OPINION

Activist investors cannot force Japanese mergers with ideas alone

Shareholder rejection shows limitations of Oasis Management's strategy

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Tsuruha Holdings, Japan's second largest drugstore chain, is facing pressure from activist investor Oasis Management. (Photo by Keigo Yoshida)

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Just as picnics attract flies and mosquitoes, industry consolidation attracts opportunistic investors.

During consolidation, stronger players take control of weaker ones through mergers and acquisitions. In such deals, investors lucky enough to be holding the shares of a target company when a takeover bid is announced expect the offer to value their stock at a premium of 30% or more to its previous market price.

Japan-focused activist funds have taken aim at potential acquisition targets in consolidating industries in recent years, hoping for a windfall when these companies are taken over.

The recent foray by Hong Kong-based Oasis Management into Japan's consolidating chain drugstore sector, though, represents a strategy that goes beyond merely guessing the next consolidation target.

In its ongoing campaign against the management of Tsuruha Holdings, Japan's second largest drugstore chain, Oasis is actively leveraging its shareholder rights to conjure a profitable transaction into being. It is seeking to pressure an unwilling Tsuruha into the arms of the company's largest shareholder, Aeon Corp., Japan's largest operator of malls and superstores.

Last month, Tsuruha shareholders rejected a slate of directors and reforms proposed by Oasis by a wide margin. This suggests that the fund overestimated the power of paper proposals to influence larger dynamics. If Aeon or another strategic acquirer makes a move for Tsuruha, it will be for reasons and objectives of its own, not because of table pounding by an activist fund shareholder.

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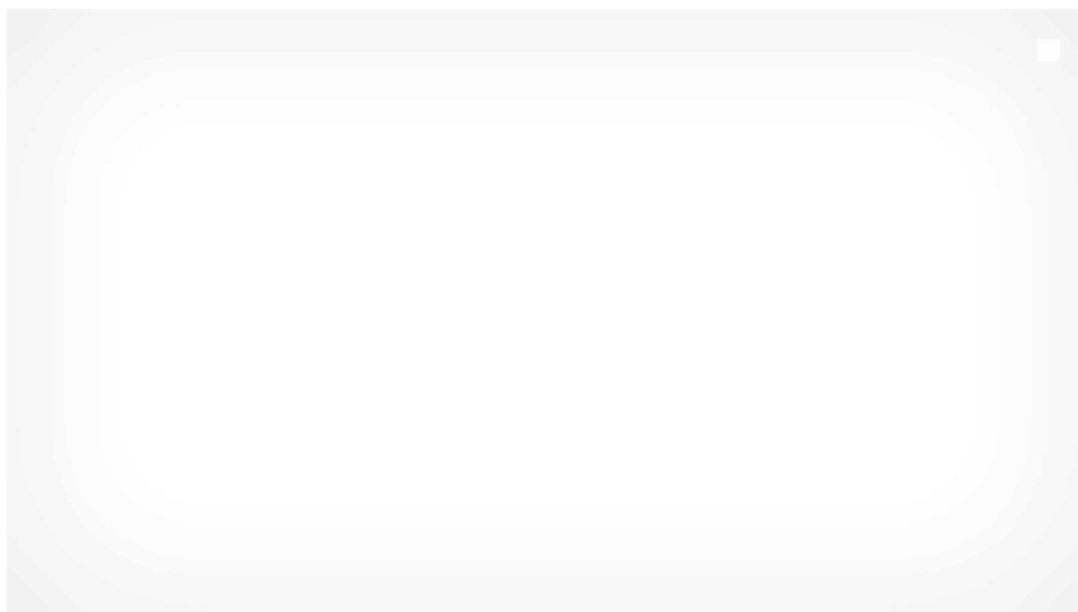

As Yoshiaki Murakami, Japan's original activist investor, has demonstrated in recent years with a series of deals in consolidating industries like construction, the key to success is not jawboning third parties to use their money to take control of a target.

What works is more direct, expensive and risky: Using your own money to take control of the target first. Once control of a weaker industry player has been secured, buyers will willingly pull up a seat at the poker table. An activist shareholder without the will or means to take control of a target is little more than a back-seat driver.

Unfortunately for Oasis and other diversified funds working with their clients' money, going all-in to take control of a target is not generally an option.

Aeon, which holds a 13% stake in Tsuruha, does not need any advice from Oasis on whether, when or how to absorb the drugstore chain into its retail empire.

Tsuruha's shareholder meeting on Aug. 10 in Sapporo: The directors and reforms put forward by Oasis were rejected by a wide margin. © Kyodo

If the time comes, Aeon is well aware that it will have to deal diplomatically with the families of Tsuruha's original founders, who remain substantial shareholders and still occupy board seats and senior executive positions. The end game will be played by Japanese rules of etiquette and face-saving that are beyond Oasis' skill set.

If Oasis' bid to replace family shareholders on Tsuruha's board with its own nominees in the name of better corporate governance has made an eventual takeover by Aeon more likely, it would be an unintentional and fortuitous result.

Aeon voted against the Oasis nominees and supported the family incumbents with whom it will have to deal if it decides to pursue a takeover. By doing so Aeon perhaps won a measure of trust from the families that will be useful currency in the endgame. But it is improbable that creating greater trust between Aeon and the family was part of a clever Oasis plan.

Murakami's recent efforts in oil refining, another consolidating industry, demonstrate that trying to make a profitable transaction happen is not a game for the fainthearted. Murakami has plowed his own capital into building a 20% stake in Cosmo Energy Holdings, Japan's third largest refiner. His stake is now worth 90 billion yen ($615.7 million).

Murakami's plan to take control of Cosmo and merge it into one of its larger rivals -- Eneos or Idemitsu Kosan -- not only requires a large war chest and a willingness to spend it but now faces the uncertainty of legal obstacles **in the form of a complex poison pill** put in place by Cosmo's board.

Even if Murakami eventually succeeds in overcoming the poison pill and increasing his stake to the point that he can assert his will over Cosmo, there is no assurance that Eneos or Idemitsu Kosan, which are both aggressively reducing refining capacity and moving into areas beyond fossil fuels, will have any interest in acquiring Cosmo at a price that represents a profitable exit for Murakami.

It is entirely natural for activist fund managers to try to stir the pot to help precipitate a profitable transaction. Submitting a shareholder proposal is cheap compared to the commitment of capital and resources involved in actually acquiring control of a target.

A strategy of shaking trees to see what falls might be rational on a cost-benefit basis. Oasis and its fellow activists should consider, however, whether the modest legal fees involved in submitting a provocative shareholder proposal designed to stir things up represent the full cost of such a gambit.

The fact that domestic asset managers and institutional investors solidly backed the family members on the Tsuruha board who Oasis criticized as compromised, conflicted and dysfunctional is a sign that Oasis' claim to be a champion of corporate governance has been taken with a large grain of salt by domestic shareholders.

The larger cost of using high-minded corporate governance rhetoric in pursuit of a profitable exit is an erosion of credibility and dignity. Everyone knows that Oasis wants the Tsuhara family directors out of the way, not for the sake of higher corporate governance ideals, but because they are likely to resist an unwanted takeover.

A hidden cost of using pious rhetoric to serve ulterior objectives is the risk of being taken less seriously the next time around.

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