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U.S.-style investor activism in Japan: The first ten years? ☆

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ABSTRACT

This paper provides a comprehensive look at the first decade of U.S.-style investor activism in Japan, the second largest stock market in the world with many underperforming and cash-rich firms. Barriers to shareholder activism have historically been high but we document an unprecedented wave of block acquisitions by hedge fund and other investors with a total of 916 stakes reported in the period between 1998 and 2009. There is, on average, a positive stock price reaction to the announcement of activist investments, particularly for events involving hostile funds. The long-run returns on activism are positive only for events involving hostile funds. We find that activists have forced target firm managers to increase their payouts compared to peer firms, and there is some evidence of change in corporate governance. Finally, after 2006 there was a widespread adoption of “poison pills” by firms, particularly those targeted by activists, and a subsequent drop in investor activism. Our paper shows how U.S.-style activist investors are responsible for the “import” of corporate governance mechanisms from the U.S. into a foreign market.

“In countries like Japan (nobody is like Japan), there are always two games being played – the appearance of shareholder activism which “Japan, Inc.” considers to be important to its international image, and the reality, which is the ultimate commitment of government to defend national interests.”

Robert A.G. Monks (U.S. activist investor) (Quote from his November 6, 2007 Harvard Law School presentation.)

1. Introduction

Capital markets in Japan have experienced a remarkable economic and regulatory transformation in recent years. Following the collapse of the real estate and stock market bubble in 1990 and the ensuing “lost decade” of economic slump, banks sold much of their equity holdings and inter-corporate shareholdings declined (Hoshi and Kashyap, 2004). Foreign investors, however, the majority of them institutional money managers, have played an increasingly active role. Foreign ownership of stocks listed on the Tokyo Stock Exchange increased from 5% in 1990 to 24% by 2008. Local pension and mutual fund holdings also increased. Fig. 1 illustrates these changes.

This rise of foreign shareholders in Japan has led to a shift in the balance of power between corporate insiders and shareholders. Several activist hedge funds and other institutional investors have been at the forefront. A common definition of an activist is a shareholder “who tries to change the *status quo* through ‘voice,’ without a change in control of the firm” (Gillan and Starks, 1998). Hedge fund activism exploded in the U.S. in the last decade (see Brav et al., 2010 for a survey) but dropped considerably during the 2007–2008 credit crisis (Greenwood and Schor, 2009). Activist investing has been especially controversial in Japan as it is perceived as an imported practice led by foreign (mostly U.S.-)based funds or by local funds employing U.S. techniques.¹

In this paper, we focus on the role that U.S.-style shareholder activism has played in corporate governance and performance in Japan. Japanese capital markets are large and liquid but conditions for U.S.-style activism were mixed. Barriers to shareholder activism are higher in Japan than in the U.S. With its relationship-based corporate culture, the social norm in Japan has been that shareholders would seldom confront management. The earliest example of U.S.-style shareholder activism in Japan was T. Boone Pickens, the U.S. corporate raider, who lost an uphill battle in 1991. In the next decade, there were no large-

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¹ See Greenwood, Khurana, and Egawa (2009) for a case study of the most prominent U.S.-based fund operating in Japan, Steel Partners.

Evolution of Stock Ownership in the Tokyo Stock Exchange

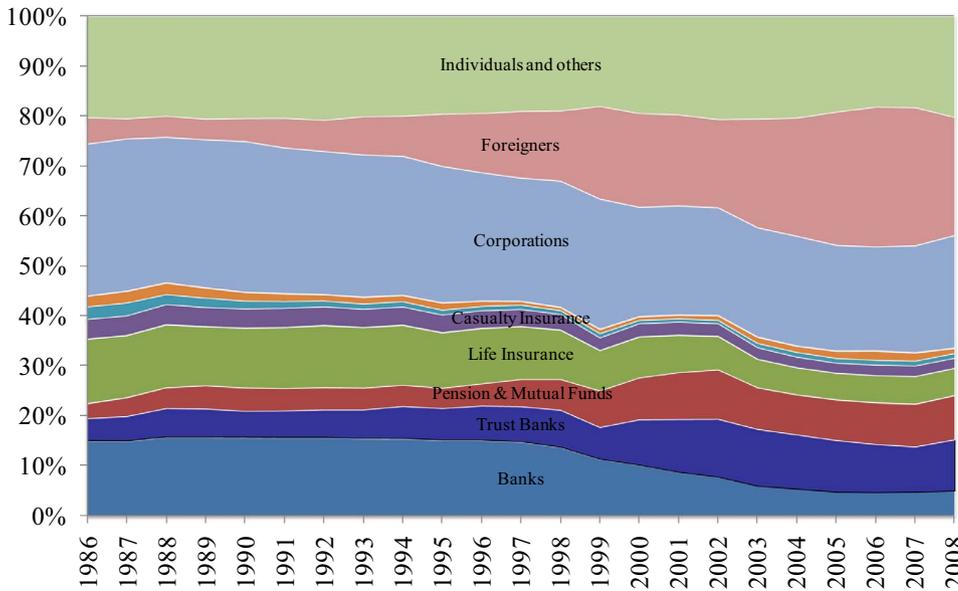


Fig. 1. Evolution of stock ownership in Japan This figure describes the evolution of ownership of stocks listed in the Tokyo stock exchange during the period from 1986 to 2008. Investor categories (from bottom to top in the graph) are: Banks (City and Regional), Trust Banks, Pension and Mutual Funds, Life Insurance, Casualty Insurance, Other Financial Institutions, Securities Houses, Corporations, Foreigners and Individuals and others. Note that the Tokyo Stock Exchange does not separate shares owned by trust banks for their own accounts from shares owned on behalf of investors in custodial accounts, so the percentage for trust banks is overstated. The data source is the Tokyo Stock Exchange.

scale shareholder activist events. The wave of investor activism started only in the early 2000s after the Japanese stock market hit bottom. Another big impediment to activism in Japan is that the market for corporate control is very thin and M&A is not a clear exit strategy for the activist investor. M&A activity has more than doubled in Japan in the last decade, from 45 completed transactions in 2000 to 98 deals in 2008 where majority stake was acquired (source: SDC Platinum) but it is still very limited for a market with over 4000 listed firms. Recent evidence for the U.S. shows that returns from activism are driven by the ability of hedge fund activists to force targets into a takeover (Greenwood and Schor, 2009). Their study also finds that activist investors perform poorly when there is little activity in the takeover market.

Activist investors in Japan may be pursuing a different strategy than putting a target firm up for sale in the M&A market. There is considerable potential to unlock shareholder value in Japan by pushing firms to increase distributions, or to put cash in productive use. Many Japanese firms have high cash balances and activist investments may be addressing agency issues (Klein and Zur, 2009). Fig. 2 shows the median holdings of cash and securities for publicly-listed firm in the G-7 nations over the last two decades. Japanese firms stand out for having

the highest median cash-to-assets ratios in the top industrialized nations.

We construct a comprehensive dataset of fund activist engagements in Japan between 1998 and 2009. We hand collect data on all mandatory filings of block-shareholdings that exceeded the 5% threshold. This requirement is similar to schedule 13-D in the U.S. (used in Brav et al., 2008; Klein and Zur 2009; Clifford 2008; Greenwood and Schor, 2009). We identify 34 activist funds, 26 of them foreign according to the nationality of the top managers. Activist block acquisitions peaked in 2006 and 2007. About half of the investors have a hostile attitude as determined by press reports and the indication in their filings of having the intention to make “significant proposals.” Our sample represents a total of 916 filings of block acquisitions by activists of 786 unique firms. Of the targeted firms, 759 are non-financials, a significant fraction of the over 3600 publicly listed non-financial firms tracked by the Nikkei database in December 2008. Activism was substantial in yen terms as well, with investments totaling ¥6.8 trillion in terms of the cost of acquisition at the initial filing dates (about US\$ 65–75 billion depending on the exchange rate used).

Fig. 3 illustrates this wave of investor activism. The figure also highlights how these activist engagements are linked to the

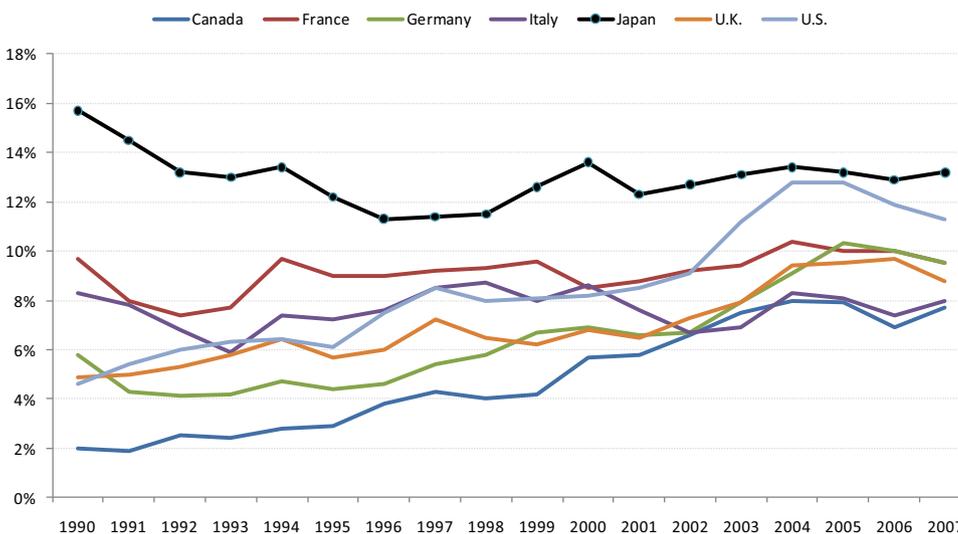


Fig. 2. Median cash-to-assets ratio for publicly-listed firms in G-7 Nations

This figure shows the median holdings of cash and securities for publicly-listed firm in the G-7 largest industrialized nations during the period from 1990 to 2007. We compute the median cash-to-assets ratio for all firms in each country in the Worldscope database.

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