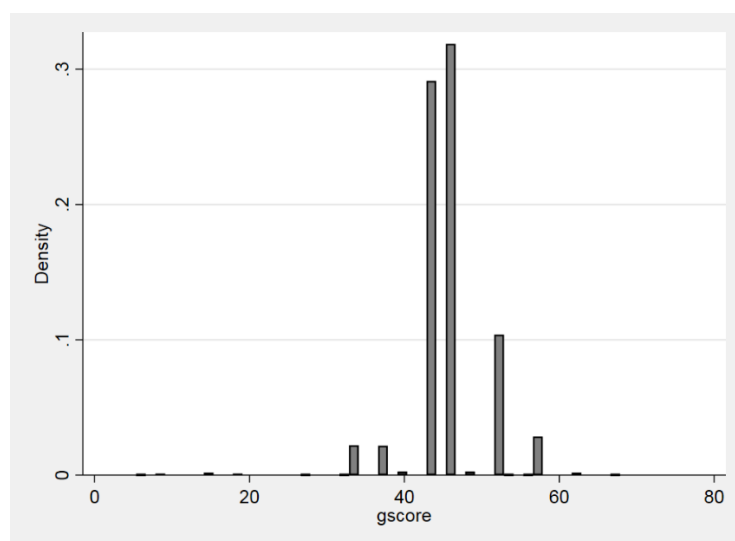
Source: TSE.

Table 4. Financial characteristics of sample firms

| | Mean (All sample) | Mean (Main-market) | Mean (Secondary-market) |
|--------------|-------------------|--------------------|-------------------------|
| Total Assets | 713,000 | 950,000 | 15,900 |
| Market Value | 202,675 | 267,475 | 11,676 |
| ROE | 4.87 | 6.52 | 0.02 |
| ROA | 3.09 | 3.71 | 1.25 |

Sources: Market values obtained from Datastream, financial data obtained from Worldscope Global.

Figure 1: Bloomberg governance-disclosure score ('G-score')



Source: Bloomberg

Table 5. G-scores of sample firms, rated as of 1 June 2015

| G-score | Frequency | Percent |
|----------|-----------|---------|
| 5.357143 | 1 | 0.05 |
| 32.14286 | 1 | 0.05 |
| 33.92857 | 42 | 2.20 |
| 37.5 | 51 | 2.67 |
| 39.28571 | 6 | 0.31 |
| 42.85714 | 662 | 34.70 |
| 46.42857 | 791 | 41.46 |
| 48.21429 | 7 | 0.37 |
| 51.78571 | 265 | 13.89 |
| 53.57143 | 1 | 0.05 |
| 55.35714 | 1 | 0.05 |
| 57.14286 | 74 | 3.88 |
| 62.5 | 5 | 0.26 |
| 67.85714 | 1 | 0.05 |
| Total | 1,908 | 100 |

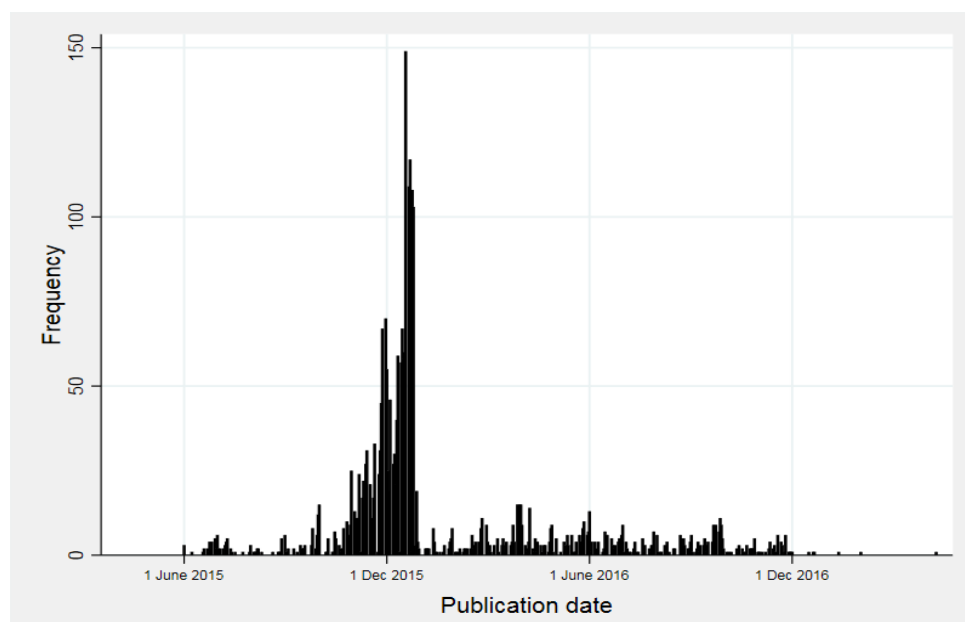
Source: Bloomberg

Table 6. Key regulatory events

| No | Date | Description |
|----|-------------------|---|
| 1 | 23 May 2014 | Liberal Democratic Party's Japan Revival Vision |
| 2 | 14 June 2014 | Prime Minister Abe's Japan Revitalization Strategy |
| 3 | 24 June 2014 | Cabinet approval of Japan Revitalization Strategy |
| 4 | 7 August 2014 | Council's 1st meeting |
| 5 | 4 September 2014 | Council's 2nd meeting |
| 6 | 30 September 2014 | Council's 3rd meeting |
| 7 | 20 October 2014 | Council's 4th meeting |
| 8 | 31 October 2014 | Council's 5th meeting |
| 9 | 12 November 2014 | Council's 6th meeting – 1st draft of the code |
| 10 | 25 November 2014 | Council's 7th meeting – 2nd draft of the code |
| 11 | 12 December 2014 | Council's 8th meeting – 3rd draft of the code |
| 12 | 5 March 2015 | Council's 9th meeting – the final draft of the code |

Sources: Liberal Democratic Party of Japan, Prime Minister's Office of Japan, TSE, Japan's Financial Services Agency. Council refers to the Council of Experts Concerning the Corporate Governance Code set by TSE and Japan's FSA. Minutes and materials of the Council's nine meetings were posted on FSA's website in both Japanese and English shortly after each meeting closed.

Figure 2: Distribution of publication dates of comply-or-explain report



Source: Bloomberg

Table 7. Regulatory-event-analysis, all sample firms

| All sample | | | | | | | | |
|-------------|-------------|----------|-----------|----------|-------------|----------|-----------|----------|
| Event | CAR3 | (t-stat) | SCAR3 | (t-stat) | CAR5 | (t-stat) | SCAR5 | (t-stat) |
| 1 | 0.00848*** | (12.55) | 0.274*** | (10.23) | 0.00893*** | (10.88) | 0.294*** | (9.13) |
| 2 | 0.00285*** | (3.99) | 0.223*** | (7.35) | 0.00576*** | (6.96) | 0.336*** | (9.20) |
| 3 | -0.000130 | (-0.20) | 0.0862** | (3.21) | -0.00175* | (-2.20) | 0.0158 | (0.45) |
| 4 | -0.00898*** | (-11.77) | -0.330*** | (-9.19) | -0.00839*** | (-8.61) | -0.246*** | (-5.20) |
| 5 | 0.00458*** | (6.43) | 0.202*** | (6.57) | 0.00703*** | (7.37) | 0.373*** | (8.67) |
| 6 | -0.00135 | (-1.76) | 0.0732* | (1.96) | -0.00465*** | (-4.79) | -0.326*** | (-6.47) |
| 7 | 0.00360*** | (4.58) | 0.124** | (3.22) | 0.000217 | (0.25) | -0.0178 | (-0.44) |
| 8 | -0.000456 | (-0.74) | 0.0941** | (2.96) | 0.00388*** | (4.06) | 0.227*** | (4.68) |
| 9 | 0.00268** | (3.20) | 0.173*** | (3.72) | -0.000856 | (-0.80) | 0.0820 | (1.36) |
| 10 | 0.00400*** | (6.07) | 0.0990** | (3.10) | 0.00620*** | (6.52) | 0.201*** | (4.49) |
| 11 | 0.00258*** | (4.14) | 0.157*** | (5.20) | -0.0000810 | (-0.09) | -0.0570 | (-1.47) |
| 12 | 0.00241*** | (3.54) | 0.128*** | (3.96) | -0.0000810 | (-0.09) | 0.0780 | (1.78) |
| Sig. events | 9 | | 12 | | 8 | | 7 | |
| (+ve : -ve) | (8:1) | | (11:1) | | (5:3) | | (5:2) | |
| Obs | 3007 | | 3007 | | 3007 | | 3007 | |

Note: CARs are computed by summing abnormal returns over an event window of 3 trading days (CAR3) or 5 trading days (CAR5). Abnormal returns are calculated as the portion of a stock's daily return that cannot be explained by the Fama-French three-factor model. Nikkei All Stock Index, TOPIX100, TOPIX Small, TOPIX Growth and TOPIX Value were used to compute the three factors. The average annual value of Bank of Japan's unsecured overnight call rate for 2015, 0.07 percent, was used as the risk-free rate in the three-factor model. Abnormal returns are deflated by their standard deviations during the estimation window for computation of SCAR3 and SCAR5. ***, ** and * indicate significance at a p-value of less than the 1% level, 5% level and 10% level, respectively. The third bottom row totals the number of events with test variables significantly different from zero at a p-value of less than 10%. The second bottom row counts the number of events with positive significant test variables and negative significant test variables.

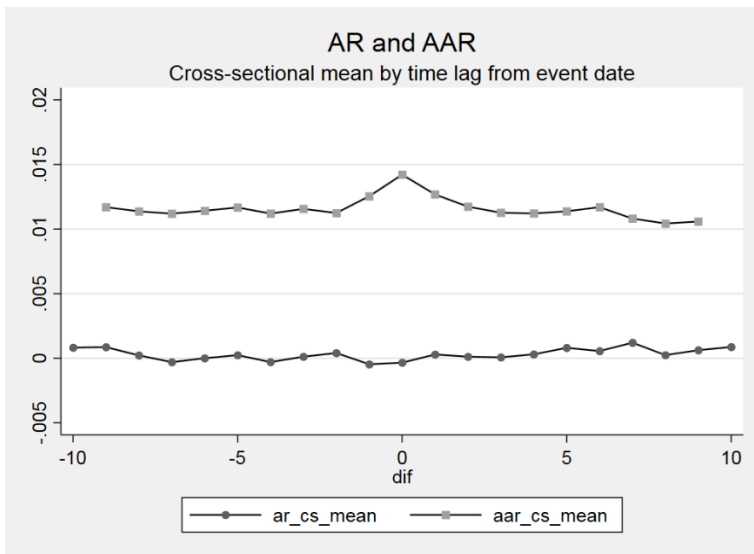
Table 8. Regulatory-event-analysis, sub-samples

| Panel A: Exposed firms | | | | | | | | |
|------------------------|-------------|----------|-----------|----------|-------------|----------|-----------|----------|
| Event | CAR3 | (t-stat) | SCAR3 | (t-stat) | CAR5 | (t-stat) | SCAR5 | (t-stat) |
| 1 | 0.00433*** | (7.59) | 0.199*** | (6.47) | 0.00414*** | (5.89) | 0.206*** | (5.59) |
| 2 | 0.00228*** | (3.48) | 0.245*** | (6.88) | 0.00343*** | (4.32) | 0.300*** | (6.92) |
| 3 | -0.000368 | (-0.66) | 0.0936** | (3.09) | -0.00104 | (-1.46) | 0.0125 | (0.32) |
| 4 | -0.00582*** | (-7.92) | -0.246*** | (-5.70) | -0.00461*** | (-4.61) | -0.113* | (-1.97) |
| 5 | 0.00251*** | (3.75) | 0.131*** | (3.88) | 0.00497*** | (5.09) | 0.302*** | (6.31) |
| 6 | 0.00125 | (1.80) | 0.142*** | (3.77) | -0.00491*** | (-5.43) | -0.394*** | (-7.62) |
| 7 | 0.00185* | (2.51) | 0.0633 | (1.45) | -0.000880 | (-1.10) | -0.0486 | (-1.08) |
| 8 | 0.00119 | (1.88) | 0.157*** | (4.17) | 0.00356*** | (3.50) | 0.200*** | (3.45) |
| 9 | 0.000701 | (1.00) | 0.0890* | (2.14) | -0.00148 | (-1.58) | 0.0296 | (0.55) |
| 10 | 0.00214*** | (3.31) | 0.0353 | (0.99) | 0.00405*** | (4.73) | 0.126** | (2.73) |
| 11 | 0.00179** | (2.89) | 0.106** | (3.04) | 0.000509 | (0.66) | -0.0719 | (-1.57) |
| 12 | 0.000761 | (1.31) | 0.0808* | (2.35) | 0.000509 | (0.66) | 0.104* | (2.31) |

| | | | | | | | | |
|-----------------------------------|-------------|---------|-----------|---------|-------------|---------|-----------|---------|
| Sig. events | 7 | | 10 | | 7 | | 8 | |
| (+ve:-ve) | (6:1) | | (9:1) | | (5:2) | | (6:2) | |
| Obs | 2245 | | 2245 | | 2245 | | 2245 | |
| Panel B: Exempted firms | | | | | | | | |
| Event | CAR3 | | SCAR3 | | CAR5 | | SCAR5 | |
| 1 | 0.0207*** | (10.32) | 0.496*** | (9.20) | 0.0230*** | (9.51) | 0.555*** | (8.46) |
| 2 | 0.00455* | (2.21) | 0.158** | (2.74) | 0.0126*** | (5.57) | 0.441*** | (6.63) |
| 3 | 0.000574 | (0.30) | 0.0643 | (1.13) | -0.00382 | (-1.64) | 0.0253 | (0.35) |
| 4 | -0.0183*** | (-8.90) | -0.579*** | (-9.33) | -0.0195*** | (-8.05) | -0.636*** | (-8.40) |
| 5 | 0.0107*** | (5.38) | 0.410*** | (5.98) | 0.0131*** | (5.43) | 0.579*** | (6.18) |
| 6 | -0.00899*** | (-4.10) | -0.131 | (-1.37) | -0.00389 | (-1.41) | -0.126 | (-0.99) |
| 7 | 0.00876*** | (3.98) | 0.303*** | (3.76) | 0.00345 | (1.40) | 0.0730 | (0.81) |
| 8 | -0.00531*** | (-3.44) | -0.0915 | (-1.59) | 0.00483* | (2.11) | 0.308*** | (3.55) |
| 9 | 0.00853*** | (3.31) | 0.420** | (3.09) | 0.000973 | (0.30) | 0.237 | (1.32) |
| 10 | 0.00949*** | (5.39) | 0.286*** | (4.12) | 0.0125*** | (4.53) | 0.422*** | (3.75) |
| 11 | 0.00493** | (2.98) | 0.309*** | (5.06) | -0.00182 | (-0.66) | -0.0130 | (-0.18) |
| 12 | 0.00726*** | (3.53) | 0.265*** | (3.48) | -0.00182 | (-0.66) | 0.000670 | (0.01) |
| Sig. events | 11 | | 9 | | 6 | | 6 | |
| (+ve:-ve) | (8:3) | | (8:1) | | (5:1) | | (5:1) | |
| Obs | 762 | | 762 | | 762 | | 762 | |
| Panel C: Opaque firms | | | | | | | | |
| Event | CAR3 | | SCAR3 | | CAR5 | | SCAR5 | |
| 1 | 0.00706*** | (5.96) | 0.286*** | (5.51) | 0.00809*** | (5.23) | 0.311*** | (4.94) |
| 2 | 0.00320** | (2.63) | 0.284*** | (4.93) | 0.00496** | (3.19) | 0.353*** | (4.90) |
| 3 | -0.000996 | (-0.83) | 0.0396 | (0.74) | -0.00262 | (-1.83) | -0.0816 | (-1.20) |
| 4 | -0.00495*** | (-3.83) | -0.214** | (-2.98) | -0.00215 | (-1.21) | -0.000615 | (-0.01) |
| 5 | 0.00319* | (2.52) | 0.162** | (2.64) | 0.00831*** | (4.07) | 0.490*** | (5.63) |
| 6 | 0.00137 | (1.15) | 0.172** | (2.66) | -0.00333* | (-2.04) | -0.299*** | (-3.32) |
| 7 | 0.00250 | (1.80) | 0.0924 | (1.11) | -0.00121 | (-0.83) | -0.0380 | (-0.49) |
| 8 | 0.00346** | (3.11) | 0.307*** | (5.05) | 0.00790*** | (4.10) | 0.441*** | (4.39) |
| 9 | 0.00144 | (1.22) | 0.107 | (1.67) | -0.00189 | (-1.18) | -0.0498 | (-0.58) |
| 10 | 0.00237* | (2.14) | 0.0188 | (0.34) | 0.00551** | (3.28) | 0.140 | (1.84) |
| 11 | 0.00297** | (2.70) | 0.168** | (2.80) | 0.000836 | (0.72) | 0.00349 | (0.04) |
| 12 | 0.00230* | (2.48) | 0.136* | (2.53) | 0.000836 | (0.72) | 0.117 | (1.73) |
| Sig. events | 8 | | 8 | | 6 | | 5 | |
| (+ve:-ve) | (7:1) | | (7:1) | | (5:1) | | (4:1) | |
| Obs | 763 | | 763 | | 763 | | 763 | |
| Panel D: Transparent firms | | | | | | | | |
| Event | CAR3 | | SCAR3 | | CAR5 | | SCAR5 | |
| 1 | 0.000326 | (0.26) | 0.0269 | (0.32) | 0.00106 | (0.71) | 0.0715 | (0.72) |
| 2 | -0.000828 | (-0.70) | -0.00515 | (-0.07) | -0.00102 | (-0.67) | -0.0553 | (-0.56) |
| 3 | 0.00226* | (2.09) | 0.214** | (2.98) | 0.00319* | (2.14) | 0.202* | (2.10) |
| 4 | -0.00199 | (-1.19) | -0.0353 | (-0.33) | -0.00123 | (-0.56) | 0.0928 | (0.67) |
| 5 | 0.00120 | (0.87) | -0.000529 | (-0.01) | 0.00107 | (0.49) | -0.0639 | (-0.55) |
| 6 | -0.000385 | (-0.25) | 0.0621 | (0.63) | -0.00694*** | (-4.17) | -0.540*** | (-4.74) |
| 7 | -0.000245 | (-0.21) | -0.0969 | (-1.29) | 0.00277 | (1.60) | 0.0927 | (0.88) |
| 8 | -0.00218 | (-1.36) | -0.108 | (-0.99) | -0.00244 | (-1.04) | -0.239 | (-1.50) |
| 9 | -0.00189 | (-1.12) | -0.0324 | (-0.29) | 0.00129 | (0.58) | 0.192 | (1.29) |
| 10 | 0.00201 | (1.58) | 0.0953 | (1.08) | 0.00265 | (1.59) | 0.0997 | (0.89) |
| 11 | -0.00181 | (-1.49) | -0.109 | (-1.33) | -0.00370* | (-2.22) | -0.190 | (-1.67) |
| 12 | -0.00127 | (-0.95) | -0.00811 | (-0.08) | -0.00370* | (-2.22) | -0.128 | (-1.10) |
| Sig. events | 1 | | 1 | | 4 | | 2 | |
| (+ve:-ve) | (1:0) | | (1:0) | | (1:3) | | (1:1) | |

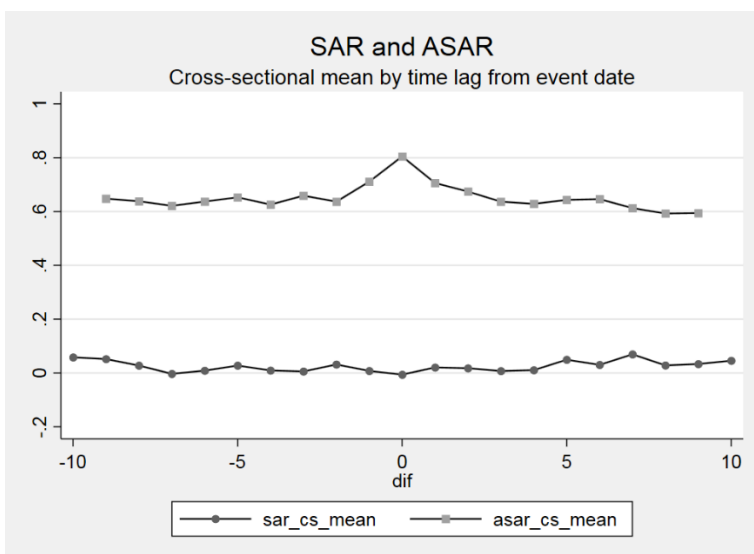
Note: Panel A sample is comprised of ‘exposed’ firms, listed on TSE’s main market section and obliged to report their policies on each and all of 73 principles of the code in a comply-or-explain report. Panel B sample is comprised of ‘exempted’ firms, listed on TSE’s secondary-market section, and exempted from 68 principles and related reporting obligations, out of 73 principles of the code. Panel C sample is comprised of ‘opaque’ firms, whose governance disclosure practices were rated lower than the median score of all Japanese firms rated by Bloomberg as of June 2015. Panel D sample is comprised of ‘transparent’ firms, whose governance disclosure practices were rated higher than the median score of all Japanese firms rated by Bloomberg as of June 2015.***, ** and * indicate significance at a p-value of less than the 1% level, 5% level and 10% level, respectively. The third bottom row totals the number of events with test variables significantly different from zero at a p-value of less than 10%. The second bottom row counts the number of events with positive significant test variables and negative significant test variables.

Figure 3. Abnormal returns (AR) and absolute abnormal returns (AAR)



Note: The horizontal axis denotes the timeline from the publication date denoted as 0.

Figure 4. Standardised abnormal returns (SAR) and absolute standardised abnormal returns (ASAR)



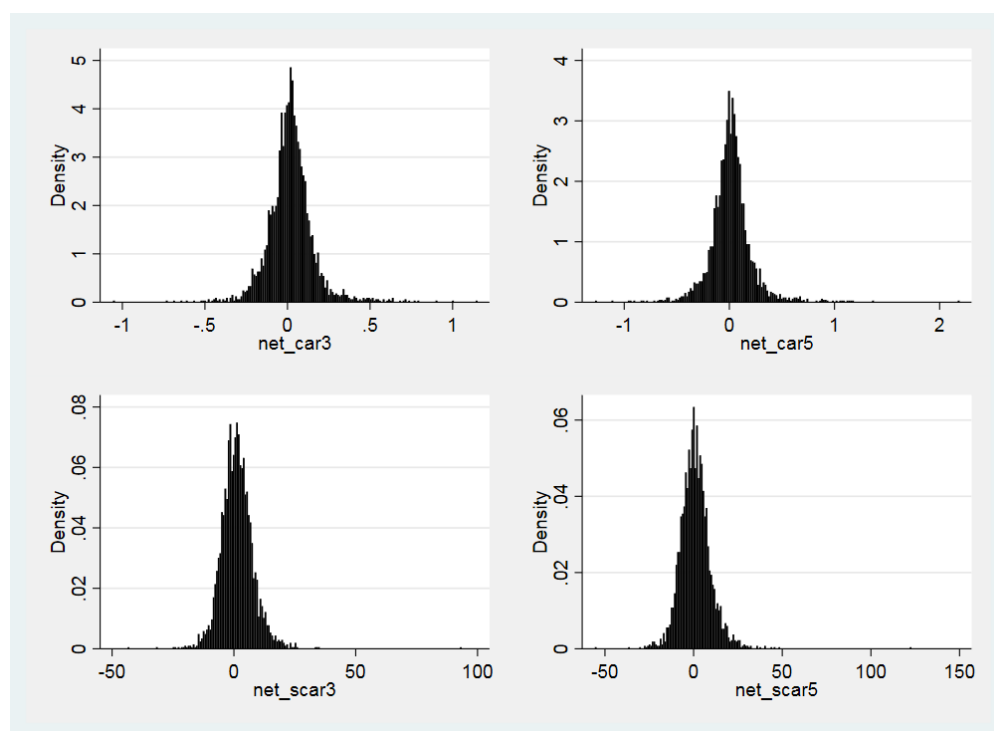
Note: The horizontal axis denotes the timeline from the publication date denoted as 0.

Table 9. Disclosure analysis, event-period and baseline-period comparison

| Variable | Period | Mean | Std.Dev. | Min | Max | z | Prob> z | Concurrent | Obs |
|-----------|----------|-------|----------|--------|-------|-------|---------|------------|-------|
| Abs CAR3 | event | 0.023 | 0.029 | 0.0000 | 0.281 | 23.20 | 0.00 | yes | 3,003 |
| | baseline | 0.012 | 0.010 | 0.0006 | 0.106 | | | yes | 3,003 |
| Abs CAR5 | event | 0.029 | 0.035 | 0.0000 | 0.373 | 30.60 | 0.00 | yes | 3,003 |
| | baseline | 0.011 | 0.010 | 0.0002 | 0.124 | | | yes | 3,003 |
| Abs SCAR3 | event | 1.309 | 1.507 | 0.0016 | 28.72 | 23.60 | 0.00 | yes | 3,003 |
| | baseline | 0.649 | 0.396 | 0.0535 | 3.441 | | | yes | 3,003 |
| Abs SCAR5 | event | 1.621 | 1.847 | 0.0004 | 40.53 | 30.75 | 0.00 | yes | 3,003 |
| | baseline | 0.640 | 0.467 | 0.0144 | 4.674 | | | yes | 3,003 |
| Abs CAR3 | event | 0.022 | 0.028 | 0.0000 | 0.281 | 19.90 | 0.00 | no | 2,591 |
| | baseline | 0.012 | 0.010 | 0.0006 | 0.106 | | | no | 2,591 |
| Abs CAR5 | event | 0.028 | 0.033 | 0.0000 | 0.373 | 27.77 | 0.00 | no | 2,591 |
| | baseline | 0.011 | 0.010 | 0.0002 | 0.111 | | | no | 2,591 |
| Abs SCAR3 | event | 1.220 | 1.411 | 0.0016 | 28.72 | 20.20 | 0.00 | no | 2,591 |
| | baseline | 0.646 | 0.398 | 0.0535 | 3.441 | | | no | 2,591 |
| Abs SCAR5 | event | 1.536 | 1.747 | 0.0004 | 40.53 | 27.92 | 0.00 | no | 2,591 |
| | baseline | 0.641 | 0.466 | 0.0144 | 4.674 | | | no | 2,591 |

Z-scores obtained by the Wilcoxon matched-pairs signed rank test. Firms that made a concurrent announcement are omitted when the eighth column denotes ‘no’. The baseline CAR3 is computed by taking the average of 5 values of CAR3, for the period (t-3 to t-5), (t-6 to t-8), (t-9 to t-11), (t-12 to t-15) and (t-15 to t-17). The baseline CAR5 is computed by taking the average of 3 CAR5 values, for the period (t-3 to t-7), (t-8 to t-12) and (t-13 to t-17).

Figure 5. Distribution of total-return variables



Notes: ‘net_car3’ and ‘net_car5’ represent the summation of cross-sectional average values of CAR3 and CAR5 throughout 12 regulatory events and one disclosure event per firm. Similarly, ‘net_scar3’ and ‘net_scar5’ represent the summation of cross-sectional average values of SCAR3 and SCAR5 throughout the 13 events.

Table 10. Total return analysis, all sample firms

| VARIABLES | (1) NET_CAR3 | (2) NET_CAR5 | (3) NET_SCAR3 | (4) NET_SCAR5 |
|--------------|----------------------|----------------------|---------------------|---------------------|
| Constant | 0.0198*** (7.680) | 0.0162*** (4.373) | 1.325*** (10.88) | 1.031*** (6.439) |
| Observations | 3,003 | 3,003 | 3,003 | 3,003 |

Robust t-statistics in parentheses. *** p<0.01, ** p<0.05, * p<0.1

Table 11. Total return analysis, sub-samples

| VARIABLES | NET_CAR3 | NET_CAR5 | NET_SCAR3 | NET_SCAR5 |
|-------------------|----------------------|-----------------------|----------------------|---------------------|
| Exposed firms | | | | |
| Constant | 0.0126*** (5.301) | 0.00885*** (2.596) | 1.138*** (8.398) | 0.744*** (4.161) |
| Observations | 2,243 | 2,243 | 2,243 | 2,243 |
| Exempted firms | | | | |
| Constant | 0.0410*** (5.595) | 0.0379*** (3.575) | 1.878*** (7.028) | 1.877*** (5.409) |
| Observations | 760 | 760 | 760 | 760 |
| Opaque firms | | | | |
| Constant | 0.0245*** (5.542) | 0.0271*** (4.057) | 1.647*** (7.055) | 1.588*** (5.019) |
| Observations | 762 | 762 | 762 | 762 |
| Transparent firms | | | | |
| Constant | -0.00541 (-0.991) | -0.00677 (-0.923) | -0.0291 (-0.0806) | -0.430 (-0.975) |
| Observations | 354 | 354 | 354 | 354 |

Robust t-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1

Table 12. Multivariate analysis on total effect, CAR

| VARIABLES | NET_CAR3 | se | NET_CAR5 | se |
|--------------------|------------|----------|----------|----------|
| SIZE | -0.0073*** | (0.0027) | -0.0065* | (0.0039) |
| DE | -0.0002 | (0.0002) | -0.0003 | (0.0002) |
| ROE | -0.0002 | (0.0001) | 0.0002 | (0.0001) |
| GSCORE | -0.0004 | (0.0008) | -0.0006 | (0.0011) |
| CONCURRENT CODE | -0.0071 | (0.0073) | -0.0064 | (0.0105) |
| SP1-1-1 | 0.0254 | (0.0157) | 0.0362 | (0.0245) |
| P1-2 | 0.0377 | (0.0495) | 0.0874 | (0.0642) |
| SP1-2-1 | -0.0346 | (0.0681) | -0.0203 | (0.0565) |
| SP1-2-2 | 0.0024 | (0.0077) | -0.0071 | (0.0108) |
| SP1-2-3 | 0.0192 | (0.0190) | -0.0024 | (0.0221) |
| SP1-2-4 | -0.0101 | (0.0067) | -0.0079 | (0.0095) |
| SP1-2-5 | 0.0070 | (0.0127) | 0.0024 | (0.0193) |
| P1-3 | 0.0174 | (0.0162) | 0.0312 | (0.0245) |
| P1-4 | -0.0034 | (0.0097) | -0.0057 | (0.0140) |
| P1-5 | 0.0079 | (0.0331) | -0.0354 | (0.0492) |
| P1-7 | -0.0362 | (0.0360) | -0.0190 | (0.0536) |
| SP2-2-1 | -0.0190 | (0.0172) | -0.0261 | (0.0255) |
| SP2-3-1 | -0.0242 | (0.0430) | -0.0059 | (0.0705) |

| | | | | |
|--------------|------------|----------|-----------|----------|
| P2-4 | -0.0784** | (0.0393) | -0.0779 | (0.0537) |
| P2-5 | 0.0608* | (0.0321) | 0.0576 | (0.0371) |
| SP2-5-1 | 0.0052 | (0.0113) | 0.0253 | (0.0162) |
| P3-1 | -0.0100 | (0.0064) | -0.0122 | (0.0090) |
| SP3-1-1 | -0.0709** | (0.0336) | -0.1117** | (0.0515) |
| SP3-1-2 | 0.0052 | (0.0075) | 0.0107 | (0.0107) |
| SP3-2-1 | 0.0060 | (0.0097) | 0.0141 | (0.0135) |
| SP3-2-2 | -0.0449*** | (0.0164) | -0.0532** | (0.0218) |
| SP4-1-1 | 0.0062 | (0.0399) | 0.0103 | (0.0543) |
| SP4-1-2 | -0.0075 | (0.0085) | -0.0204* | (0.0120) |
| SP4-1-3 | 0.0017 | (0.0093) | 0.0113 | (0.0124) |
| P4-2 | 0.0024 | (0.0090) | 0.0087 | (0.0133) |
| SP4-2-1 | 0.0004 | (0.0069) | -0.0045 | (0.0095) |
| P4-3 | 0.0036 | (0.0275) | 0.0176 | (0.0356) |
| SP4-3-1 | -0.0153 | (0.0191) | -0.0347 | (0.0248) |
| SP4-4-1 | 0.0177 | (0.0173) | 0.0206 | (0.0292) |
| P4-6 | -0.0279 | (0.0176) | -0.0340 | (0.0277) |
| P4-7 | -0.0161 | (0.0162) | -0.0367 | (0.0241) |
| P4-8 | -0.0019 | (0.0059) | 0.0032 | (0.0083) |
| SP4-8-1 | 0.0067 | (0.0135) | 0.0157 | (0.0212) |
| SP4-8-2 | 0.0114 | (0.0123) | 0.0022 | (0.0179) |
| P4-9 | 0.0267** | (0.0136) | 0.0345* | (0.0186) |
| P4-10 | 0.0055 | (0.0122) | 0.0033 | (0.0164) |
| SP4-10-1 | -0.0161** | (0.0071) | -0.0089 | (0.0099) |
| P4-11 | -0.0016 | (0.0117) | -0.0118 | (0.0160) |
| SP4-11-1 | 0.0342 | (0.0268) | 0.0575 | (0.0455) |
| SP4-11-2 | 0.0192 | (0.0304) | -0.0134 | (0.0390) |
| SP4-11-3 | 0.0044 | (0.0062) | 0.0116 | (0.0088) |
| SP4-12-1 | -0.0347* | (0.0180) | -0.0389 | (0.0257) |
| P4-14 | 0.0190 | (0.0247) | -0.0330 | (0.0370) |
| SP4-14-1 | 0.0041 | (0.0312) | 0.0400 | (0.0544) |
| SP4-14-2 | -0.0224 | (0.0188) | -0.0238 | (0.0248) |
| P5-1 | -0.0122 | (0.0306) | -0.0130 | (0.0349) |
| SP5-1-2 | -0.0080 | (0.0191) | 0.0169 | (0.0298) |
| P5-2 | -0.0076 | (0.0112) | -0.0090 | (0.0141) |
| Observations | 1,605 | | 1,605 | |
| R-squared | 0.1337 | | 0.1485 | |

Notes: The table reports the results of ordinary least squares regression using the following model;
 $NET_CAR_j = \alpha_j + \gamma_1 SIZE_j + \gamma_2 DE_j + \gamma_3 ROE_j + \gamma_4 GSCORE_j + \gamma_5 CONCURRENT_j + \sum \gamma_k INDUSTRY_j + \sum \gamma_l CODE_j + \varepsilon_j$. NET_CAR3 and NET_CAR5, are computed by totalling cross-sectional average values of CAR3 and CAR5 throughout announcement events. SIZE is the natural logarithm of firm j's total assets, DE is the ratio of debt to total capital, ROE is the return on equity and GSCORE is Bloomberg's governance disclosure score, all measured as of June 1, 2015, when the code took effect. CONCURRENT denotes 1 if there was a concurrent announcement made by firm j on the same day as its disclosure of first-time comply-or-explain report, otherwise 0. Each regression includes industry fixed effects. CODE is an indicator variable denoting 1 if the firm j reports a deviation from a code principle, otherwise zero. 25 code principles having less than 10 firms that reported a non-compliance are omitted. Robust t-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1

Table 13. Multivariate analysis on total effect, SCAR

| VARIABLES | NET_SCAR3 | se | NET_SCAR5 | se |
|------------|-----------|----------|-----------|----------|
| SIZE | -0.3279** | (0.1421) | -0.3325* | (0.1943) |
| DE | -0.0090 | (0.0084) | -0.0025 | (0.0110) |
| ROE | -0.0059 | (0.0039) | 0.0121*** | (0.0041) |
| GSCORE | -0.0479 | (0.0452) | -0.0584 | (0.0615) |
| CONCURRENT | -0.3021 | (0.4345) | -0.1437 | (0.5760) |
| CODE | | | | |

| | | | | |
|--------------|------------|----------|------------|----------|
| SP1-1-1 | 0.7534 | (0.8803) | 2.0853 | (1.5901) |
| P1-2 | 2.8158 | (2.8690) | 6.6788* | (3.9087) |
| SP1-2-1 | -1.7697 | (2.6681) | -1.8705 | (2.6292) |
| SP1-2-2 | 0.3182 | (0.4651) | -0.2796 | (0.6087) |
| SP1-2-3 | 0.7715 | (1.0632) | -0.8985 | (1.2672) |
| SP1-2-4 | -0.1785 | (0.3966) | -0.0631 | (0.5116) |
| SP1-2-5 | -0.0854 | (0.7042) | 0.0177 | (1.0179) |
| P1-3 | 1.2346 | (0.9462) | 2.2898* | (1.3049) |
| P1-4 | -0.0394 | (0.5939) | 0.0938 | (0.8184) |
| P1-5 | 0.3570 | (1.7921) | -1.0382 | (3.5384) |
| P1-7 | -0.4582 | (1.5772) | 1.6467 | (2.2747) |
| SP2-2-1 | -1.6029* | (0.9355) | -2.0632 | (1.3658) |
| SP2-3-1 | -1.9333 | (2.5049) | -4.4482 | (4.3165) |
| P2-4 | -3.2539* | (1.8667) | -5.2394* | (2.9521) |
| P2-5 | 3.7224* | (2.0700) | 3.0578 | (2.5446) |
| SP2-5-1 | 0.0588 | (0.6953) | 0.1876 | (0.9006) |
| P3-1 | -0.5481 | (0.3730) | -0.6224 | (0.4879) |
| SP3-1-1 | -3.6330** | (1.4480) | -3.1622 | (2.2034) |
| SP3-1-2 | 0.0700 | (0.4311) | 0.4163 | (0.5844) |
| SP3-2-1 | 0.3628 | (0.6123) | 0.4740 | (0.7697) |
| SP3-2-2 | -2.7827*** | (0.9654) | -3.0762*** | (1.1337) |
| SP4-1-1 | -1.1922 | (1.9366) | -2.1861 | (2.7628) |
| SP4-1-2 | -0.1473 | (0.4802) | -0.5716 | (0.6227) |
| SP4-1-3 | -0.1790 | (0.4809) | 0.0753 | (0.6239) |
| P4-2 | 0.1858 | (0.5421) | 0.8401 | (0.7493) |
| SP4-2-1 | -0.0333 | (0.4087) | -0.2245 | (0.5381) |
| P4-3 | 0.1723 | (1.5354) | 0.3827 | (2.1050) |
| SP4-3-1 | -0.3871 | (1.0370) | -1.0469 | (1.2441) |
| SP4-4-1 | 1.1738 | (0.9555) | 1.5639 | (1.3839) |
| P4-6 | -1.8196* | (0.9339) | -1.0623 | (1.4616) |
| P4-7 | -0.8458 | (0.8378) | -0.9985 | (1.1424) |
| P4-8 | 0.0688 | (0.3568) | 0.3515 | (0.4613) |
| SP4-8-1 | 0.1322 | (0.7037) | -0.6121 | (0.9702) |
| SP4-8-2 | 1.0762* | (0.6298) | 1.4056 | (0.8796) |
| P4-9 | 0.9298 | (0.6961) | 0.9278 | (0.9298) |
| P4-10 | 0.3211 | (0.7002) | 0.1462 | (0.9307) |
| SP4-10-1 | -0.9375** | (0.3993) | -0.6205 | (0.5183) |
| P4-11 | -0.2209 | (0.7326) | -0.7827 | (0.9398) |
| SP4-11-1 | 0.9493 | (1.3718) | 0.9773 | (1.8301) |
| SP4-11-2 | 1.1834 | (1.7717) | 0.4889 | (2.1611) |
| SP4-11-3 | 0.3056 | (0.3614) | 0.6394 | (0.4783) |
| SP4-12-1 | -1.4520 | (1.1292) | -2.1666* | (1.3033) |
| P4-14 | 1.3338 | (1.2931) | -0.0324 | (1.8624) |
| SP4-14-1 | 0.9666 | (2.2637) | 1.8554 | (2.8534) |
| SP4-14-2 | -1.1015 | (0.9580) | -0.6772 | (1.4300) |
| P5-1 | -0.2323 | (1.7747) | 0.0854 | (2.0444) |
| SP5-1-2 | -0.6278 | (1.0201) | -0.9771 | (1.6129) |
| P5-2 | -0.6979 | (0.5876) | -0.1400 | (0.7483) |
| Observations | 1,605 | | 1,605 | |
| R-squared | 0.1467 | | 0.1309 | |

Notes: The table reports the results of ordinary least squares regression using the following model;
 $NET_SCAR_j = \alpha_j + \gamma_1 SIZE_j + \gamma_2 DE_j + \gamma_3 ROE_j + \gamma_4 GSCORE_j + \gamma_5 CONCURRENT_j + \sum \gamma_k INDUSTRY_j + \sum \gamma_l CODE_j + \varepsilon_j$. NET_SCAR3 and NET_SCAR5, are computed by totalling cross-sectional average values of SCAR3 and SCAR5 throughout announcement events. Independent variables are the same as reported in Table 12: Robust t-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1

Appendix B

Japan's corporate governance code principles (excerpt)

| No | Layers | Summary | Applicable to JASDAQ & Mothers | Narrative disclosure |
|--------------------|--------|--|--------------------------------|----------------------|
| Chapter I | | | | |
| 1 | GP | Securing shareholder rights and equal treatment of shareholders | * | |
| 2 | P | Securing shareholders' voting rights | | |
| 3 | SP | Analysing the reasons behind opposing votes to a proposal | | |
| 4 | SP | Adequate constitution of the board in proposing to shareholders delegation of certain powers to the board | | |
| 5 | SP | Adequate consideration for minority shareholders' right to seek an injunction against illegal activities | | |
| 6 | P | Securing shareholder rights at general shareholder meetings | | |
| 7 | SP | Providing accurate information needed for decision-making at GSM | | |
| 8 | SP | Sending convening notices for GSM early, disclosing information included in the notices by electronic means. | | |
| 9 | SP | Determination of GSM date under the consideration of facilitating dialogue with shareholders | | |
| 10 | SP | English translation of convening notices and the creating of infrastructure for electronic voting | | |
| 11 | SP | Cooperation with trust banks and custodial institutions | | |
| 12 | P | Explanation of strategy with respect to capital policy | | * |
| 13 | P | Disclosure of policy with respect to cross-shareholdings | | * |
| 14 | P | Examination by the board and kansa-yaku the necessity and rationale of anti-takeover measures | | |
| 15 | SP | Explanation of the board's position over any tender offer | | * |
| 16 | P | Examination by the board and kansa-yaku the necessity and rationale of capital policy that may harm shareholder interests | | |
| 17 | P | Setting and disclosing procedures for the board's approval for related party transactions | | * |
| Chapter II | | | | |
| 18 | GP | Ensuring cooperation with stakeholders other than shareholders | * | |
| 19 | P | Drafting and maintaining corporate behavior principles | | |
| 20 | P | Implementing a code of conduct for employees | | |
| 21 | SP | Revision by the board whether a code of conduct is widely implemented | | |
| 22 | P | Taking appropriate measures to address sustainability issues, including social and environmental matters | | |
| 23 | SP | Consideration by the board addressing ESG matters positively and productively | | |
| 24 | P | Ensuring diversity of personnel, including the active participation of women | | |
| 25 | P | Establishing a framework for whistleblowing | | |
| 26 | SP | Setting a rule to secure the confidentiality of whistleblowers | | |
| Chapter III | | | | |
| 27 | GP | Ensuring information disclosure and transparency | | |
| 28 | P | Disclosure of company objectives, the basic view over governance, procedures in determining remuneration, explanations over appointment/dismissal of directors | | * |
| 29 | SP | Ensuring disclosed information is not boiler-plate or lacking detail | | |
| 30 | SP | English language disclosure to the extent reasonable | | |
| 31 | P | Securing proper execution of audits | | |
| 32 | SP | Setting standards for selection of external auditors and their evaluations | | |
| 33 | SP | Ensuring adequate time and access needed for high quality audits | | |
| Chapter IV | | | | |
| 34 | GP | The board should fulfil its responsibilities | * | |
| 35 | P | Recognition by the board its responsibilities include setting corporate goals and strategic decisions | | |
| 36 | SP | Disclosure of board's decisions | | |
| 37 | SP | Full analysis of any failure of achieving medium-term business goals | | |
| 38 | SP | The board's engagement in establishment of a succession planning for top executives | | |
| 39 | P | Recognition by the board its responsibilities include setting an environment allowing appropriate risk-taking | | |
| 40 | SP | Designing incentive-based remuneration systems | | |

GP: general principle P: principle SP: supplementary principle