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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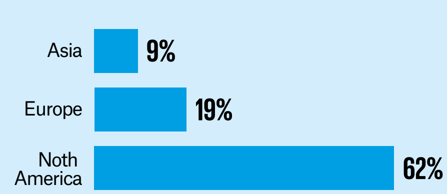
Impact assessment

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 reforms open a door

By ALICIA OGAWA, COLUMBIA UNIVERSITY

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.