



INVESTORS UNLEASHED: THE RISE OF SHAREHOLDER ACTIVISM IN JAPAN

Eighth Annual Mitsui USA Symposium

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On January 30, the eighth annual Mitsui USA Symposium, entitled “Investors Unleashed: The Rise of Shareholder Activism in Japan,” was held at Columbia Business School. The panel consisted of Koji Fusa, CEO of Sandringham Capital Partners Limited; Anthony Miller, president of RCG Japan Ltd.; and Curtis Milhaupt, the Fuyo Professor of Law and director of the Center for Japanese Legal Studies at Columbia Law School. The panel was moderated by Alicia Ogawa, director of the Program on Alternative Investments of the Center on Japanese Economy and Business at Columbia Business School.

The event began with a presentation by Koji Fusa, who provided an overview of the current Japanese economy and highlighted some prevailing trends in the alternative investment markets in Japan. It is noteworthy to see many private equity players moving into the activist investment space typically occupied by hedge funds. Part of this transition has to do with the more attractive fee structure in private equity funds, as opposed to hedge funds. Hedge funds receive a performance fee (20 percent a year) plus a management fee (usually 1–1.5 percent), but a PE shop charges a performance fee over the fund life that can be set off against a management fee.

Nevertheless, the question remains why alternative investments in Japan have been so popular. First, Japan is currently home to the second-largest financial market in the world—half the size of the U.S. market—with GDP equal to approximately \$4.5 trillion. Although Japan still lags behind the United States in terms of real GDP growth (2.6 percent versus 3.2 percent in the United States in 2005; 2.9 percent versus 3.3 percent in 2006), the current low interest rates in Japan also provide a good environment for alternative investment opportunities. Bank lending has also increased each year since 2004.

Mr. Fusa highlighted some significant transactions by private equity in the telecom industry since 2002, such as Ripplewood’s investment in Japan Telecom, Nikko Principal Investments’s acquisition of Bellsystem 24 and the Carlyle Group’s purchase of 60 percent of Willcom. More recently, there have been several funds that have entered or are expected to enter the Japanese market and raise Japan/Pan-Asia funds: CCMP Capital,

CVC Capital, Advantage, Unison, MKS Partners and RHJ International. There has also been a steady increase in the annual volume of M&A deals by private equity players in Japan, from 6 worth about \$617 million in 1998 to approximately 180 worth \$11.3 billion near year-end 2006.

Anthony Miller contrasted the Japanese experience with U.S. market history. Even with the size of the Japanese market, tremendous inefficiencies exist that are slowly being rectified with reforms. Some of these inefficiencies—firms operating in an inefficient manner, with entrenched management failing to perform—were similarly manifested by American companies circa the 1970s. The situation was ultimately rectified by activist private-equity and investment bankers, who took a leading role in striking fear into the hearts of management if they did not work in the best interest of their shareholders. Some in the industry would claim that this created a sense of checks and balances on management.

There are many in the private-equity/investment banking space who would like to replicate this model in Japan by taking underperforming existing companies and allowing shareholder activism to reign to the benefit of a particular firm, its shareholders and the market in general. However, in Japan this is no easy feat. There are many factors that serve as impediments to shareholder activism in Japan, including corporate xenophobia and a general sense that corporate takeovers are “bad,” particularly foreign takeovers of Japanese firms.

Mr. Miller raised a fundamental yet profound question that was on the minds of all in the room: Is friendly activism possible? He mentioned the three channels by which one controls a company: the board, the banks that service the company and the shareholders. However, in a midcap Japanese company no one controls the CEO. Mr. Miller also noted that techniques for activist investment in Japan include management visits, value creation presentations to the board, management buyouts, proxy fights and tender offers.

Curtis Milhaupt’s comments provided a framework for shareholder value creation, particularly from a legal perspective. Shareholders in Japan historically have been passive because of a strong managerial model and legal rules that make it costly to challenge management. There is a stigma attached to takeovers, particularly those by foreign investors. Interestingly, in the early 2000s there were a few small but notable hostile-takeover attempts, but all of these hostile bids failed in the end.

In March 2005, Japan saw the emergence of the “poison pill,” which in the United States gives management leverage to negotiate a better offer. Japan currently rates poorly in proxy voting. There is often little notice of a shareholder meeting and insufficient

information provided in proxy materials for shareholders to make an educated decision. The current tax law in Japan is rather antiquated, producing negative ramifications for M&A activity. At the very least, Japan's legal environment will continue to evolve, provide incentives or facilitate shareholder activism.

Noteworthy too is the public sentiment against shareholder activism in Japan. It is seen as a manifestation of greed and as ultimately harmful to dedicated employees. Some of this sentiment has been fueled by the media and by selective prosecution of high-profile Japanese businessmen. However, as more Japanese companies engage in hostile takeovers, there is the possibility that foreign-acquisition activity will not be viewed as taboo.

Japan will have to overcome the norm of "managerialism" if shareholder activism is to flourish. From a macro perspective, Japan's shareholder activism is on the rise. What remains to be seen is the speed at which this rise in shareholder activism will continue.

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