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東京大学大学院法学政治学研究科
東京都文京区本郷 7-3-1
http://www.securities.j.u-tokyo.ac.jp/

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Jingzhi Li

I. Introduction

For decades, corporate governance in Japan has been considered to be distinct from the Anglo-American style. Features of traditional Japanese corporate governance include insider boards, cross-shareholding, enterprise unions and main banks[1], all of which are associated with one another. During the main bank era, companies largely relied on banks rather than on equity markets, and management was mainly accountable to the company's primary lender. Management was further stabilized through cross-shareholding, whereby companies entered into similar agreements with each other and created a spider-web of mutual shareholding among inside stakeholders. Under this structure, management prioritized stakeholders over shareholders, since the majority of contributing stakeholders usually supported management's decisions and protected them from opposition on the part of shareholders.[2] As Shishido Zenich, a widely respected scholar in the field of corporate law explained, the Company Community, which is composed of management, board members and core employees, "is the key to understanding Japanese corporate governance."[3]

However, people began to observe changes in the 1990s. After the collapse of the so-called "bubble economy," Japan's financial system gradually shifted from being

[1] Sanford M. Jacoby, *Convergence by Design: The Case of CalPERS in Japan*, 55 Am. J. Comp. L. 239 (2007).

[2] *See, e.g.*, Zenichi Shishido, *Japanese Corporate Governance: The Hidden Problems of Corporate Law and their Solutions*, 25 Del. J. Corp. L. 189, 211 (2000); John Buchanan, Dominic Chai, and Simon Deakin, Hedge Fund Activism in Japan: The Limits of Shareholder Primacy, Cambridge University Press 136 (2012).

[3] Zenichi Shishido, *supra* note 2, at 202.

bank-based to being capital market-based.[4] As a result, in the sphere of corporate governance, a decline in stable shareholding accompanied the rise of dispersed ownership, and shareholder activism further drove management to pay more attention to shareholders.

While academics have not reached a consensus regarding the actual impact of shareholder activism on corporate governance in Japan[5], this is not the primary focus of this paper. Based on a review of the existing literature on different patterns of shareholder activism in Japan, and by examining current regulatory convergence in major economies (including the U.S., the U.K., and Japan), this paper seeks to illustrate a new pattern of shareholder activism that served the purpose of the new regulatory trends well.

The existing literature on shareholder activism in Japan dealt with active foreign investors, particularly the California Public Employees Retirement System (CalPERS), one of Japan's largest foreign institutional investors, and a few high-profile hedge funds including Steel Partners, the Children's Investment Fund Management (U.K.) LLP (TCI), and Taiyo Pacific Partners.[6] Although these were the first activists in Japan, some of them have already exited the market. Studies later emerged on the pattern of domestic shareholder activism, based on a case study of Japan's Pension Fund Association (PFA),[7] an umbrella organization for Japanese corporate pension funds, and one of few domestic institutional activists in Japan.

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[4] Hideki Kanda, *Regulatory Differences in Bank and Capital Market Regulations*, University of Tokyo Journal of Law and Politics 29 (Vol. 2, 2005).

[5] Jacoby finds positions espoused by CalPERS had a positive effect on corporate governance at both a macro level and a micro level, see Sanford Jacoby, *supra* note 1; Others conclude that activists can perform poorly where market-wide takeovers decline, see Yasushi Hamao, Kenji Kutsuna, and Pedro Matos, *Investor Activism in Japan: the First 10 Years*, Center on Japanese Economy and Business, Working Paper Series No. 289 (2010), available at: http://academiccommons.columbia.edu/catalog/ac:127288.

[6] *See, e.g.*, Sanford Jacoby, *supra* note 1; Christina Ahmadjian, *Foreign Investors and Corporate Governance in Japan*, in CORPORATE GOVERNANCE IN JAPAN: INSTITUTIONAL CHANGE AND ORGANIZATIONAL DIVERSITY 125, Oxford University Press (2007); Yasushi Hamao, Kenji Kutsuna, and Pedro Matos, *supra* note 5.

[7] Bruce E. Aronson, *A Japanese CalPERS or a New Model for Institutional Investor Activism? Japan's Pension Fund Association and the Emergence of Shareholder Activism in Japan*, 7 NYU Journal of Law & Business 571 (2011).

The above studies primarily illustrate two extremes regarding shareholder activism in Japan, with foreign investors representing the traditional adversarial Anglo-American approach, and domestic investors representing the silent majority that rarely executes shareholder rights.

Although Japanese investors and their Anglo-American counterparts act differently in terms of their activist approaches, regulatory authorities in Japan, the U.S. and the U.K. seem to have reached a consensus on how to guide shareholders, especially institutional investors. According to these authorities, institutional shareholders should focus on the medium- to long-term investment returns of investee companies through constructive engagement. In particular, the U.K. Financial Reporting Council and the Japan Financial Services Agency have each published a "Stewardship Code" for institutional investors.[8]

Furthermore, consistent with recent regulatory trends, a new pattern of shareholder activism has emerged in Japan. The cooperative approach adopted by two resident funds in Japan not only illustrates a new pattern of shareholder activism not seen in the existing literature, but also demonstrates the feasibility of Japan's newly established Stewardship Code. The remainder of this paper is organized as follows: Part II reviews the standard views of shareholder activism in Japan, Part III focuses on the recent regulatory convergence of shareholder activism as observed in the U.S., the U.K. and Japan, Part IV conducts case studies on two activists as resident fund manager and investment adviser, respectively, and elaborates details of the cooperative approach, Part V concludes that, with the changes initiated by regulatory authorities, the cooperative approach may be widely adopted to

[8] See, Financial Reporting Council, *The UK Stewardship Code* (September 2012); Financial Services Agency, *Principles for Responsible Institutional Investors 《Japan's Stewardship Code》*, February 26, 2014. Available at: http://www.fsa.go.jp/en/news/pub/01.pdf.

cultivate more responsible foreign and domestic investors, as well as to facilitate further changes in corporate Japan.

II. Shareholder Activism in Japan: A Retrospective

1. Foreign Investor Activism: The Traditional Approach

With the advent of substantial foreign investments in Japan in the 1990s, the percentage of publicly listed Japanese shares held by foreigners increased from 4.2% to 16.5% from 1990 to 2002.[9] Of these foreign investments, the Americans and the British have been the leading investors, and institutional investors and private equity funds are the dominant activists.

CalPERS appears to be a paradigm of foreign institutional investors, which has been an aggressive advocate of promoting better corporate governance in Japan since 1992. Jacoby divides the mechanisms used by CalPERS in initiating this change into two phases. The first included proxy voting, regular meetings with the management of Japanese companies, and the use of media to spread its principles. In the second phase, CalPERS further moved to cooperate with other foreign investors and domestic groups.[10] Although CalPERS's accomplishments are considered to be modest with respect to board structure, shareholder rights and takeover barriers, their impact on disclosure and transparency is substantial. In response to CalPERS' efforts, regulators have launched a series of statutory reforms to require consolidated accounting, fair-value accounting, internal controls and the like to be mandatory instead of permissive.[11]

[9] Christina Ahmadjian, *supra* note 6, at 126-128.

[10] Sanford Jacoby, *supra* note 1, at 241.

[11] *Id*., at 282-283.

Meanwhile, foreign funds present a more adversarial approach to shareholder activism. Unlike CalPERS, which is influenced by its members and political alliances that enthusiastically support corporate governance initiatives, private funds are essentially investing for return on investment. One consequence of this difference in motives is foreign funds' inclination to buy and sell shares in short. This sets foreign funds apart from typical, stable domestic investors. However, as the percentage of the shares held by foreign funds increases, domestic long-term shareholders tend to observe and to follow the moves. Thus, Japanese companies began to realize that, if they fail to maximize shareholder value, they may face a drastic drop in share prices.[12] In this way, foreign funds can influence Japan's corporate governance through exit to some extent.

In addition, foreign funds are inclined to achieve their goals through more active means. Although information for private funds is not as transparent and accessible as it is for institutional investors like CalPERS, we can still learn from several activist funds with greater public exposure. Many foreign funds openly confront management, just as they are accustomed to do in the U.S. or the U.K. The two most recognized cases are Steer Partners and TCI. The former, a demanding investor in the U.S. context, is also well known for its activist strategy of investment followed by hostile takeover in Japan.[13] The latter, a British fund activist, raised several shareholder proposals to Japanese companies in which they held shares, in order to demand higher dividends.[14]

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[12] Christina Ahmadjian, *supra* note 6, at 133-134.

[13] John Buchanan, Dominic Chai, and Simon Deakin, *supra* note 2, at 174-180.

[14] See, e.g., *TCI's proposal on increase dividend fails in Chubu Electrics' AGM* (「中部電力の株主総会、英ファンドTCI の増配提案を否決」), Reuters Japan, June 27, 2006, available at: http://jp.reuters.com/article/businessNews/idJPJAPAN-26617620070627; Michiyo Nakamoto, *TCI bows to Japan on J-Power stake*, FT.com, July 14, 2008, available at: http://www.ft.com/intl/cms/s/0/5437be7e-517f-11dd-a97c-000077b07658.html?siteedition=intl#axzz2ckok5Szq.

On the other hand, Japan seems to be hostile to traditional Anglo-American fund activists—TCI's proposals were rejected in almost all cases. Steer Partners not only lost the lawsuit challenging the board's defense plan against Bull-Dog Sauce, but was also lampooned by the lower court as an "abusive acquirer."[15] Such reactions towards foreign fund activism have triggered western investors' pessimism regarding corporate Japan. In explaining the market subsequent to Steer Partners and TCI's failure, Allan Smith, the president of the American Chamber of Commerce, said: "Japan goes through cycles. When the economy is in decline, people talk about reform. But the Japanese don't like change and it is only usually triggered by a crisis. It is always two baby steps forward and one back."[16] Although a correlation has not yet been confirmed, investors' disappointment might have led to a decaying interest in investing in Japan. Steer Partners have reduced the number as well as the value of their investments, and have not launched fresh interventions since 2008, while TCI made no further publicized investments in Japan after selling its shareholdings in J-Power in 2008.[17] Foreign fund activism seems to have peaked in 2007, and has since been in decline

2. Few Domestic Activists and the Silent Majority

While foreign shareholder activism experienced ups and downs over the past 20 years, domestic investors have tended to remain silent and insulated from management, with a few exceptions. Even when the Olympus Corporation faced its grave scandal, the company's

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[15] *See, e.g.*, *Japan High Court Keeps Bull-Dog Sauce from Steel Partners' Jaws*, Forbes, 2007, August 8, 2007, available at: http://www.forbes.com/2007/08/08/bulldog-steel-partners-markets-equity-cx_jc_0808markets03.html.

[16] Michiyo Nakamoto and Kate Burgess, *Dividends to reap: Shareholder activists begin to make their mark in Japan*, FT.com, July 2, 2008, available at: http://www.ft.com/intl/cms/s/0/be842ae4-4863-11dd-a851-000077b07658.html?siteedition=THOUGH#axzz2ckok5Szq.

[17] John Buchanan, Dominic Chai, and Simon Deakin, *supra* note 2, at 283.

major domestic shareholders merely quietly reduced their stakes as the share price plunged, rather than publicly demanding the president should resign.[18]

PFA is among the few domestic institutional investor activists in Japan. Having emerged as an active voice in 2002, PFA adopted a similar approach to CalPERS, including executing proxy voting rights, promulgating proxy voting guidelines, and frequent informal communication with its portfolio companies.[19] PFA's sudden shift to activism is understandable in a context in which Japanese pension funds began to face devastating financial pressure. As the "baby boom" generation began to retire and the society began to age more rapidly, payouts surged, whereas contributions decreased. PFA had to discover better ways to generate investment returns, and thus started to demand better performance from the portfolio companies. Still, PFA has certain limitations in collaborating with other market players to achieve its corporate governance goals. As mentioned above, both the Japanese business community and the media have been inhospitable to foreign activists. Having been criticized in some quarters as being "anti-business," PFA chose to work on its own in terms of the governance activities, and to draw a line between itself and the "aggressive foreigners."[20]

Other domestic activists include Yoshiaki Murakami, a former civil servant at the Ministry of Economy, Trade and Industry, who became a professional investor in around 2000. Murakami managed several funds, which were collectively known as the "Murakami

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[18] *Olympus scandal triggers Japan shareholder activism*, the Sydney Morning Herald, January 23, 2012, available at: http://www.smh.com.au/business/world-business/olympus-scandal-triggers-japan-shareholder-activism-20120123-1qcsk.html.

[19] Bruce E. Aronson, *supra* note 7, at 611, 619.

[20] *Id.*, at 623.

Fund". Although none of the individual funds bears the name, they reflect Murakami's rigorous and eccentric investment style. The activist measures taken by Murakami are very close to those most familiar to the Anglo-American investors, such as initiating takeover plans, pressing boards to raise dividends, and accepting external directors.[21] Murakami's investment stance was pragmatic, and his funds kept earning returns. Nevertheless, like his foreign counterparts, he was unwelcome in the Japanese business community. In July 2007, Murakami was alleged to have been involved in insider trading and was sentenced to prison for two years, which seems to have ended an era of domestic fund activism in Japan.

Overall, the previous studies on Japanese domestic investors suggest that, in contrast to traditional Anglo-American investors, the majority of Japanese investors are reluctant to adopt activist tactics. The cases of PFA and the Murakami Fund further indicate that, while a few domestic investors emerged as active voices, they often needed to fight on their own due to outside pressure, or were even expelled from the Japanese business community.

III. Regulatory Convergence of Shareholder Activism and a New Approach

Looking back on shareholder activism in Japan over the past 20 years, there seems to have been a gap between the aggressive Anglo-American fund activists and the silent majority of domestic shareholders. However, recent regulatory trends in shareholder activism in the U.S., the U.K. and Japan suggest a convergence: While regulatory authorities in these countries are concerned with aggressive shareholder activists, they welcome those who focus on the medium- to long-term investment returns of investee companies through constructive engagement. Such regulatory convergence may bring about a new pattern of shareholder

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21 John Buchanan, Dominic Chai, and Simon Deakin, *supra* note 2, at 155.

activism in Japan.

Although the stereotype of U.S. shareholder activists is usually categorized as aggressive and adversarial, U.S. scholars have long criticized aggressive activists who are involved with short investment horizons.[22] According to these scholars, intervention conducted by such activists creates the problem of "short-termism", which means management may be under the pressure to take actions that are profitable in the short term, but which are detrimental in the long term.

Many public officials and policymakers have also recently adopted the claims of short-termism. For example, Chancellor Leo Strine of the influential Delaware Court of Chancery once noted that institutional investors in listed companies have "a myopic concern for short-termism" and, to foster sustainable economic growth, they must look beyond short-term movements in stock prices to create and to preserve long-term wealth.[23] The U.S. Securities Exchange Commission was also persuaded by the short-termism claim that it limited the use of the proxy access rule providing shareholders with access to the corporate ballot.[24] All this evidence indicates that the claim of insulating boards from shareholder pressure serves the long-term interests of the investee companies is broadly accepted. Therefore, demanding activists like Steer Partners are not only unwelcome in Japan, but will possibly be challenged in the U.S. as well. Under this new regulatory trend, it is conceivable that traditional Anglo-American activists will need to modify their activist tactics.

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[22] For example, Stephen M. Bainbridge, *Response, Director Primacy and Shareholder Disempowerment*, 119 Harv. L. Rev. 1735 (2006); William W. Bratton & Michael L. Watcher, *The Case Against Shareholder Empowerment*, 158 U. Pa. L. Rev. 653 (2010); Lynn Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public*, Berrett-Koehler Publishers (2012).

[23] Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?*, 66 Bus. Law. 1, 10-18, 26 (2010).

[24] Lucian A. Bebchuk, *The Myth That Insulating Boards Serves Long-Term Value*, 113 Colum. L. Rev 1637, 1648 (2013).

In the U.K., the implementation of the UK Stewardship Code reveals a similar trend regarding regulating shareholder activism. The UK Stewardship Code was first compiled as a code describing the responsibilities of institutional investors issued by the Institutional Shareholder Committee (ISC) in 2009.[25] Following the 2007-2008 global crisis that pushed the financial sector to the brink of collapse, former Prime Minister Gordon Brown appointed Sir David Walker to publish his independent review of the corporate governance of UK banks and other financial institutions (hereinafter the "Walker Review").[26] As the Walker Review pointed out, institutional investors appeared to be slow to act when issues of concern arose in their investee companies during the crisis. Since the engagement of long-term investors was not effective, the influence of short-term shareholders was amplified, which heightened the vulnerability of investee companies.[27] Thus, the Walker Review recommended that the long-term engagement of the institutional investors should be enhanced through establishing a set of "principles of stewardship" under the oversight of the Financial Reporting Council (FRC).[28]

In 2010, the FRC published the first version of the UK Stewardship Code, based on the code issued by ISC in 2009. The current version was amended in 2012, and maintains the spirit of the 2010 Code.[29] The UK Stewardship Code comprises seven principles, such as requiring institutional investors to have a robust policy on managing conflicts of interest, and

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[25] Financial Reporting Council, *Implementation of the UK Stewardship Code* (July 2010). See also, Financial Reporting Council, *The UK Stewardship Code* (September 2012).

[26] David Walker, *A Review of Corporate Governance in UK Banks and Other Financial Industry Entities: Final Recommendations*, HM Treasury, November 26, 2009.

[27] *Id.*, at 71-72.

[28] See, *supra* note 26, at 82-85.

[29] See, *supra* note 25, *The UK Stewardship Code*, at 2.

to establish clear guidance on when and how they will escalate their activities as a method of protecting and enhancing shareholder value. The core purpose of the Code is to promote the engagement of long-term investors with the investee companies on a collaborative basis.

Applying primarily to asset managers, institutional investors, and service providers, as well as to overseas investors, the UK Stewardship Code is not mandatory, but consists of principles and guidance that signatories can choose to "comply or explain". In other words, the FRC expects the signatories to describe and disclose on their websites how the principles of the Code have been applied, or to explain why the elements of the Code have not been complied with. Currently, 206 asset managers, 75 asset owners, and more than 14[30] service providers have published individual statements of commitment to the UK Stewardship Code, and 20 other organizations have produced a public letter of support for the Code.[31] The growing number of signatories of the UK Stewardship Code may accompany a shift in shareholder activism in the U.K., from a short-term investor-centered approach to a long-term shareholder-centered and a more cooperative approach.

In alignment with the regulatory convergence in the U.S. and the U.K., Japan also published the Japanese Version of the Stewardship Code in February 2014.[32] The issue of crafting the principles for stewardship responsibilities of institutional investors in Japan was first raised in the sixth meeting of the Headquarters for Japan's Economic Revitalization on

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[30] Such number does not include organizations who have informed the FRC that they wish to explain their alternative investment strategy rather than commit to the Code, or organizations who are a signatory of the Code but wish to be excluded from the list. See Financial Reporting Council, *UK Stewardship Code Statement*, available at: https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code/UK-Stewardship-Code-statements.aspx#Public Letters of Support.

[31] *Id*., *UK Stewardship Code Statement*.

[32] See *supra* note 8, *Principles for Responsible Institutional Investors 《Japan's Stewardship Code》*.

April 2, 2013.[33] In June 2013, the Japanese Cabinet approved the Japan Revitalization Strategy, which further clarified the purpose of the Japanese version of the Stewardship Code. Resembling its U.K. counterpart, the Japanese version of the Stewardship Code aims at "promoting sustainable growth of investee companies, through constructive dialogue with them".[34] In August 2013, the Council of Experts Concerning the Japanese Version of the Stewardship Code (hereinafter the "Council") was established by the Financial Services Agency. After meeting six times and reviewing suggestions from 26 individuals and entities in Japanese, as well as 19 in English, the Council finalized Japan's Stewardship Code on February 26, 2014.[35]

Similar to the UK Stewardship Code, Japan's Stewardship Code consists of seven principles that mainly target institutional investors and proxy advisors, and which are applied in the manner of "comply or explain". The contents of such principles are also largely consistent with those of the UK Stewardship code, except that the UK Stewardship Code requires institutional investors to act collectively with other investors, while there is no such requirement in Japan's Stewardship Code. So far, the Financial Services Agency has not disclosed how many institutional investors have demonstrated their commitment to Japan's Stewardship Code. However, since most suggestions for the first draft of the Code are supportive of its establishment[36], publishing the Code will possibly have the effect that the silent majority of Japanese investors becomes more active in monitoring the investee

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33 *Id.*, at 1.

34 See, *supra* note 8, *Principles for Responsible Institutional Investors《Japan's Stewardship Code》*, at 2.

35 *Id*.

36 Financial Services Agency, Summary of Public Comments for the Japanese Version of Stewardship Code (『責任ある機関投資家の諸原則』《日本版スチュワードシップ・コード》パブリックコメントの概要), dated February 27, 2014. Available at: http://www.fsa.go.jp/news/25/singi/20140227-2/01.pdf.

companies. As a result, the patterns of shareholder activism in Japan may also be subject to change.

In fact, a new pattern of shareholder activism is emerging in Japan which, in many ways, is in accordance with the principles defined in Japan's Stewardship Code. In the latter part, I will examine two resident activists, namely Ichigo Asset Management, Ltd. (Ichigo) and Symphony Financial Partners (SFP). Both companies are registered as financial advisers under the Financial Instruments and Exchange Act, and are institutional investors with stewardship responsibilities under Japan's Stewardship Code. The term "resident" suggests that the companies are based and operate in Japan, although both of them contain some foreign elements. For instance, the founder or co-founder is a foreigner, or the funds managed by the companies are established offshore Japan. For the reasons above, the two companies are sometimes labeled as foreign funds.[37] Nonetheless, I would like to distinguish the two from foreign companies, because their activist approach is distinctively different from that of traditional Anglo-American fund activists and, in many ways, is consistent with the newly published Stewardship Code. Both companies have succeeded in their activist approach based on frequent communication and cooperation with the investee companies, and have established good reputations in the Japanese equity market. In this sense, they serve as the best examples to demonstrate the necessity of establishing Japan's Stewardship Code, and provide a useful reference for domestic and foreign investors to comply with the Code.

IV. Case Study of Ichigo and SFP

[37] In the Research and Analysis Report on Foreign Investment Fund (「外国投資ファンド等に関する調査・分析報告書（経済産業省委託）」), entrusted by the Ministry of Economy, Trade and Industry and conducted by Mizuho Research Institute Ltd. in 2009, Ichigo and SFP are both categorized as foreign funds.

1. Ichigo Asset Management, Ltd.

A. Company Overview

Ichigo is a fund management company that has been based in Tokyo since May, 2006. The company was founded and is led by Scott Callon, who used to be the head of the equities department at Morgan Stanley Japan. Ichigo also manages several offshore funds and runs Ichigo Group Holdings, a JASDAQ-listed holding company focused on the management of Japanese real estate investment funds, and hereafter referred to as "Ichigo". Although Ichigo's Chief Executive Office is a foreigner, it is worth noting that the majority of the board consists of Japanese nationals.[38] In addition, Callon himself has lived in Japan for 24 years and is extremely fluent in Japanese. The company's name derives from an ancient Japanese proverb "Ichigo Ichie", meaning that particular moments must be fully lived and realized since they only exist once, also indicating the founder's familiarity with and appreciation of Japanese culture.

In addition to the private fund's strong aspiration for investment returns, Ichigo positions itself as a "committed shareholder and responsible investor" that believes in the strong tie between good corporate governance and strong company performance, and which is seeking "a new model for Japanese corporate governance that includes active, committed, and responsible shareholders".[39] This motto demonstrates Ichigo's ambition to be a value investor that focuses on long-term investments, which happens to be consistent with the connotation of "stewardship responsibilities". Furthermore, in a message delivered to the

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[38] See, Notice Concerning Ichigo Groups Holdings' Management Affairs (「グループ役員人事に関するお知らせ」), dated February 25, 2013.

[39] See, Ichigo's official site, available at: http://www.ichigoasset.com/.

investee companies, Ichigo stated “we have a primary focus on investment returns, but we also recognize that you have commitments to other important stakeholders, including employees, customers, and communities”[40], which further reveals Ichigo’s true understanding of Japanese business culture and its cooperative attitude regarding its investees’ management.

B. Proxy Fight against Tokyo Kohtetsu

Ichigo’s investments are generally concentrated in small Japanese companies with high growth potential. The epoch-making event that pushed Ichigo into the spotlight was its proxy fight against Tokyo Kohtetsu Co., Ltd.’s (Tokyo Kohtetsu) merger plan with Osaka Steel Co., Ltd. on February 22, 2007. Tokyo Kohtetsu has been a steel maker since 1918, and is headquartered in Tokyo. In order to avoid excessive competition in the steel industry, Tokyo Kohtetsu’s management started negotiations with Nippon Steel & Sumimoto Metal Corporation (NSSMC) regarding a takeover of Tokyo Kohtetsu by Osaka Steel, a subsidiary of NSSMC. The negotiation between the companies’ managements went smoothly, and only required a special resolution from an interim general meeting of shareholders, which would not normally be challenged.

However, Ichigo said no, not to the entire merger plan, but to the 1:0.228 share swap ratio, which it deemed unfair and to be a substantial underestimation of Tokyo Kohtetsu’s corporate value. As Ichigo reflected, the premium paid to shareholders shall at least reach 30% of the one-month average price of Tokyo Kohtetsu’s shares.[41] Tokyo Kohtetsu and Osaka Steel refused to consider adjustment to the terms of the merger, which left Ichigo the

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40 *Id.*, available at: http://www.ichigoasset.com/investee-companies.html.

41 Daiwa Institute of Research, *What does “Ichigo’s Revolt” Mean?* (「いちごの乱」とは何だったのか), July 9, 2009, available at: http://www.dir.co.jp/souken/research/report/esg/cg/07070901strategy.pdf.

only option of rejecting the entire plan. In order to veto the board's approval of the merger, Ichigo had to obtain at least one third of the total votes. By the time of the interim general meeting, Ichigo held 12.6% of Tokyo Kohtetsu's shares and initiated a proxy solicitation. In an interview conducted by Japan Society, an American organization dedicated to strengthening US-Japan understanding, with Scott Callon dated May 3, 2007, Callon described the solicitation process of posting proxy materials on the internet and setting up an inbound-only hotline. It was the first shareholder-initiated proxy solicitation in Japan, and Ichigo sent out almost 13,000 pieces of material to 70 institutional shareholders and 1,200 individuals, at an approximate cost of USD 200,000.[42]

It was a difficult vote. 55.9% of shareholders voted for the merger, whereas 42.1% were against it, and the remainder abstained. Overall, more than 500 individual shareholders and eight institutional investors sided with Ichigo.[43] According to Callon, they did not expect that they would win, but were willing to "create a positive precedent of supporting shareholder rights in a respectful way"[44]. It turned out that they not only won the vote, but also won the reputation of being a defender of shareholder rights, instead of being seen as activists seeking a higher payout. What is more important, although the incident was considered "shareholder revolt" by some media, Ichigo never attacked the management. In fact, Ichigo still retained the Tokyo Kohtetsu shareholding as of July, 2011, and confirmed that they were satisfied with the company's performance.[45] It also received positive feedback from the media, as well as

42 *Ichigo's Scott Callon Leads Japan's First Successful Shareholder Revolt*, Japan Society, May 3, 2007, available at: http://www.japansociety.org/content.cfm/ichigos_scott_callon_leads_japans_first_successful_shareholder_r.

43 *Id.*, see also, *A First in Japan: Shareholders Block a Takeover*, the New York Times, February 22, 2007, available at: http://www.nytimes.com/2007/02/22/business/worldbusiness/22steel.reuters.html?_r=2&.

44 See, *supra* note 42.

45 John Buchanan, Dominic Chai, and Simon Deakin, *supra* note 2, at 189.

from Tokyo Kohtetsu. It is fair to conclude that, although Ichigo's proxy fight against Tokyo Kohtetsu appeared to be confrontational at first, the company duly complied with its conduct principle of being a value investor and a responsible shareholder, and sufficiently distinguished itself from typical foreign fund activists. In addition, the above case helps to explain the rationale behind Principle 5 of Japan's Stewardship Code, which requires institutional investors to establish a clear policy on voting. The proxy solicitation initiated by Ichigo shows that proxy voting, if applied appropriately, can safeguard shareholder rights and achieve good corporate governance.

After blocking the takeover of Tokyo Kohtetsu in 2007, Ichigo resumed a low profile. Based on the information it discloses on EDINET[46], the company's investment portfolio has maintained a small and steady level regarding the companies in which it has over 5% shareholding. While Ichigo's shareholder activism post in Tokyo Kohtetsu is barely detectable, we can tell from the traces that it has adhered to the approach as a value investor, pursuing a win-win situation with its portfolio companies.

2. Symphony Financial Partners

A. Company Overview

SFP is a Tokyo-based financial adviser that was established by Kazuhiko Shibata and David Baran in 2000. SFP advises two funds, one being a Cayman Island vehicle called the SFP Value Realization Master Fund (hereinafter the "SFP fund"), which is primarily focused on the Japanese market, and the other is a Pan-Asia macro fund called Sinfonietta. Shibata is a former merger and acquisitions and real estate banker at Normura Securities Co., while

[46] Ichigo's EDINET code is E25848.

Baran has lived in Japan since 1987, and worked for Lehman Brothers, Goldman Sachs and a few other employers in the financial industry prior to the establishment of SFP.[47] Like Ichigo's Scott Callon, Baran is also fluent in Japanese and understands Japanese business culture very well. In addition, the company's employees are a combination of Japanese nationals and Americans. Of the American employees, many of them have lived in Japan since high school, and others are married to Japanese nationals.[48] Therefore, SFP can also be regarded as semi-foreign and semi-domestic in essence, which is in accordance with our definition of resident activists.

SFP targeted undervalued Japanese companies with a market value range from 200 to 300 million USD in order to seek opportunities from mispricing.[49] Moreover, in the annual conference conducted by Opalesque, an information provider in the alternative investment sector, Baran reiterated that SFP's investment strategy is neither passively "waiting for the market to re-price the company", nor offensively "demanding management to do something to raise the share price".[50] Here, Baran expressed a cooperative view of helping management to achieve certain corporate governance goals.

B. Legal Action Against Nireco

SFP's first public action in relation to investee companies tended to be quite adversarial. In 2005, it fought against the first poison pill plan in Japan. Starting in the late 1990s, hostile takeovers began to emerge and increase in Japan, which resulted in a greater number of

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47 Tomoko Yamazaki, *Bargain Hunting in Japan*, Bloomberg Markets, December 2012.

48 Tatsuhiro Saitou, *Learn from Sanjo Machine's MBO: Corporate Finance* (「三條機械の MBO から学ぶ：コーポレート・ファイナンス」), Research Note for the Graduate School for Management of Technology at Niigata University 23 (2012), available at: http://www.econ.niigata-u.ac.jp/~tsaito/WP_No150.pdf.

49 Tomoko Yamazaki, *supra* note 47.

50 *Opalesque Round Table Series 2012 Japan* 11, available at: http://www.bingham.com/Events/Files/2012/05/Opalesque-Japan-2012.

companies adopting the poison pill as an ex-post defense. However, Nireco Corporation (Nireco), a manufacturer of printing-press controls and one of SFP's investee companies at the time, issued a poison pill plan against SFP as a precaution against a potential takeover by SFP. Nireco used to be a machinery maker with a stable shareholding structure consisting of steer companies and banks. However, Nireco transferred its main business to printing-press controls and lost most of its stable shareholders. According to Nireco, as of March 31, 2005, nearly 13% of its shares were held by investment companies with a pure pursuit of profit. SFP was also included in such a category, and accounted for 2.85% of Nireco's shares. Feeling threatened by a potential takeover, Nireco decided to issue a poison pill plan at the meeting of directors dated March 14, 2005.[51] Facing a share dilution of up to one third of its shares, SFP brought legal action against Nireco to prevent the execution of the plan, which was admitted by the Tokyo District Court on June 1, 2005, as the proposed issuing was "substantially unfair and may impair the interests of shareholders who have no relation with a takeover."[52] The decision was upheld by the Tokyo High Court on June 15, 2005.[53]

C. The Management Buyout of Sanjo Machine

Although the legal action against Nireco made SFP look confrontational at first glance, it differed from the adversarial approach taken by other foreign activists. Indeed, Nireco was the one that initiated confrontation, while the possibility of a hostile takeover was based on mere deduction. Having deterred the issuance of the poison pill plan, the company continued

[51] See, *Nireco v. SFP* (「ニレコ新株予約権発行差止認容決定事件」), Tokyo District Court Decision dated June 1, 2005, Kinyu Shoji Hanrei No. 1218 8 (2005).

[52] *Id.*, at 15.

[53] See, *Nireco v. SFP* (「ニレコ新株予約権発行差止認容抗告審決定事件」), Tokyo High Court Decision dated June 15, 2005, Kinyu Shoji Hanrei No. 1219 8 (2005).

to hold Nireco's shares until February 27, 2009, without any intention of confrontation.[54]

SFP's next move concerning shareholder activism was its engagement with Sanjo Machine Works., Ltd.'s (Sanjo Machine) management buyout. Sanjo Machine is a company engaged in the manufacture and sales of automobile engine parts, and had been listed in the second section of the Tokyo Stock Exchange since November, 1961. Being a long-term shareholder in Sanjo Machine, SFP considered Sanjo Machine to be mispriced and was looking for ways to unlock the company's value. As a result of intensive negotiations with the management, SFP facilitated the completion of a management buyout at a tender price with a 135%-premium. The company was delisted from the Tokyo Stock Exchange on April 23, 2012.[55]

Many commentators criticized SFP, claiming that it benefited unfairly by making a 135%-premium out of the corporate action. However, Baran asserted that, aside from the massive premium generated, the company mainly acted as it did for economic reasons. Baran pointed out that Sanjo Machine has been a crucial supplier of cam rods for Honda engines for over 40 years; it has neither lost money nor been in debt since it was listed. Nonetheless, Sanjo Machine had been traded at an incredibly low price in an unloved market, so that it would make more economic sense for the company to de-list and to privatize.[56]

No matter whether SFP pushed such corporate action to make a profit or for the sake of its investee company, it provided a successful example of shareholder's constructive

[54] See information disclosed on EDINET; the SFP fund's EDINET code is E08950.

[55] See, e.g., *Symphony Financial Partners Co., Ltd. Sells Stake of Portfolio Company at 135% Premium*, Bloomberg, December 5, 2011, available at: http://www.bloomberg.com/article/2011-12-05/ad0fF2BgAudA.html; Tokyo Stock Exchange's decision on Sanjo Machine's delisting, available at: http://www.tse.or.jp/english/news/07/120322_a.html.

[56] See *Opalesque Round Table Series 2012 Japan, supra* note 50, at 17-18.

engagement in management decisions. There are currently 3,409 listed companies in Japan[57], among which only a small fraction can raise money from the sagging market. Therefore, the management buyout of Sanjo Machine may become a favorable precedence for other investee companies.

D. The Nagawa Buyback

SFP was also involved in a buyback of shares of Nagawa Co., Ltd. (Nagawa), which manages prefabricated business land. According to information disclosed on EDINET, SFP became Nagawa's stakeholder prior to 2009, and has been a stable shareholder ever since. Based on similar rationale to that behind Sanjo Machine's management buyout, SFP believed that Nagawa deserved a better share price due to its strong earnings and dividends. Therefore, SFP initiated informal communications with the management, suggesting the company should buy back its own shares. The management adopted SFP's suggestion and bought back 6.6% of its shares on May 21, 2012, which was instantly followed by a boost to 129% of its original price as of May 30 that year.[58] Although it would be reasonable for SFP to sell Nagawa's shares shortly after the rise and to gain profits as did the other short-term investors, SFP did not do this. It is worth noting that SFP still holds nearly 14.3% of Nagawa's shares to date[59], and the advice regarding Nagawa's buy back proved to be another successful cooperation between SFP and its investee company in terms of achieving certain corporate ideals.

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[57] See, *Breakdown of TSE Listed Stocks* (last updated on August 29, 2013), Tokyo Stock Exchange website, available at: http://www.tse.or.jp/english/listing/breakdown/index_e.html.

[58] Tomoko Yamazaki and Komaki Ito, *Ex-Goldman Trader's Symphony Seeks Money for Hedge Funds*, Bloomberg, May 30, 2012, available at: http://www.bloomberg.com/news/2012-05-30/ex-goldman-trader-run-symphony-seeks-1-billion-for-hedge-funds.html.

[59] See, company data of Nagawa, FT.com, available at: http://markets.ft.com/research/Markets/Tearsheets/Business-profile?s=9663:TYO.

Of course, it is too reckless to conclude that SFP is cooperative under all circumstances. When deemed necessary, it may also lead to public confrontation on occasion. For instance, the SFP fund used to be a shareholder of Matsuya Co., Ltd. (Matsuya), a department store chain based in Tokyo. Holding nearly 8% of Matsuya's shares in 2010, SFP raised a shareholder proposal that year and called for prohibiting Matsuya's introduction of anti-takeover defense, for such an introduction would prevent future gains in the share price. The shareholder proposal encountered a veto.[60] However, such a case is not a contradiction to SFP's fundamental principles regarding a cooperative approach, but rather a demonstration that SFP would take a diverse approach in order to reach its goals. Even before the establishment of Japan's Stewardship Code, SFP realized that the aggressive tactics under the Anglo-American approach do not work in Japan, and that an activist would accomplish more when working closely with management.[61] Of course, there is no definite formula for determining how to approach Japanese management. Nonetheless, SFP's frequent and continuous engagements with its investee companies over the past years appear to satisfy the requirements for institutional investors under Japan's Stewardship Code, and would provide useful references for other private funds and proxy advisers.

V. Conclusion

This paper reviewed the shareholder and investor activism in Japan since the 1990s. The orthodox opinion, as viewed from abroad, is that Japan does not embrace foreign shareholder activism, and that the market does not cultivate competent domestic activists. Such a view is

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[60] *Shareholders' Dissatisfaction of Company Performance Reached Peak* (「2 月期決算企業、株主総会ピーク　業績に不満の声も」), Nikeii News, May 27, 2010, available at: http://www.nikkei.com/article/DGXNASGD2702G_X20C10A5000000/.

[61] Stephen Taub, *David Baran Banks on Japan's Prospects*, Institutional Investor's Alpha, March 25, 2013, available at: http://www.institutionalinvestorsalpha.com/Article/3176976/Ex-Lehman-Trader-Banks-on-Japans-Prospects.html.

supported by numerous examples, including CalPERS and traditional Anglo-American fund activists' ups and downs in the early days, PFA's more prudent approach of insisting on changes while keeping its distance from other activists, and the notorious Murakami Fund as being alien among the silent majority of domestic shareholders. In general, both the adversarial approach led by traditional Anglo-American investors and the insulating approach led by the majority of domestic investors seem to be far from the ideal approach of shareholder activism, and can hardly improve the corporate governance in Japan.

Despite the differences between activist approaches adopted by foreign and domestic investors, regulatory convergence has been witnessed in recent years. Regulatory authorities in the U.S., the U.K. and Japan believe that shareholders, notably institutional investors, should cooperate with the investee companies through constructive engagement to achieve medium- to long-term value. This regulatory trend leaves space for more approaches regarding shareholder activism that better promote corporate governance and the performances of equity markets in Japan.

The cooperative approach led by resident financial advisers and fund managers could be one such approach. Activists of this kind are more open to change than are stereotypical Japanese shareholders, while they are also more tolerant of the distinctiveness of corporate Japan, and more skilled in handling Japanese business relationships than are stereotypical foreign investors. The case studies of Ichigo and SFP examined detailed examples of how resident investors influenced management decisions and facilitated change through a friendly and cooperative approach.

In the meantime, this paper neither aims at exhausting all possible approaches under the recent regulatory trend, nor does it intend to quantify the impact of the new approach on corporate governance. Instead, this paper hopes to provide some empirical evidence to support the establishment of Japan’s Stewardship Code, and to reveal the potential of shareholder activism in Japan. The cooperative approach, as discussed in this paper, shows that despite proxy voting, shareholder proposals, hostile takeovers and derivative actions, proxy solicitation, private and constructive engagement in corporate decisions and other means can also facilitate changes in Japan’s market. In general, the practical model provided by Ichigo and SFP demonstrates how an activist strategy can work effectively within Japan’s corporate governance system, and this will possibly be modeled by other investors to trigger market vitality. The questions left unresolved, as mentioned above, invite further research and discussion.