



Cue for more engagement

By **TIM PAYNE**

UNTIL RECENTLY, a combination of less mature capital markets and controlling positions in companies held by families have made Asia an unattractive place for US-style hedge fund activists to create returns. Japan in particular has seen several high-profile US-style campaigns easily defeated, as a result of differences in corporate culture and governance structures.

However, recent moves by mainstream funds point to a changing landscape, where activists in Asia are increasingly portrayed as shareholder champions. Elliott Management’s 2015 campaign against Samsung, protesting the sale of its construction unit, was audacious, aiming right into the belly of the Korean business establishment. While the final vote sided with management, the activist took 30 percent of the tally.

Historically, activism in Asia has taken three primary forms. In the first, dissident management fights for control of an asset. The most extreme example is Chinese electrical appliance retailer Gome’s former chairman fighting a proxy contest from prison in an attempt to unseat the incumbent management.

In the second, small minorities of otherwise unconnected shareholders band together to block actions by the board. Hedge funds have played a role in these situations, helping drive outcomes in favor of minority shareholders.

The third form, short activism, is sometimes anonymous, but includes Muddy Waters’ high-profile attacks on companies such as Sino-Forest and Olam. US companies have also been attacked by short-sellers over their business practices in China, such as hedge funds that alleged Lumber Liquidators lied about formaldehyde levels in China-made flooring.

Such campaigns against Asian companies exploit a deep anxiety over information arbitrage. Foreign shareholders often have a shallow understanding of companies’ business practices. Transparency levels can also be low, helping fuel fears of unknown monsters swimming beneath the surface of a company’s results.

While activism in Asia does not yet compare to the US type that aims to drive significant structural change, companies long perceived as secure are becoming vulnerable, and complacency is dangerous. Asian companies need to be ready to fight an attack on their track record and values. The governance of family businesses, in Asia in particular, is less likely to be trusted and understood by

the wider market. Boards need to be ready to show that they are aligned to the interests of all shareholders, instead of running businesses for themselves. To see off an activist threat, boards and key shareholders will need to engage investors more directly and clearly than they have had to do in the past.

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Abe’s reforms open a door

By **ALICIA OGAWA,**
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BUILDING ON HIS 2012 ELECTION PROMISE to revitalize Japan, Prime Minister Shinzo Abe launched a series of reforms that includes significant changes in corporate governance, potentially permitting greater pressure from shareholders. With a new Corporate Governance Code, Stewardship Code (aimed at investors), and amendments to the Company Act, Abe hopes to force market discipline on company management. By themselves these measures won’t bring a rapid rise in US-style activist shareholder campaigns, but they are a first step.

The new rules do help unlock an important door for foreign investors, who now own more than 30 percent of all listed shares in Japan. Foreign activists are very likely to succeed in prying higher dividends and share buybacks out of cash-rich Japanese companies. Dan Loeb’s Third Point has had some much-noticed success already with challenges to Sony and robot-maker Fanuc. However, activists’ ability to promote long-term change in corporate restructuring and board function will be very weak for a long time to come.

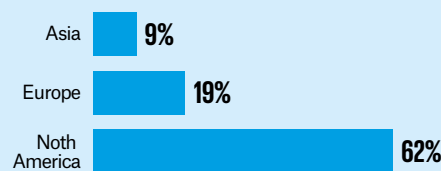
Popular practices that helped drive Japan’s economic boom in the 1970s and ’80s are now regarded by Abe and others to be a cause of the country’s sclerosis. These include the

commitment to lifetime employment, limiting ownership of shares to passive and friendly investors, and preventing outsiders from joining corporate boards.

The typical Japanese company is a tightly knit family, favoring the stakeholders most directly involved in the business – particularly customers and workers. A 2013 survey by the Ministry of Economy, Trade and Industry ranked management’s top three stakeholder priorities. Ninety percent put customers first, while only 8 percent identified foreign investors as a priority.

Impact assessment

Global dealmakers were asked to rank the impact of various factors on M&A in 2015. In the survey, shareholder activism ranked far lower in Asia and Europe than in the US



Source: Brunswick Insight

Abe's new rules may help change that culture, but adoption will be slow and companies may opt out of compliance if they can offer a reasonable justification. One change in particular seeks to move companies toward a US-style corporate structure by requiring that outside directors serve on auditing, nominating and compensation committees. Traditionally, Japanese companies strongly favor insider control. An amendment to the Company Act offers a compromise that puts outside directors on a single audit committee with supervisory functions that include nominations and compensation.

Corporate governance is being hailed as Abe's signature accomplishment. Getting such a contentious item on the political agenda at all is significant, a signal of the potential for change. Given entrenched resistance however, true structural reform will be a difficult, painful and slow process.

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Minority stakes gain a new voice

By **AZHAR KHAN**

TOUGHER REGULATIONS and a trend toward better governance are giving rise to a new wave of activism in India by small, large and even foreign shareholders. Companies in India are typically owned by insiders who control all decisions in cooperation with management, often conflicting with the interests of other shareholders. However, some developments have given minority investors a powerful voice.

First, tougher rules set in 2010 by India's Securities and Exchange Board require mutual funds to disclose how they vote on shareholder resolutions. This accountability has led to voting by domestic institutions doubling in two years. Institutional funds even forced Maruti Suzuki, India's largest carmaker, to rewrite a deal for a new plant in western India. Second, a requirement that companies offer electronic ballots has greatly improved access by India's shareholders and the reliability of votes. Third, a rise in proxy advisory firms gives shareholders access to rigorous analysis to use as ammunition. Finally, as of 2013, majority shareholders are prohibited from voting where they have a potential conflict of interest. This measure strikes at the heart of owner-management impunity and gives minority shareholders a decisive say.

These elements came together when UK brewer Diageo acquired a controlling stake in India's United Spirits in 2014.

Minority shareholders, aided by proxy firm IiAS, were able to force management to disclose important financial details.

Foreign activists have also begun taking a close look at India. The Children's Investment Fund took on Coal India, a state-owned miner, in 2012. The UK-based activist hedge fund established a large position in the monopoly and launched a bold demand for changes, including a hike in coal prices. The campaign ultimately failed, but as a challenge to the status quo, it set a precedent that will be difficult to ignore.

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Investors press for social change

By **CAROL ROOS**
and **TIMOTHY SCHULTZ**

WHILE SOUTH AFRICA doesn't have US-style activists yet, its culture of corporate transparency has encouraged a domestic form of activism, emphasizing social transformation.

South Africa was an early adopter of a set of world-class "best practice" principles for corporate governance called the King Reports. These include increases in reporting transparency that are required for a listing on the Johannesburg Stock Exchange.

To help reverse the dire socio-economic effects of apartheid, the government created the Black Economic Empowerment program, targeting areas such as black management control and ownership, and support for smaller black business.

Controlling assets of more than R1.6 trillion (\$115 billion) – comprising mostly government employee pension funds – South Africa's Public Investment Corporation is Africa's largest fund manager and engages in a form of socio-economic impact activism. While independent, the PIC has what it calls a "dual mandate, to generate returns on behalf of clients and to contribute to the developmental goals of South Africa."

The PIC has supported a number of state policies, including blocking Chile's CFR Pharmaceuticals' bid for local healthcare company Adcock Ingram, to keep control in South Africa. The PIC also supports income equality by voting against excessive pay, and has pressed for more black directors at companies such as fuel maker Sasol and industrial services supplier Barlorld.

As shareholder activism continues to grow in South Africa, it is likely that this intersection of politics and business will remain critically important, and the power of investors to act as agents of social policy will increase.

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