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MONASH CENTRE FOR FINANCIAL STUDIES

RESEARCH BRIEF

SHAREHOLDER ACTIVISM IN JAPAN

How traditional corporate culture is being challenged

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This Research Brief summarises the results of a study by the Monash Centre for Financial Studies into shareholder activism in Japan, and its implications for shareholder returns.

Shareholder activism is on the rise in Japan, with potential implications for the behaviour and performance of listed Japanese companies. The upsurge in the activity has been encouraged by major reforms to Japan's corporate legal and regulatory framework implemented since 2014 to improve companies' governance and financial performance. The nation's biggest institutional investor, the Government Pension Investment Fund of Japan (GPIF), has also contributed to the change in corporate governance and stewardship by requiring its asset managers to disclose and explain their voting records at AGMs of investee companies.

Shareholder activism in Japan has not yet developed to the same degree or in the ways it has in the United States and in Europe, where investors are increasingly focusing on so-called ESG issues – environmental, social and governance. In Japan, by contrast, shareholder activism has been mainly concerned with governance and financial performance.

KEY FINDINGS

- Positive short-term abnormal returns occur around the announcement of activist campaigns.
- Positive short-term abnormal returns are higher for M&A-related activism than for all other categories.
- Buy-and-hold excess returns are statistically positive within a 120-trading-day window. Beyond 120 days, no evidence of significant excess returns exists.
- Buy-and-hold excess returns generated by primary-focus investors are significantly higher than those of individual shareholders and investors with only a partial focus on activism.
- Activist shareholders with high levels of equity ownership are more likely to succeed with their campaigns than shareholders with lower levels of ownership.
- The level of equity ownership of activist shareholders is typically highest in M&A-related cases and board-related cases.
- We found no evidence for the impact of firm size and sector on activism-related excess returns.

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The full version of this research report is available on our website.

INTRODUCTION

Shareholder activism is a relatively new phenomenon in Japan. Although there are some famous cases of (largely unsuccessful) shareholder activism dating back to the 1980s, it was not until the second decade of this century that changes in the regulatory environment facilitated rapid growth in activism, including some successful public campaigns by shareholders to force change.

Shareholder activism can be defined broadly as the application of pressure by shareholders to influence or change company behaviour – typically involving issues of strategy, operation, performance or governance. To date, issues of business performance and governance have been the dominant focus of activism in Japan.

Shareholder activism comes in various forms; it can involve private engagement between shareholders and companies, or public campaigns. Shareholders can press their claims individually or collectively, and make a single demand or conduct a wider campaign, often involving a series of demands.

Until about a decade ago, public shareholder activism in Japan was rare, and nearly always unsuccessful, particularly when it involved hostile campaigns by foreigners. The most famous of these came in 1989 when US investor T.Boone Pickens' bid for three board seats at Koito Manufacturing Co. was voted down by Toyota, a key shareholder and customer of Koito, and other shareholders. It was one of several high-profile examples of cross-shareholdings – a common feature of Japanese corporate culture – and business ties being used to suppress shareholder activism in its early years. Although levels of cross-shareholding have decreased in recent years, they can still be high enough to present a barrier to external pressure. Activists also face the persisting challenge of cultural resistance to the notion of shareholder rights, particularly given Japanese companies' historical dependence on debt rather than equity financing, and a view that companies' first obligations are to employees and customers, rather than to shareholders (Buchanan, Chai, & Deakin, 2012). And until recent years, these deeply-rooted cultural barriers to shareholder activism were buttressed by a protectionist regulatory environment.

The recent growth in shareholder activism Japan has been supported by substantial changes in the corporate legal and regulatory environment implemented under Prime Minister Shinzo Abe – often referred to as 'Abenomics'. The Corporate Governance Code (2015) and Stewardship Code (2014), and subsequent revisions to both, involved reforms aimed at enhancing corporate value and capital efficiency after decades of stagnation. In the new environment, cash-rich firms with low valuations, low efficiency and low profitability have become targets of shareholder activism.

The regulatory and legal changes have also encouraged big increases in the level of equity held by foreign institutions in Japanese companies, which in turn has put additional pressure on historical norms in Japanese corporate culture.

The significant growth in public shareholder activism in Japan between January 2013 and June 2019 is illustrated in Figure 1 below.

Figure 1: Activists' campaigns and exits

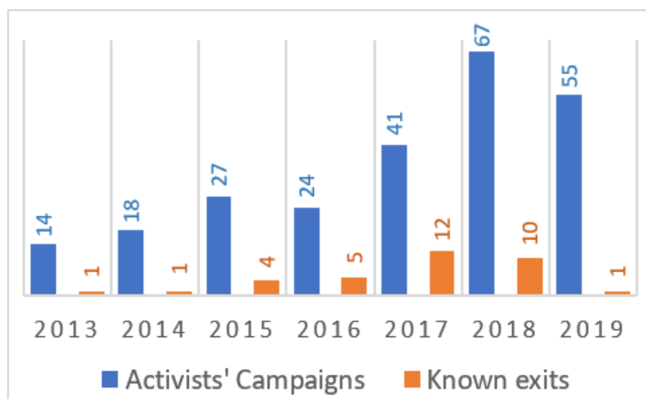


Figure 2: Sector distribution of companies facing shareholder activism

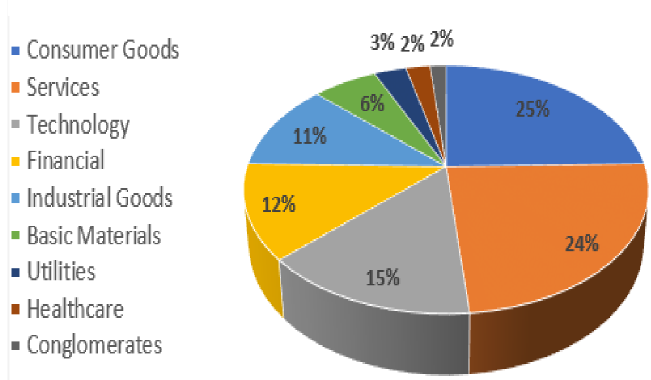
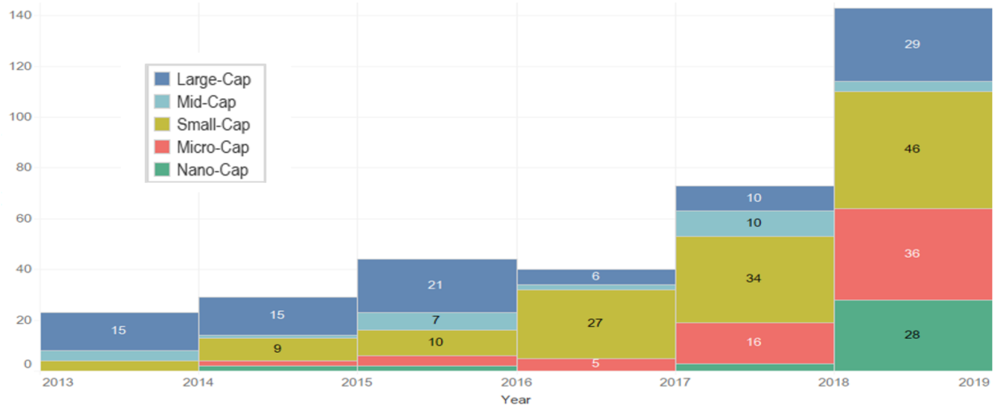


Figure 3: Shareholder activism targets by market capitalisation



STUDY METHODS AND FINDINGS

A large proportion of shareholder activism in Japan cannot be reliably analysed because it happens behind closed doors. Hence, our study is by necessity confined to campaigns involving publicly listed companies. Our dataset, sourced from the international Activist Insight database, covers the period between January 2013 and June 2019. It includes public shareholder demands filed on companies with head offices in Japan with no size filtering criteria. Most are listed either on the Tokyo Stock Exchange, Nagoya Stock Exchange or JASDAQ.

The study explores two main issues:

- Why shareholders become activists, and the tools they employ to do so, and
- Whether shareholder activism succeeds in improving returns to shareholders.

A total of 246 activist campaigns targeted 130 different companies with 456 individual demands. A notable feature of the figures is the relatively low number of shareholder activists (34) known to have divested their shareholdings after campaigns ('known exits').

Approximately two-thirds of the companies were in the consumer goods, services and technology sectors, as shown in Figure 2 (below).

Large-cap firms were the main targets of activists during the early part of the study period (2013-2015). After 2015, however, while the number of public demands on large-cap firms still increased each year, much stronger growth was observed in demands on small-cap and micro-cap firms (see Figure 3).

One possible explanation for increased focus of activism on smaller firms can be found in their collective record on governance issues. Tokyo Stock Exchange figures (2019) reveal only 2% of large listed firms had less than 90% compliance with Japan's Corporate Governance Code. The comparative figures for nano, micro and small-cap firms were 39%, 21% and 14% respectively. A possible reason for the relative lack of large and mid-cap firms in the data is their engagement with large institutional shareholders tends to occur in private.

Defining activist shareholders

Activist Insight identifies two broad categories of activist shareholders – concerned shareholders and institutional investors, with the latter including the sub-categories of primary activist, partial focus, occasional focus and engagement focus.

Activist investor type	*No. of investors*	*No. of demands*
Institutional investors	55	277
- Primary activist	*13*	*110*
- Partial focus	*13*	*97*
- Occasional focus	*23*	*64*
- Engagement	*6*	*6*
Concerned shareholder	56	179
Total	***111***	***456***

Out of 55 identified activist institutional shareholders, 13 had activist investing as their primary focus. These included four institutions based in Japan and five in the United States, while the others were based in Singapore and the United Kingdom.

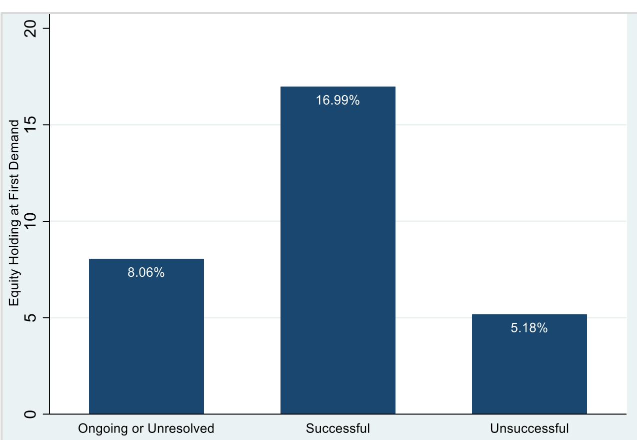
Approximately half of the reported cases of public shareholder activism involved individual shareholders, sometimes operating in groups, classified as "concerned shareholder", with most based in Japan. Key areas of investor concerns included company balance sheets, boards and other corporate governance issues (see Figure 4 below).

Figure 4: Activism issues and investor types

Demand Group	Concerned Shareholder	Engagement	Occasional	Partial Focus	Primary Focus
Balance Sheet Activism	30		18	38	53
Other Governance	71	1	11	10	26
Board Related Activism	67	5	23	19	16
M&A Activism	4	1	5	16	11
Remuneration	12		3	4	3
Business Strategy			6	11	2

Specific agenda items included demands for bylaw amendment (95 cases), higher dividends (68), share repurchase (33), board representation (57), CEO/director removal (44), and remuneration (26). The level of equity holdings of activist investors varied significantly according to their specific interests and the ultimate outcomes of their campaigns. For example, the equity percentage held by activist shareholders pursuing M&A and board issues was significantly higher than in other cases. Also, as shown in Figure 5 (below), shareholders whose proposals succeeded tended to have significantly higher equity levels than those associated with unsuccessful or ongoing/unresolved proposals. This is consistent with findings in other countries, analysed by Matthew R. Denes (2017), that shareholder activism without a substantial block of shares is often ineffectual.

Figure 5: Equity holding by activist shareholders at first demand



Company responses to shareholder demands

Japanese culture values harmony, and this is reflected in how companies deal with shareholder demands. Typically, companies wait until annual general meetings to respond. This presents practical issues for activist shareholders. Most AGMs are crammed into a short period around the end of June, and typically last for just 30 minutes, with few questions accommodated. And foreign investors are sometimes not recognised as shareholders of record, and therefore are unable to vote. Companies also tend to avoid public confrontation with shareholders, with only a minority of cases examined in this study leading to public disagreement.

The rate of successful and partially successful cases based on the whole sample was 12.5%. The success rate of institutional shareholders with ‘engagement’ strategies was highest at 33.3%, while concerned shareholders had the lowest success rate.

ACTIVISM AND INVESTMENT RETURNS

A key focus of the study was whether shareholder activism is associated with abnormal returns to shareholders (rates of return different from what would be normally expected). The estimated expected return is based on an asset pricing model reflecting the security’s normal risk characteristics. We used the market model to estimate expected returns, with the price return from the Tokyo Stock Price Index (TOPIX) being market return. To reflect the sample of firms in our study, we also used the MSCI Japan Small-Cap Value Index in the market model.

Table 1: Abnormal returns on announcement date*

		Abnormal returns - AR(0) (%)				
Year	**Count**	**Min**	**Max**	**Mean**	**Median**	**SD**
2013	14	-3.30	1.99	-0.92	-1.08	1.44
2014	18	-1.96	23.93	1.97	0.15	5.96
2015	27	-1.66	5.46	0.72	0.22	1.97
2016	24	-3.87	13.11	0.43	0.42	3.20
2017	41	-3.17	15.27	0.75	0.25	2.86
2018	67	-4.57	17.92	0.55	-0.12	3.79
2019	55	-3.72	11.66	0.86	0.47	2.74
Total	**246**	**-4.57**	**23.93**	**0.68**	**0.10**	**3.33**

* For further robustness, we included the three-factor Fama-French model for Japan. The distribution of the abnormal returns around announcement did not vary significantly across all three models. for brevity, we report abnormal returns of the base model.

Figure 6: Cumulative abnormal returns before and after the event

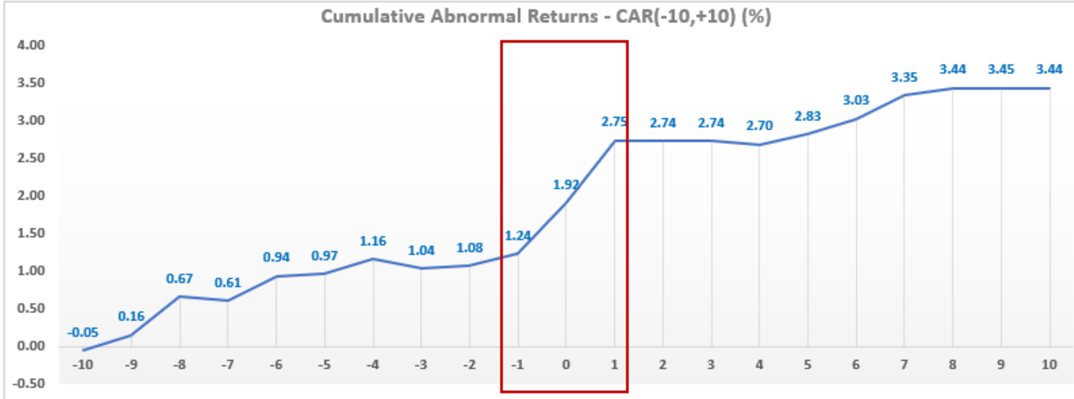


Table 2: Cumulative abnormal returns across different windows

	CAR(-1,+1)	CAR(-2,+2)	CAR(-3,+3)	CAR(-4,+4)	CAR(-5,+5)	CAR(-10,+10)
Day window starts	-1	-2	-3	-4	-5	-10
Day window ends	1	2	3	4	5	10
Cumulative abnormal return	1.666***	1.691***	1.564***	1.705***	1.867***	3.444***
	(0.378)	(0.449)	(0.479)	(0.527)	(0.580)	(0.789)
Observations	246	246	246	246	246	246

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Announcement returns

On the announcement date of a demand, the mean abnormal return was 0.68%. Given a total market value of these firms of almost US$1.23 trillion, a 0.68% abnormal return implies an addition of US$8.4 billion of wealth for investors on the announcement date.

Cumulative abnormal returns

Cumulative abnormal return (CAR) is the sum of all daily abnormal returns, typically observed in a small timeframe to ensure the abnormal returns are not associated with other events. Evidence of significant cumulative abnormal returns appeared around six trading days before a shareholder demand or campaign was announced. CAR remained significant from Day (-6) to Day (+10), suggesting the existence of pre-event trends. As can be seen from Figure 6 above, however, most of the abnormal returns were accumulated on the announcement date and the day after.

As the CARs were positive and statistically significantly different from zero for all symmetrical windows examined, there was strong evidence of positive abnormal returns for investors around the event announcement date. The results could also signal that the market, in general, treats announcements of shareholder proposals positively, possibly anticipating good outcomes for the company.

Our results were similar to findings by Hamao and Matos (2018), who examined investor activism in Japan between 1998 and 2009. They identified a pattern of stock prices suddenly increasing about 1% in the five days before the filing date of a demand by an activist investor, and an abnormal return of 1% on the date. They also reported +1.8% of buy-and-hold abnormal returns for the (-5,+5) trading day window.

In addition to the returns over symmetric pre and post-event windows, we also found evidence of statistically significant cumulative abnormal returns across all post-event windows, implying opportunities for other investors to benefit from an abnormal price movement after an activist shareholder publicly announces a demand. The magnitude of the abnormal returns amounted to 2.19% for a holding period of ten trading days from the announcement date.

Figure 7 compares the mean values of the CAR of each demand group (1) against those of all other groups (0). CARs for campaigns related to M&A were significantly higher than those related to other categories. Single-demand campaigns also delivered higher short-term announcement returns than multiple-demand campaigns.

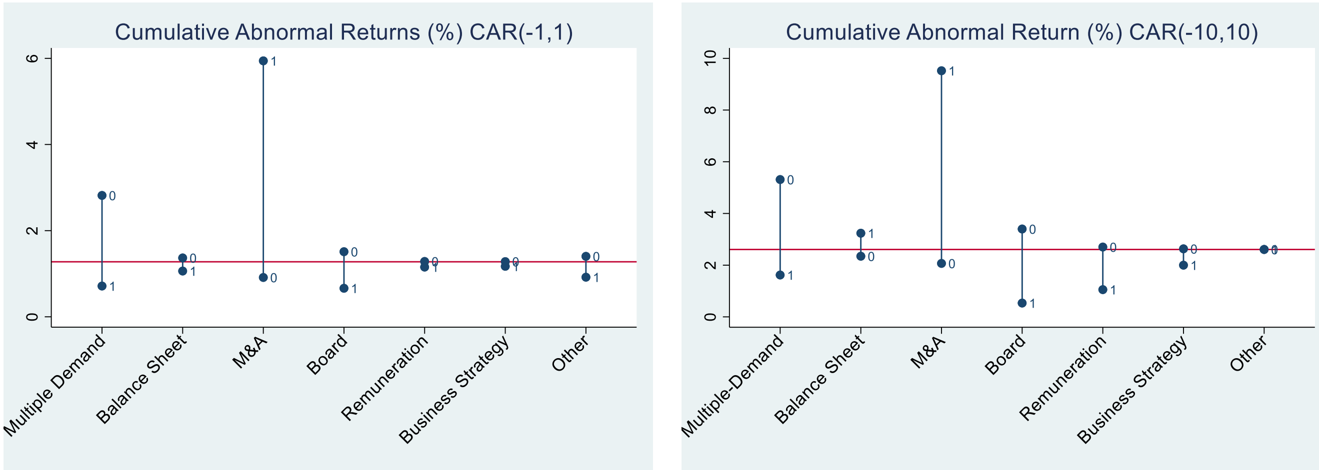


Figure 7: CAR (%) by demand groups

Table 4: Buy-and-hold excess returns

Window - Number of days	30	60	90	120	180	250
BHER_MXJP (%)	2.499**	3.061*	3.810**	3.177*	1.671	1.636
	(3.14)	(2.52)	(2.93)	(2.22)	(0.98)	(0.76)
BHER_TOPIX (%)	2.699**	3.460**	4.467***	4.097**	3.283	3.355
	(3.26)	(2.83)	(3.46)	(2.81)	(1.84)	(1.49)
N	244	225	197	183	172	160

Buy-and-hold excess returns

After a short-term surge in the abnormal returns around announcement date, does shareholder activism lead to increased share values over longer timeframes? We examined buy-and-hold excess returns (BHER) of stocks over periods of 30, 60, 120, 180 and 250 trading days. Excess returns are returns achieved in excess of the return of a benchmark. For a closely comparable proxy with similar risk and return characteristics, we used the TOPIX and the MSCI Japan Small-cap Value Index (MXJP).

Based on both indices, BHERs were significantly positive for investors who bought the stock on the announcement day and held it for 120 trading days or less.

For a holding period of 30 days, investors on average earned 2.7%, or an annualised 25% over the return generated by TOPIX. The BHER for 120 days was 4.1%, equivalent to 8.8% p.a. over TOPIX. Beyond 120 days, however, BHERs were not statistically significant.

The BHERs over the TOPIX benchmark were higher than over the MXJP Index, as shown in Figure 8, which could be explained in part by the size bias (small-cap and micro-cap) and value bias of the study sample.

Post-proposal BHERs were significant for primary focus activists and engagement focus activists but not for other categories. Post-announcement returns were higher for demands by primary focus activists than those by partial focus activists.

In the short term, within the first six months, there were no significant differences between the post-campaign excess returns of firms. However, when the return window was extended to one year, there was noticeable divergence in the return trajectory of firms of different sizes. Post-campaign BHERs of mid-cap firms outperformed the whole sample, whereas BHERs of nano-cap firms went into the negative zone. It is also noted that during the 12-month post-campaign period, while large-cap firms did not outperform in terms of returns, their BHER volatility was the lowest. BHERs of other firms exhibited much greater volatility.

We observed different price trajectories for different types of demands. Proposals related to remuneration, M&A, balance sheets and other governance issues were associated with positive BHERs. However, the differences in BHERs between the demand categories were statistically insignificant.

Figure 8

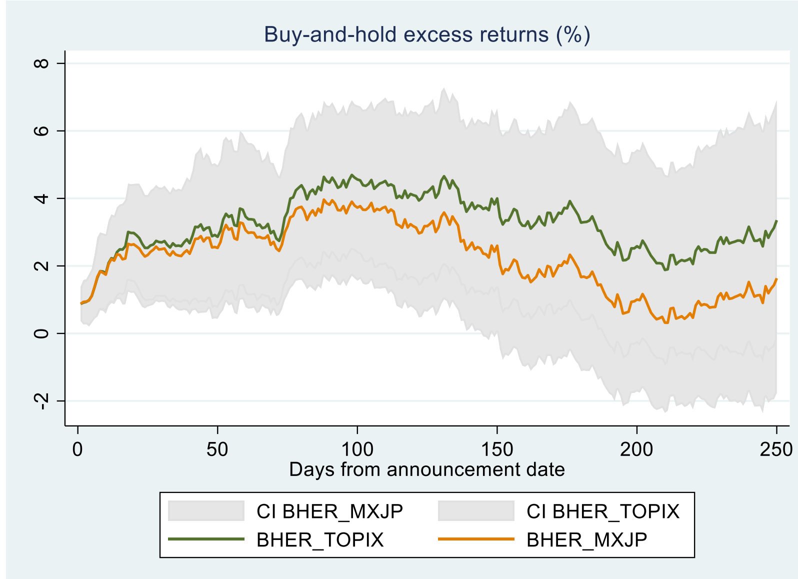
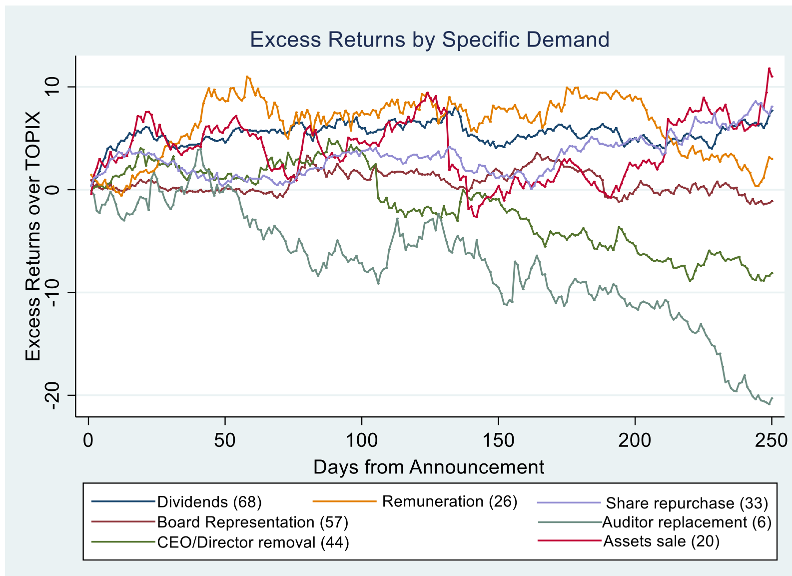


Figure 9



CONCLUSION

Despite the rise of shareholder activism in Japan in recent years on the back of major legal and regulatory changes, deeply rooted cultural and structural barriers remain to the success rate of shareholder demands on companies. Nevertheless, our study reveals evidence of statistically significant short-term abnormal returns to investors after the launch of activist campaigns by shareholders.

While we found such abnormal returns do not hold for the medium and long term, it does not follow, necessarily, that shareholder activism is having little impact. Indeed, it is quite possible that the emergence and rise of the general threat of activism may have caused companies to pre-emptively change their behaviour – to be more receptive and attuned to the interests of shareholders to head off the possibility of direct conflict. Additionally, as engagement between shareholder activists and companies, particularly large ones, often happens behind closed doors, the extent and outcome of this activity could be underestimated.

The existence of short-term positive abnormal returns suggests that active engagement between investors and companies could potentially unlock shareholder value.

The wider impact of shareholder activism in Japan, while difficult to measure, is certainly worthy of further inquiry beyond this study.

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