Columbia Business School
Center on Japanese Economy and Business

Mitsui USA

How to Buy Japan:
Private Equity in a Global Economy

The 15th Annual Mitsui Symposium

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Columbia University

Left to right: David E. Weinstein, Richard Folsom, Bruce Greenwald, Neal Doying

Richard Folsom, representative partner and co-founder of Advantage Partners, LLP, commenced the 15th annual Mitsui Symposium by providing his perspective as a private equity (PE) investor in today's Japanese market, giving a detailed overview of recent trends in the industry – particularly considering recent macroeconomic policy changes. Bruce C. Greenwald, Robert Heilbrunn Professor of Finance and Asset Management at Columbia Business School (CBS), and Neal Doying, senior vice president at Lazard Asset Management, LLC, then shared their thoughts on the prospects for PE in Japan. David E. Weinstein, director of research at the Center on Japanese Economy and Business (CJEB) at CBS, Carl S. Shoup Professor of the Japanese Economy and chair of the Department of Economics at Columbia University, moderated the session.

When Mr. Folsom meets with institutional investors around the globe, he sees renewed interest in Japan. The most pressing issue on these investors' minds is the promise of "Abenomics." There have been clear changes to the macroeconomic environment in Japan and, therefore additional PE opportunities; Japan now has an opportunity to emerge from a "lost two decades" of stagnant economic performance.

David E. Weinstein

Mr. Folsom went on to discuss recent positive developments stemming from Abenomics over the past 18 months; because of the Bank of Japan's easing policies, equity markets have appreciated, and the yen has already reached one percent of the two percent inflation target. The economy has witnessed an improvement in corporate and household sentiment, and wage increases have followed a similar trend, which Folsom noted is very significant. Additionally, though they aren't tangible today, the 2020 Olympics provide a positive psychology to the market; this was Abenomics' biggest challenge.

While the sentiment in the market is more positive now than it has been for the past two decades, this enhanced market mentality will be short-lived if more tangible evidence does not appear. Mr. Folsom noted that, at least so far, the Japanese population seems to believe that Prime Minister Abe should continue in his position in order to carry out his economic reforms.

Despite this positive outlook, Mr. Folsom sees challenges remaining. Many corporations have improved their profitability, but export volumes have not experienced the same success. Many Japanese corporations have lost their competitive edge, notably Sony and Panasonic. Market psychology is positive now, but in the few weeks before the symposium, specifically with the increase in the consumption tax in early April 2014, Mr. Folsom noted that confidence had wavered. Mr. Folsom explained that the interest foreign equity investors have in Japan is often sidelined due to their concern about Japan's longer-term fiscal situation. In addition, the geopolitical challenges Japan faces, which affect corporate decisions and earnings, came sharply into focus recently during President Obama's visit when he stated his support for Japan and its sovereignty in the Senkaku Islands, over which the Chinese have claimed ownership. Demographic trends, such as the shrinking labor force due to the aging population and absence of women in the workforce, also pose tough challenges.

Richard Folsom

Mr. Folsom moved on to discuss the PE environment in Japan. PE investors invest in mid-size Japanese companies with the goal of generating a return, and then exiting when effective management is in place. Mr. Folsom explained that Japan is a very attractive exit environment, giving the example that his firm turned over $1 billion in capital to investors in eight exits over the past year, which represented a record level of activity.

Advantage Partners' ongoing investment activity sees certain drivers accelerating PE opportunities in some areas. These include corporate divestitures, founder succession, secondary buyouts, public-to-private investments, and restructuring or distress situations. As such, there is opportunity for value creation, under the right circumstances. Japanese public companies' aggregate earnings dropped by half after the financial crisis and have not reached pre-crisis levels.

Bruce Greenwald

The concept of PE in Japan still is not as developed or penetrated as in U.S., European, or even some other Asian markets. This is a result of a range of cultural and historical barriers that have prevented an active mergers and acquisitions market. Barriers include regulatory challenges, a lack of efficient market incentives, and cultural perceptions. While the deregulation of FDI in the 1990s caused perceptions to change, global competition has made Japanese companies realize that they are not invincible. This has led to the buying and selling of companies as a necessary economic activity. When looking at overall control acquisitions, four percent are PE, which shows Japan as an underpenetrated market; the equivalent figure in Europe is 15-20 percent. Considering Japan's large size, Mr. Folsom sees a long-term market growth opportunity.

Professor Greenwald was also optimistic about Japan's PE market. Stating his belief that the success of Abenomics is still an open question, he went on to propose that the source of Japanese stagnation is not just demographics, but also an issue of productivity growth. In the 1970s, Japanese productivity growth was higher than in the United States. Since 2000, the United States' annual growth has been 0.5 percent higher annually on average. Japan is a resource-poor, densely-populated country; as such, its economic focus has been on manufacturing. However, more recently, enormous manufacturing capacity in India and China has created an obstacle to this sector.

Neal Doying

Professor Greenwald argued that Japan needs to redeploy capital, labor, and management talent to its dynamic, yet ignored, service sector. Existing companies and culture do not seem likely to be the change agent in this case; imported institutions that are willing to intervene are going to be absolutely critical. Greenwald further argued that, in order to successfully intervene in developing service sectors, PE firms must have industry expertise. These interventions can, in turn, fundamentally serve as models for change management in the service sector.

Mr. Doying focused his talk on the public-private space of publicly-traded companies. There is a unique Japanese phenomenon in which subsidiaries of listed parent companies are traded; Japan has the most subsidiaries of any other market, and these subsidiaries account for 17 percent of securities traded in the Japanese market. These subsidiaries are typically listed because they were not the key business in a conglomerate, and the parent wished to either monetize its assets or have a subsidiary publicly traded to enhance its reputation. After the financial crisis, the number of listed subsidiaries has decreased consistently, now representing only eight percent of publicly-traded companies. Therefore, there is a growing market in taking public companies private, especially with subsidiaries.

Question and Answer session

Professor Weinstein opened up the Q&A session by asking, “If the PE market offers such enormous opportunities in Japan, why are more firms not taking advantage of this?” Professor Greenwald responded, stating that Japanese shareholding is dominated by institutions. Cross-institutional holdings were the way of influence in the past, and typically there was no room for others to intervene. While that aspect has disappeared, institutional solidarity remains. Entrenched management has been tough to break, not only for PE but also for activist shareholders. This is true throughout Asia; the institutional structure is pathologically favorable to entrenched management, no matter how incompetent.

Mr. Doying then posed a question regarding succession opportunities, asking if it is true that the older generation of Japanese executives is afraid of giving up their companies. Mr. Folsom thought they were indeed more concerned than the younger generation. Professor Greenwald observed that this generation of executives (who are now in their sixties) experienced the beginning of their careers as members of the most successful corporate environment in the world, and they have not come to terms with the new economy.

Professor Weinstein then asked, “If the future is so bright for PE in Japan, why is it so difficult to take over a company?” Mr. Folsom responded that change is happening steadily as the business community realizes that these changes must happen. Many quasi-governmental funds have been formed to do the job of private sector PE, and they represent the culturally-accepted way to handle distressed businesses. Professor Greenwald asserted that when this generation has passed, true change will occur and PE will penetrate.

An audience member then asked if there was a connection between Japan's education system, which encourages memorization, with a lack of risk-taking in business. Mr. Folsom said that the current administration is tackling this issue and is working toward a fundamental change, but there is no immediate solution. Professor Greenwald believed there was a connection, since failure is heavily penalized; this discourages risk-taking, and thus discourages innovation as well.

Another audience member asked about the necessity of specialization in PE, referring back to Professor Greenwald's previous comments. Mr. Folsom argued that specialization has evolved; his partners have gained expertise by doing deals in certain spaces and drawing on outside industry experts. Professor Greenwald said that drawing on outside expertise is not simple, and that those who are in the right side of an investment are always the industry specialists.

Hugh Patrick

The final question concerned Abenomics and the implementation of the three "arrows." Referring to a statement by Haruhiko Kuroda, governor of the Bank of Japan, regarding a possible stalling of the economy, the questioner asked whether or not this would affect the prospects for PE in Japan, and asked which service industries investors should be investigating as a result. Mr. Folsom responded that Abenomics has had some positive impacts, but his view as a PE investor is that there will be individual companies suitable for PE intervention irrespective of macroeconomic overtones. Mr. Doying agreed, saying that his firm's investment style is bottom-up; they investigate companies in every sector. Given Japan's demographics, he suggested that there would be opportunities in the healthcare sector, as well as retail banking for retirees.

This event was presented by CJEB with the cosponsorship of the Mitsui USA Foundation. Professor Hugh Patrick, director of CJEB and Robert D. Calkins Professor of International Business Emeritus at CBS, provided closing remarks.

Left to right: Eric Campbell and Tadashi Sano, Mitsui & Co. (USA); David E. Weinstein; Alicia Ogawa, CJEB; Robert Greenwald; Richard Folsom; Neal Doying; Hugh Patrick