‘You need the trust of management’: AVI’s activist approach in Japan

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Asset Value Investors’ Daniel Lee discusses his firm’s engagement approach

How has your firm’s approach to Japan evolved?

We have been investing in Japan for two decades now. Until about 2017, we didn’t have much of an allocation but now we have invested more than £400 mn ($524 mn), which is almost 50 percent of our assets.

What changed for us was the introduction of the corporate governance code in 2015, which was part of Shinzo Abe’s three-arrow policy to try to improve corporate value and increase the use of company cash balances to bolster the economy. How he thought to do that was to help shareholders engage with companies and shake the tree a little.

Since then, we’ve allocated a lot of capital and launched a dedicated fund. Our main role is to use the corporate governance code as a catalyst to change companies through activism and shareholder engagement. We do that for all of our companies to varying degrees.

How do you engage with companies?

We have initial meetings face to face – now telephone calls [given Covid-19] – and then we send letters and follow up with suggestions. For a select few companies, we also send a presentation, normally about 45-slides long, on how to improve the corporate value of the business.

That normally takes the structure of targeting four specific areas of corporate value. The first is operational efficiency, to try to improve margins and the business structure. Second is capital efficiency, so typically reducing the cash on the balance sheet. [Third is] corporate governance, and then finally shareholder communication.

In Japan what works really well is repetition: sending multiple emails, multiple letters, just reiterating the same point. Because then it starts to feed through to the management after the third or fourth time, especially if there are other shareholders asking the same thing.

Are Japanese companies becoming more open to shareholder engagement?

Since the corporate governance code, there has been a marked shift in attitudes from management toward shareholders in Japan. My first trip to Japan was in 2015 and the conversations I had with the IR guys were pretty superficial.

Now they're interested to hear what you have to say; there's a discussion, especially when it is accompanied by a letter– it gives you a basis for what to discuss. They're much more aware of issues and where shareholders are coming from, and they're more open to having a dialogue, particularly if you're seen as a long-term shareholder, rather than a short-term hedge fund trader. If you can create a brand image where you are seen to be supportive of long-term value creation and understand where management is coming from, you are typically received with a more sympathetic attitude.

Most companies don't have dedicated IR functions. We invest in the small [and] mid-cap space so it's usually someone from the corporate planning, admin or finance department [we see]. They will meet with investors, and typically are the face of the company. But their sole responsibility isn't IR, which means the investor relations materials and the communication aren't as good as we find in other countries.

How would you like companies to improve their investor communications?

As foreign investors in Japan, that's an easy one: disclosure in English. There is some disclosure in Japanese but, with a lot of companies, there's either very little or none in English. It's very easy to translate all documents into English, and that's the first port of call.

The other message we try to send [focuses on] business strategy. The thinking of the company – mid-term plan, capital markets days – these things are largely non-existent in Japan. I'm mainly speaking for the small-cap and mid-cap space. Shareholders don't really have an idea of the direction of the company and, if there is a mid-term plan, maybe it’s just two slides long.

What is access to management and the board like?

Poor. It’s quite hard and rare to get a meeting with the president, or even to get a meeting with the directors. It’s becoming easier for us as we’ve become better known but you normally have to request a meeting with a board director. In particular, if you want to see an independent director, you’ve really got to push.

It is hard to get that access, it requires building a relationship, and you need the trust of management. It needs to understand where you are coming from before it will start granting access to senior directors. When these CEOs came into power, or at least when they were in senior management roles 10 years ago, speaking to shareholders wasn’t part of their job. It wasn’t an important aspect then, but that is now changing.

At what point would you go public with your proposals for a company?

At the point when all other avenues have been exhausted and we’re not really getting anywhere. It’s a process: it’s private, and then it becomes private with a threat to go public, and then it goes public. It will only go public if there’s been no action taken on any of the points we’ve raised.

With Fujitec, for example, we’ve been engaging for almost two years. We’ve sent it numerous letters, had numerous meetings, and then other shareholders were asking similar things, but nothing was happening, nothing was changing.

We could just sit there for another five years and not realize that potential corporate value or we could do something. We released this public presentation, which was more like a white paper – it was very informative on what the business is and how it can improve. And that had the desired effect. Other shareholders came out of the woodwork and started saying the same thing. And then all of a sudden management is under pressure, public pressure, making it harder to dismiss shareholders’ concerns.

So it is quite a powerful tool, but it’s very time-consuming and costly. It can also have an impact on the relationship if you are too critical publicly so we do prefer to stay private, if possible.

How has Covid-19 affected access to companies? Jason Bellamy joined AVI as an investment consultant in April this year and is based in Japan – has that helped?

[The arrival of Bellamy] has been quite fortunate because we’ve been unable to go to Tokyo to visit companies. Calls are good, but face-to-face meetings are better. He’s been able to do that for us. But some companies aren’t holding face-to-face meetings with anyone because of Covid-19 concerns, so even being on the ground doesn’t necessarily guarantee face-to-face access.

Conference calls and Zoom calls have become much more common, even in Japan. Six months ago, it was very hard to get a conference call with a Japanese company: they hated discussing investor issues with shareholders over the phone. We’ve had companies say our policy is to not discuss anything with shareholders over the phone. Of course, now it’s entirely changed and you can get a meeting via a call whenever you like, so that’s been a positive aspect of Covid-19.

Have you altered your proposals in response to Covid-19?

The demands on the capital side are still important, but we are focusing on all four areas I mentioned before. We’re probably more sympathetic to companies that want to keep cash back for a little bit longer than we would have been six months ago.

But there’s no reason why Covid-19 should stop improvements in corporate governance, shareholder communication and operational efficiency. It’s actually a good time to restructure, because people are more willing to recognize change and make hard decisions they couldn’t have made before, so we are definitely pushing on all of those angles. Perhaps Covid-19 has made it a little easier to push because people are more willing to do things differently.