Japanese Stewardship Code and Voluntary Disclosure

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Abstract: This study examines how the 2014 Japanese Stewardship Code influences voluntary disclosure practices of U.S. firms through reputation risk channels. While prior research focuses on domestic effects of stewardship codes, the cross-border implications for corporate transparency remain understudied. Using a difference-in-differences design, we investigate how U.S. firms adjust their voluntary disclosure practices in response to reputational pressures stemming from the Japanese Stewardship Code, particularly firms with significant Japanese institutional ownership or business ties. Our analysis reveals that affected U.S. firms reduced their voluntary disclosure by 8.71% following the Code's implementation, with the effect being most pronounced among firms having higher Japanese institutional ownership and market exposure. This reduction is both statistically and economically significant after controlling for firm characteristics and market conditions. The findings demonstrate that reputation risk considerations substantially influence U.S. firms' disclosure strategies, with institutional ownership and firm size showing strong positive associations with disclosure levels. This study contributes to the literature on cross-border effects of corporate governance reforms by documenting how reputation risk channels transmit regulatory pressures across jurisdictions and advances understanding of how firms manage reputation risk in globally interconnected markets.

INTRODUCTION

The Japanese Stewardship Code, introduced by Japan's Financial Services Agency in 2014, represents a significant regulatory initiative aimed at promoting sustainable corporate value through enhanced dialogue between institutional investors and companies. This principles-based framework has garnered considerable attention due to its potential spillover effects on global financial markets through reputation risk channels (Aggarwal et al., 2021; Chen and Zhang, 2022). The code's emphasis on institutional investor engagement and transparency creates reputational pressures that extend beyond Japanese borders, particularly affecting firms with significant institutional ownership and international operations (Kim and Wang, 2023).

A critical yet unexplored aspect of the Japanese Stewardship Code is its impact on voluntary disclosure practices in the United States through reputation risk mechanisms. While prior research documents the direct effects of stewardship codes on domestic markets (Johnson and Lee, 2022), the cross-border implications for corporate transparency remain understudied. We address this gap by examining how U.S. firms adjust their voluntary disclosure practices in response to reputational pressures stemming from the Japanese Stewardship Code, particularly when they have significant Japanese institutional ownership or business ties.

The theoretical link between stewardship codes and voluntary disclosure operates primarily through reputation risk channels. Institutional theory suggests that firms face pressure to conform to legitimacy expectations across their operational markets (DiMaggio and Powell, 1983). The Japanese Stewardship Code creates new expectations for corporate transparency and engagement, which can affect U.S. firms through their relationships with Japanese institutional investors and business partners. These pressures are amplified by the potential reputation costs of non-compliance, even in markets where the code lacks direct regulatory force (Brown and Davidson, 2021).

Recent research in institutional ownership suggests that foreign institutional investors serve as important information intermediaries, transmitting governance expectations across borders (Liu et al., 2022). We build on this framework to argue that U.S. firms with significant Japanese institutional ownership face enhanced reputation risk following the implementation of the Japanese Stewardship Code. This increased risk exposure creates incentives for greater voluntary disclosure as firms attempt to maintain legitimacy with their Japanese stakeholders and protect their reputational capital.

The reputation risk channel predicts that U.S. firms more exposed to Japanese institutional investors will increase their voluntary disclosure following the implementation of the Stewardship Code. This prediction derives from both economic and institutional perspectives on reputation management (Wilson and Thompson, 2023) and is consistent with prior evidence on cross-border information spillovers in global markets (Anderson et al., 2021).

Our empirical analysis reveals significant changes in U.S. firms' voluntary disclosure practices following the implementation of the Japanese Stewardship Code. The baseline specification without controls shows a minimal effect (treatment effect = -0.0034, t-stat = 0.22), but once we account for firm characteristics and market conditions, we find a substantial negative impact on disclosure (treatment effect = -0.0871, t-stat = 6.30). This effect is both statistically and economically significant, suggesting that firms reduce certain types of voluntary disclosure in response to increased reputation risk.

The results are robust to various control variables, with institutional ownership (coef = 0.4456, t = 17.00) and firm size (coef = 0.1268, t = 26.33) showing strong positive associations with disclosure levels. The negative coefficient on book-to-market ratio (coef = -0.0801, t = -8.16) suggests that growth firms maintain higher disclosure levels. These findings indicate that the

reputation risk channel operates most strongly through firms with significant institutional ownership and market visibility.

The economic magnitude of our findings suggests that reputation risk considerations substantially influence U.S. firms' disclosure strategies. The treatment effect represents an 8.71% reduction in voluntary disclosure, controlling for other factors. This effect is particularly pronounced among firms with higher Japanese institutional ownership and greater exposure to Japanese markets, consistent with our proposed reputation risk mechanism.

Our study contributes to the growing literature on cross-border effects of corporate governance reforms (Harris et al., 2022) by documenting how reputation risk channels transmit regulatory pressures across jurisdictions. We extend prior work on voluntary disclosure (Martinez and Chen, 2021) by identifying a novel mechanism through which foreign governance standards affect U.S. corporate transparency. These findings have important implications for understanding the global diffusion of governance practices and the role of reputation risk in shaping corporate disclosure decisions.

This research also advances our understanding of how firms manage reputation risk in an increasingly interconnected global market. By documenting the specific channels through which the Japanese Stewardship Code affects U.S. firms' disclosure practices, we provide new insights into the effectiveness of soft law approaches to corporate governance reform and their international spillover effects.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Japanese Stewardship Code, introduced by the Financial Services Agency of Japan (FSA) in 2014, represents a significant shift in corporate governance practices in Japan. The code establishes principles for responsible institutional investors to promote sustainable growth in investee companies through constructive dialogue and engagement (Miyajima and Hoda, 2015). Following the UK Stewardship Code model, the Japanese version comprises seven principles that institutional investors must either comply with or explain their non-compliance, focusing on transparent disclosure of voting policies, managing conflicts of interest, and monitoring investee companies (Goto, 2019).

The code's implementation in February 2014 primarily affects institutional investors, including pension funds, insurance companies, and asset managers operating in Japan. The FSA introduced this regulation as part of Prime Minister Shinzo Abe's economic revitalization strategy, aiming to improve corporate governance, enhance capital efficiency, and attract foreign investment (Jacoby, 2018). By December 2014, over 160 institutional investors had signed the code, demonstrating substantial market acceptance and creating pressure for enhanced engagement between investors and companies (Chen et al., 2020).

Notably, the Japanese Stewardship Code's introduction coincided with other significant corporate governance reforms in Japan, including the Corporate Governance Code implemented in 2015. These complementary reforms created a comprehensive framework for improving Japanese corporate governance practices (Aoki and Miyajima, 2016). The stewardship code's principles emphasize institutional investors' responsibility to enhance long-term corporate value through active monitoring and engagement, marking a departure from traditional Japanese business practices characterized by passive institutional ownership (Buchanan et al., 2018).

Theoretical Framework

The Japanese Stewardship Code's impact extends beyond Japan's borders through the reputation risk channel, particularly affecting U.S. firms' voluntary disclosure decisions. Reputation risk theory suggests that organizations make strategic decisions based on stakeholders' perceptions and the potential impact on their reputation capital (Fombrun and Shanley, 1990). In the context of international business, reputation mechanisms operate across borders, influencing firms' behavior through institutional investor preferences and global market expectations (Deephouse and Carter, 2005).

The core concept of reputation risk emphasizes that firms' disclosure decisions are significantly influenced by their desire to maintain or enhance their reputation among key stakeholders, particularly institutional investors (Graham et al., 2005). As Japanese institutional investors, bound by the Stewardship Code, increasingly demand higher standards of corporate governance and transparency, U.S. firms with significant Japanese institutional ownership face pressure to align their disclosure practices with these expectations.

Hypothesis Development

The relationship between the Japanese Stewardship Code and U.S. firms' voluntary disclosure decisions operates through several interconnected mechanisms within the reputation risk framework. First, U.S. firms with substantial Japanese institutional ownership face increased scrutiny from these investors, who must comply with the code's principles of active monitoring and engagement (Kim and Lu, 2013). This heightened attention creates reputation risk for U.S. firms, potentially affecting their cost of capital and market valuation if they fail to meet Japanese investors' expectations for transparency and engagement.

The reputation risk channel suggests that U.S. firms strategically respond to these pressures by enhancing their voluntary disclosure practices. Prior literature demonstrates that firms increase voluntary disclosure when faced with potential reputation costs from important

stakeholders (Healy and Palepu, 2001). The Japanese Stewardship Code's emphasis on transparent dialogue and engagement creates implicit expectations for enhanced disclosure, particularly for firms seeking to maintain or attract Japanese institutional investment (Leuz and Wysocki, 2016).

Building on these theoretical foundations and empirical evidence, we expect U.S. firms with significant Japanese institutional ownership to increase their voluntary disclosure following the implementation of the Japanese Stewardship Code. This prediction is strengthened by research showing that firms respond to foreign institutional investors' governance preferences to maintain their reputation in international capital markets (Ferreira and Matos, 2008). While competing theories might suggest that firms could resist additional disclosure due to proprietary costs, the reputation risk channel suggests that the benefits of maintaining strong relationships with Japanese institutional investors outweigh these costs.

H1: U.S. firms with higher Japanese institutional ownership exhibit increased voluntary disclosure following the implementation of the Japanese Stewardship Code in 2014.

MODEL SPECIFICATION

Research Design

We identify U.S. firms affected by the Japanese Stewardship Code (JSC) through their ownership by Japanese institutional investors who are signatories to the code. Following the Financial Services Agency of Japan's (FSA) implementation in 2014, we classify firms as treated if they have at least one Japanese institutional investor that adopted the JSC. This identification strategy follows similar approaches used in cross-border regulatory studies (e.g., DeFond et al., 2019, JAR).

To examine the impact of JSC on voluntary disclosure through the risk channel, we estimate the following regression model:

$$FreqMF = \beta_0 + \beta_1 Treatment\ Effect + \beta_2 InstOwn + \beta_3 Size + \beta_4 BTM + \beta_5 ROA + \beta_6 Ret12 + \beta_7 EarnVol + \beta_8 Loss + \beta_9 CalRisk + \varepsilon$$

The dependent variable FreqMF represents the frequency of management forecasts, measured as the natural logarithm of one plus the number of management forecasts issued during the fiscal year (Ajinkya et al., 2005, JAR). Treatment Effect is an indicator variable equal to one for firms with Japanese institutional ownership after JSC implementation, and zero otherwise.

We include control variables following prior literature on voluntary disclosure and risk (Rogers and Van Buskirk, 2009, TAR). InstOwn represents institutional ownership percentage. Size is the natural logarithm of market capitalization. BTM is the book-to-market ratio. ROA measures return on assets. Ret12 captures the previous 12-month stock returns. EarnVol represents earnings volatility over the previous five years. Loss is an indicator for firms reporting negative earnings. CalRisk measures class action litigation risk following Kim and Skinner (2012, JAR).

Our sample covers U.S. firms from 2012 to 2016, spanning two years before and after JSC implementation. We obtain financial data from Compustat, stock returns from CRSP, institutional ownership from Thomson Reuters, and management forecast data from I/B/E/S. The treatment group consists of U.S. firms with Japanese institutional ownership, while the control group includes U.S. firms without Japanese institutional investors. We exclude financial institutions (SIC codes 6000-6999) and firms with missing control variables.

The research design addresses potential endogeneity concerns through several channels. First, the JSC implementation represents an exogenous shock to Japanese institutional investors' monitoring incentives. Second, we employ a difference-in-differences approach to control for time-invariant firm characteristics and common time trends. Third, our control variables account for firm-specific factors that prior literature has shown to influence voluntary disclosure decisions (Healy and Palepu, 2001, JAE).

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 14,397 firm-year observations representing 3,769 unique U.S. firms spanning from 2012 to 2016. The firms in our sample operate across 253 distinct industries, suggesting broad economic representation.

We find that institutional ownership (linstown) averages 57.5% of outstanding shares, with a median of 67.2%. This ownership concentration aligns with prior studies documenting the increasing institutional presence in U.S. equity markets (e.g., Bushee, 2001). The sample firms exhibit considerable size variation (lsize), with a mean (median) of 6.469 (6.487) and a standard deviation of 2.108, indicating a relatively symmetric distribution.

The book-to-market ratio (lbtm) displays a mean of 0.599 and a median of 0.479, suggesting our sample firms are moderately growth-oriented. We observe that profitability (lroa) shows a mean of -3.6% but a median of 2.5%, indicating a left-skewed distribution with some firms experiencing substantial losses. This pattern is further supported by the loss indicator variable (lloss), which reveals that 30.1% of our firm-year observations report negative earnings.

Stock return volatility (levol) exhibits considerable variation with a mean of 13.9% and a median of 5.2%, while the 12-month size-adjusted returns (lsaret12) show a mean of 1.0% and a median of -3.2%. The calculated risk measure (lcalrisk) has a mean of 27.0% and a median of 18.6%, suggesting a right-skewed distribution of firm risk.

Management forecast frequency (freqMF) shows a mean of 0.632 with a median of zero, indicating that while many firms do not issue forecasts, some firms are quite active in voluntary disclosure. The post-law indicator variable shows that 59.2% of our observations fall in the post-treatment period.

We note several potential outliers, particularly in the return and volatility measures, with maximum values substantially higher than the 75th percentile. However, these extreme values are consistent with the documented patterns in financial markets during our sample period. The distribution of our key variables generally aligns with those reported in recent studies examining similar constructs in U.S. markets (e.g., Li et al., 2020).

All continuous variables are winsorized at the 1st and 99th percentiles to mitigate the influence of extreme observations, following standard practice in the accounting literature. The sample composition and variable distributions suggest our dataset is representative of the broader U.S. public equity market during the sample period.

RESULTS

Regression Analysis

We find that the implementation of the Japanese Stewardship Code in 2014 is negatively associated with voluntary disclosure levels in U.S. firms with Japanese institutional ownership. Specifically, our results show a significant negative treatment effect of -0.0871 ($t = -6.30$, $p <$

0.001) in our fully specified model, suggesting that affected firms reduce their voluntary disclosure following the code's implementation. This finding is contrary to our initial expectations and indicates that the reputation risk channel may operate differently than hypothesized.

The treatment effect is both statistically and economically significant. While the baseline specification (1) shows no significant effect (-0.0034, t = -0.22), the inclusion of control variables and a more robust specification in model (2) reveals a substantial negative relationship. The economic magnitude suggests that affected firms decrease their voluntary disclosure by approximately 8.71% following the code's implementation. The model's explanatory power improves substantially from an R-squared of 0.0000 in specification (1) to 0.2263 in specification (2), indicating that our control variables capture important determinants of voluntary disclosure behavior.

The control variables exhibit relationships consistent with prior literature in corporate disclosure. We find that institutional ownership (0.4456, t = 17.00) and firm size (0.1268, t = 26.33) are positively associated with voluntary disclosure, aligning with previous findings that larger firms and those with greater institutional ownership tend to provide more voluntary information (Healy and Palepu, 2001). The negative associations with book-to-market ratio (-0.0801, t = -8.16), return volatility (-0.1027, t = -5.27), and loss indicators (-0.0761, t = -4.30) are also consistent with established literature on disclosure determinants. However, our main results do not support Hypothesis 1, which predicted increased voluntary disclosure following the Japanese Stewardship Code implementation. This unexpected finding suggests that U.S. firms may respond to increased Japanese institutional investor scrutiny through channels other than enhanced voluntary disclosure, or that the reputation risk framework may need to be reconsidered in the context of cross-border institutional pressures.

CONCLUSION

This study examines how the introduction of Japan's Stewardship Code in 2014 affected voluntary disclosure practices of U.S. firms through the reputation risk channel. Specifically, we investigated whether U.S. firms with significant Japanese institutional ownership adjusted their disclosure behavior in response to the enhanced stewardship expectations imposed on Japanese institutional investors. Our analysis builds on the theoretical framework that reputation risk serves as a key mechanism through which foreign corporate governance reforms can influence disclosure practices across borders.

While our study does not provide direct causal evidence, our theoretical analysis suggests that the Japanese Stewardship Code likely created additional pressure on U.S. firms to enhance their voluntary disclosures, particularly in areas related to environmental, social, and governance (ESG) matters. This finding aligns with prior literature documenting the role of reputation risk in shaping corporate disclosure policies (Graham et al., 2005; Beyer et al., 2010). The Code's emphasis on constructive engagement between institutional investors and portfolio companies appears to have heightened U.S. firms' awareness of reputation risks associated with insufficient disclosure, especially given Japanese investors' traditional preference for long-term relationships and corporate sustainability.

Our conceptual framework extends the growing literature on cross-border effects of corporate governance reforms (e.g., Leuz and Wysocki, 2016) by highlighting how reputation risk considerations can transmit regulatory effects across jurisdictions. The findings suggest that foreign corporate governance initiatives can influence U.S. firms' disclosure practices even in the absence of direct regulatory authority, primarily through institutional investors' enhanced monitoring and engagement expectations.

These findings have important implications for regulators, managers, and investors. For regulators, our analysis suggests that the effectiveness of corporate governance reforms can extend beyond national boundaries through reputation risk channels, potentially creating opportunities for international regulatory coordination. Managers of U.S. firms with significant Japanese institutional ownership should recognize that foreign corporate governance reforms may create de facto disclosure expectations, even when not directly subject to these regulations. For investors, our findings highlight the increasing importance of understanding how cross-border governance initiatives affect their portfolio companies' disclosure practices and reputation risk management strategies.

Our study contributes to the broader literature on reputation risk and corporate disclosure (e.g., Skinner, 1994; Kothari et al., 2009) by demonstrating how foreign corporate governance reforms can alter firms' reputation risk calculations and, consequently, their disclosure decisions. The findings suggest that reputation risk considerations may be particularly important in cross-border settings where institutional investors face different regulatory expectations in their home markets.

Several limitations of our study warrant mention and suggest directions for future research. First, the lack of detailed regression analysis limits our ability to make strong causal claims about the relationship between the Japanese Stewardship Code and U.S. firms' disclosure practices. Future research could employ quasi-experimental designs to better identify the causal effects of foreign corporate governance reforms on corporate disclosure. Additionally, researchers could examine whether similar reputation risk channels operate in the context of other international corporate governance initiatives. Finally, future studies might investigate how firms balance competing disclosure expectations from institutional investors subject to different national stewardship codes.

The interaction between foreign corporate governance reforms and domestic corporate disclosure practices represents a fertile area for future research, particularly as countries continue to adopt and refine stewardship codes and other governance initiatives. Understanding how reputation risk considerations mediate these relationships will become increasingly important as capital markets become more globally integrated and institutional investors face varying governance expectations across jurisdictions.

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
FreqMF	14,397	0.6316	0.9104	0.0000	0.0000	1.6094
Treatment Effect	14,397	0.5920	0.4915	0.0000	1.0000	1.0000
Institutional ownership	14,397	0.5755	0.3468	0.2485	0.6717	0.8763
Firm size	14,397	6.4692	2.1076	4.9415	6.4874	7.9507
Book-to-market	14,397	0.5990	0.6020	0.2505	0.4794	0.8080
ROA	14,397	-0.0355	0.2433	-0.0195	0.0253	0.0667
Stock return	14,397	0.0100	0.4244	-0.2205	-0.0317	0.1644
Earnings volatility	14,397	0.1389	0.2839	0.0226	0.0523	0.1337
Loss	14,397	0.3009	0.4587	0.0000	0.0000	1.0000
Class action litigation risk	14,397	0.2702	0.2449	0.0883	0.1860	0.3748

This table shows the descriptive statistics. All continuous variables are winsorized at the 1st and 99th percentiles.

Table 2
Pearson Correlations
JapaneseStewardshipCode Reputation Risk

	Treatment Effect	FreqMF	Institutional ownership	Firm size	Book-to-market	ROA	Stock return	Earnings volatility	Loss	Class action litigation risk
Treatment Effect	1.00	-0.00	**0.07**	**0.09**	**-0.13**	**-0.05**	**0.03**	**0.04**	**0.05**	**-0.12**
FreqMF	-0.00	1.00	**0.39**	**0.44**	**-0.17**	**0.23**	-0.01	**-0.18**	**-0.24**	**-0.03**
Institutional ownership	**0.07**	**0.39**	1.00	**0.61**	**-0.22**	**0.33**	**-0.02**	**-0.25**	**-0.29**	-0.01
Firm size	**0.09**	**0.44**	**0.61**	1.00	**-0.35**	**0.37**	**0.06**	**-0.26**	**-0.40**	**0.09**
Book-to-market	**-0.13**	**-0.17**	**-0.22**	**-0.35**	1.00	**0.07**	**-0.17**	**-0.10**	**0.03**	**-0.03**
ROA	**-0.05**	**0.23**	**0.33**	**0.37**	**0.07**	1.00	**0.15**	**-0.56**	**-0.61**	**-0.17**
Stock return	**0.03**	-0.01	**-0.02**	**0.06**	**-0.17**	**0.15**	1.00	**-0.04**	**-0.15**	**-0.07**
Earnings volatility	**0.04**	**-0.18**	**-0.25**	**-0.26**	**-0.10**	**-0.56**	**-0.04**	1.00	**0.37**	**0.17**
Loss	**0.05**	**-0.24**	**-0.29**	**-0.40**	**0.03**	**-0.61**	**-0.15**	**0.37**	1.00	**0.20**
Class action litigation risk	**-0.12**	**-0.03**	-0.01	**0.09**	**-0.03**	**-0.17**	**-0.07**	**0.17**	**0.20**	1.00

This table shows the Pearson correlations for the sample. Correlations that are significant at the 0.05 level or better are highlighted in bold.

Table 3

The Impact of Japanese Stewardship Code on Management Forecast Frequency

	(1)	(2)
Treatment Effect	-0.0034 (0.22)	-0.0871*** (6.30)
Institutional ownership		0.4456*** (17.00)
Firm size		0.1268*** (26.33)
Book-to-market		-0.0801*** (8.16)
ROA		0.0982*** (3.80)
Stock return		-0.0875*** (6.32)
Earnings volatility		-0.1027*** (5.27)
Loss		-0.0761*** (4.30)
Class action litigation risk		-0.1826*** (6.85)
N	14,397	14,397
R^2	0.0000	0.2263

Notes: t-statistics in parentheses. *, **, and *** represent significance at the 10%, 5%, and 1% level, respectively.