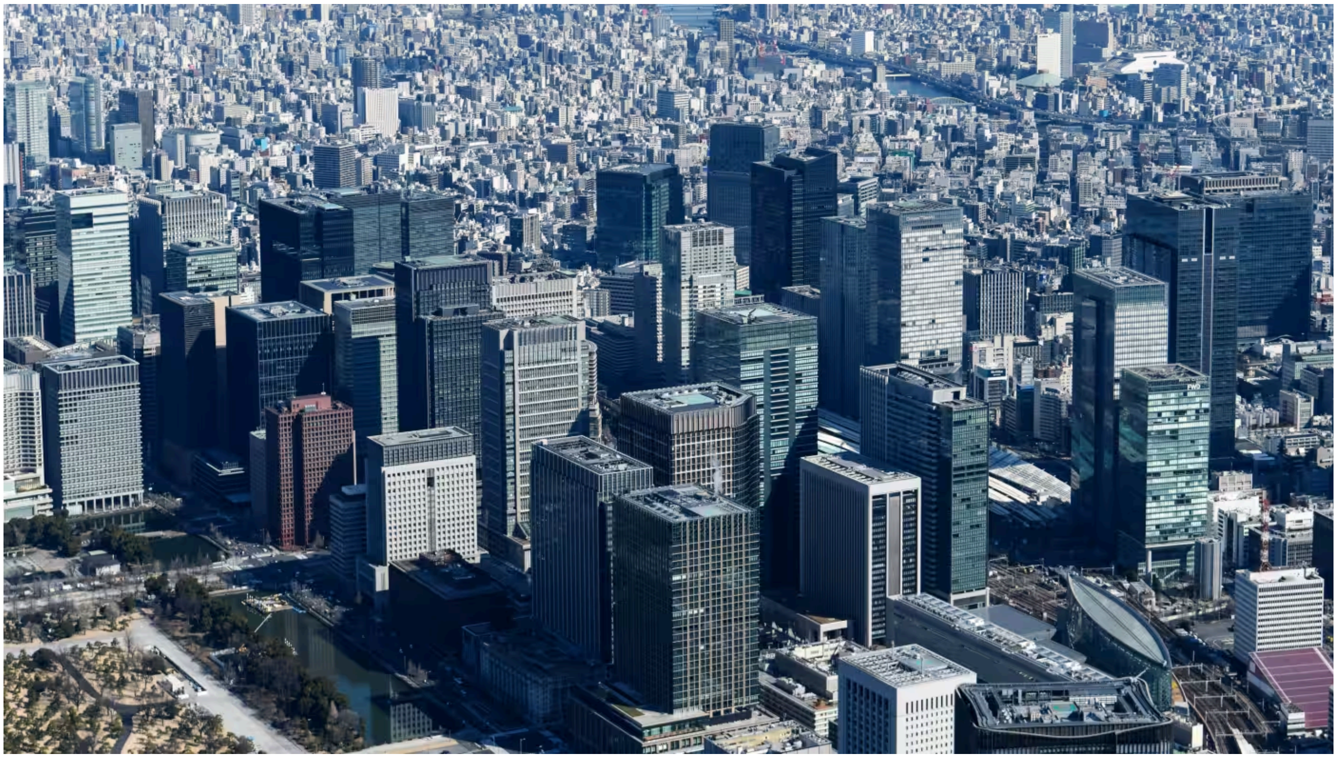
FINANCE

Japanese retail investors rally around activism

Activists still see challenges in winning over institutional investors



As Japanese companies shift away from cross-shareholding, more shares are finding their way into the hands of retail investors and activists. (Photo by Kai Fuji)

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July 16, 2024 12:31 JST

TOKYO -- This year, Freund's annual general meeting was unusually contentious, thanks to one participant: Nao Makino from Kaname Capital.

At the Tokyo-based manufacturer of equipment for making pharmaceutical powders and coating tablets, shareholders meetings used to be truncated affairs with few questions asked, according to a shareholder.

But at the meeting on May 31, 14 questions were asked, including by Makino over management's responsibility for missing targets in the last four medium-term business plans and over a lack of explanation about the generous remunerations paid to the 86-year-old founder and honorary chairman.

A handful of individual investors followed Makino's lead and put management to task, urging them not to dodge the questions.

"What impressed me most," said Makino, an associate partner and head of research at the Boston-based activist investor, "was the fact that individual investors came out in support of us, instead of distancing themselves from us."

Kaname started buying Freund shares in 2019. On Sept. 5, 2023, it reported an ownership in excess of 5%. Since then, Kaname has raised its stake twice, in December and April, to the current 7%. Each time Kaname reported share purchases, Freund shares went up, and now are 39% higher from a year before.

"Some investors became intrigued by our activity and came to the shareholders meeting to see us," Makino said. Freund's president was approved at the meeting in the end, but his approval rating is now 87%, compared with 97% two years ago.

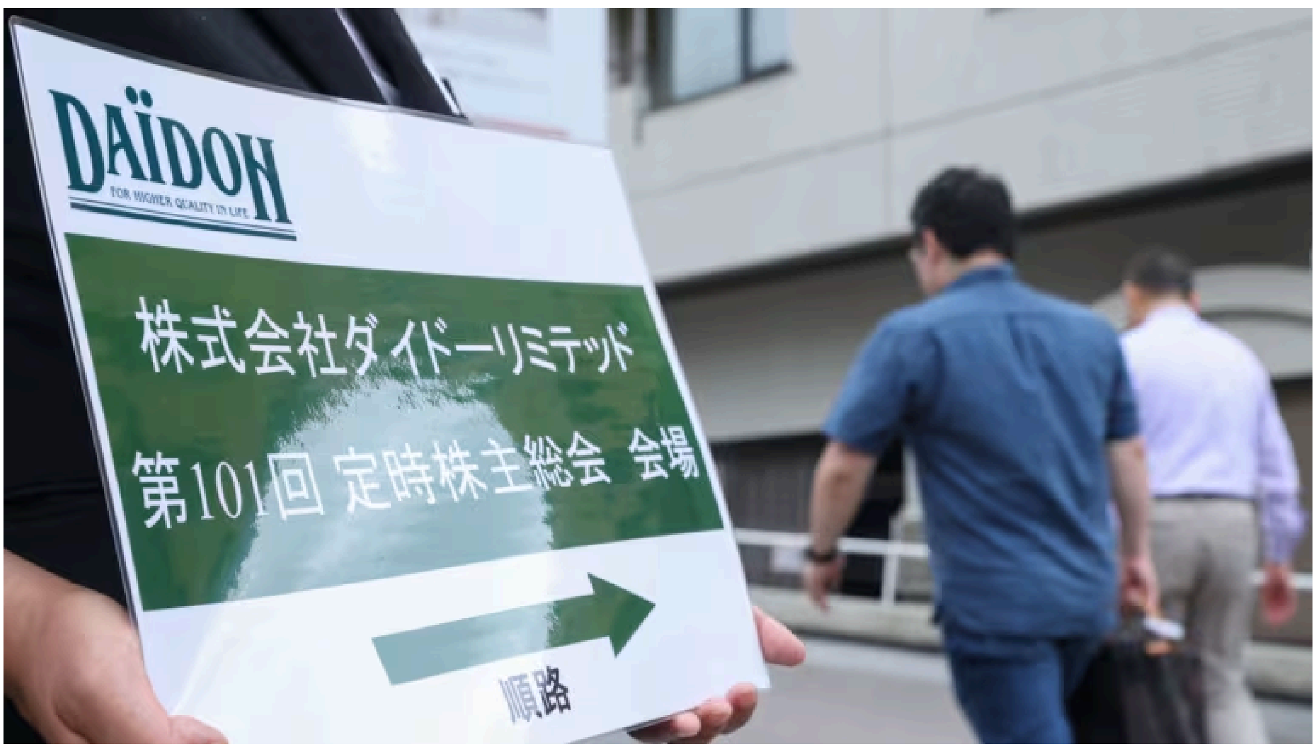
This event illustrates the growing clout that retail investors and activists have come to exercise over corporate Japan as more shares find their way into their hands as Japanese companies shift away from the practice of holding shares in each other. The Freund meeting also illustrates the much greater receptiveness of individual investors to activism than big institutional investors.

"Unlike Japanese institutional investors, we can ask questions in a straightforward way because we are not hamstrung by business relationships," Makino said. "Our task is to come up with proposals that other investors want to support."

The clout of retail investors was on display in other shareholders meetings, including one at Toyo Securities, a struggling broker that has fluctuated in and out of losses in the past few years. The broker is 27% owned by activists, but growing support for activists among retail investors forced the company to withdraw its president from the list of eight board nominees the day of the annual meeting on June 26.

The activists were demanding that Toyo replace its management, stop its money-losing real estate business and come up with a plan to improve its share price above book value. In the end, Toyo Securities managed to get six of its seven board nominees approved, but with support of 50% to 51%.

In another example, apparel maker Daidoh won only five board seats on June 27, compared to three by activists. The apparel maker has had operating losses for 11 straight years and was clashing with activist investor Strategic Capital, which owned 32% of the company, over how to revamp it. On July 4, Daidoh announced a big payout to shareholders as a poison pill defense. Strategic Capital unloaded its entire stake in Daidoh the next day, it was disclosed on July 12.



Apparel maker Daidoh saw only five of its eight board nominees approved on June 27. (Photo by Akitoshi Sugiura)

The shifting tide is driven in part by the Tokyo Stock Exchange's move in March 2023 requesting publicly listed companies to keep a return-on-equity ratio of at least 8% and a price-to-book ratio of at least 1, or come up with plans to achieve these benchmarks. Another factor is a decline in stable shareholders amid pressure from the TSE and the Financial Services Agency against corporate cross-shareholding.

In February, major non-life insurers vowed to unload all cross-shareholdings, while some Toyota group companies like Denso and Aisin have dumped all the shares of group companies. Japan's three largest banks sold 40% more shares in fiscal 2023 than the previous year.

Companies try to sell these shares to individual investors in the hope they will become new stable shareholders. They are now learning that individual investors are, indeed, not cross-shareholders.

Shareholder activism in Japan tends to target small- and mid-cap stocks because activists themselves aren't so large yet. "The impact [of shareholder activism] on the broader market is still limited in Japan," pointed out Chisa Kobayashi, a strategist at UBS SuMi Trust Wealth Management.

But she added that it is adding momentum to the broader governance reform effort. "Japanese companies become more willing to take governance steps when they see others doing so -- they have a herd mentality," she said. "Activism has a spillover effect."

There are still many who view activism as a disguise for making quick profits. Masumi Nishida, a partner at Dalton Investments, is trying to change this image through his radio show.

His "Investor's Sunday" program on the popular InterFM network invites a guest every week to talk about the world of high finance, including shareholder activism and private equity investment. Past guests have included the heads of private equity companies, a venture capital firm and activist hedge funds. The show was launched in September.

"There is a stereotype about activists being a bunch of faceless foreign investors telling companies whatever they want," Nishida said. "It is not necessarily understood why activists raise the kind of questions they do." Dalton owns 9% of InterFM, which serves the Tokyo metropolitan area, mainly with music programs.

The idea of a radio show originally came from James Rosenwald, a Dalton co-founder and radio lover, but Nishida has come to enjoy the job, as the program generates social media comments like "It was much more interesting than I thought," "It taught me different ways of looking at business" and "I've learned that there is something strange about the way companies are run in Japan."

Dalton invests in more than 20 Japanese companies, including the TV broadcaster and newspaper publisher Fuji Media Holdings, surgical kit maker Hogy Medical, clinical testing reagent maker Eiken Chemical, fluorine compound maker Stella Chemifa and shutter maker Bunka Shutter.

Nishida says that winning over institutional investors is a bigger challenge.

Japanese institutional investors do not necessarily side with activists even on issues that have the backing of global proxy advisers such as Institutional Shareholder Services, he said.

A case in point is Fuji Media Holdings, an operator of the Fuji TV network and national daily Sankei Shimbun. Dalton and its partner investors own 6.55% of Fuji Media and demand a board revamp, a spin-off of real estate assets, and a management buyout -- Fuji Media shares are down by over 5% in the last 10 years and are worth less than half of book value, its return on equity is just 4.4% and its board members average 72.4 years old, making it one of the oldest at any company in Japan. "Such an entrenched group can hardly provide the open-mindedness, energy and dynamism your businesses need," they argued in a letter to Fuji Media.

But in this year's annual meeting, Osamu Kanemitsu, the president, was approved by 72.2% of shareholders, compared with 58.05% last year.

Such examples do not necessarily mean Japan Inc. is backtracking on governance reforms, some analysts say. "Governance reforms don't work if they rely only on pressure," said Kobayashi, the UBS strategist. "Dialogue will become more important."

Dalton's Nishida is unfazed by the outcome of the shareholder vote at Fuji Media. "We won't give up just because of the results of this vote," he said. “It’s just one of the stops along the way toward the destination.”

Activists have an investment horizon of two to five years, meaning they can wage an extended campaign, he added.

"There's still a lot to improve on governance in corporate Japan," he added, noting that only 16% of companies listed on the TSE's Prime section have a majority of independent board members and that the return on investment is less than 10% for companies on the Topix index, compared with about 20% for the S&P 500.

"Our job will never end as long as Japanese companies have a low return on equity."