REZENSIONEN / REVIEWS

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Hedge Fund Activism in Japan: The Limits of Shareholder Primacy

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If comparative corporate governance can generally be qualified as a topic of lasting if not growing interest, comparative corporate governance with Japan may be described as a lasting if not growing puzzle to many western observers – numerous analytical attempts not withstanding.[1] Two economists (Buchanan and Chai) and one lawyer (Deakin), all of Cambridge University, were not deterred and undertook a fresh look at the topic from the perspective of hedge fund activism in Japan in the years from 2000 to 2008. The result of this venture is a highly rewarding study in the form of a comprehensive empirical analysis of corporate governance in Japan, which is all the more of interest as it came out just when the Olympus scandal blew up in 2012, seen by some as the "worst corporate governance debacle of modern Japan"[2]. Successive generations of CEOs and other board members of Olympus, an internationally renowned producer of medical devices, listed on the Tokyo Stock Exchange, had cooked the books to cover losses of more than € 1.1 billion for over two decades. In 2013 some of those responsible were duly fined for accounting fraud and sentenced to imprisonment. However, as the pertinent managers had been part of the traditional Japanese business elite the sentences were suspended.[3] In sharp contrast, few years ago Yoshiaki Murakami, an ex-bureaucrat and founder of the so called Murakami Fund, an aggressive Japanese hedge fund, and his erstwhile business partner Takafumie Horie, the (in)famous entrepreneur and founder of Livedoor corporation, the former *bêtes noires* of Japan's business establishment and initiators of hostile takeover bids for traditional Japanese companies, were,

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1 A recent bibliography of western writings on Japanese law lists under the heading "Corporate Governance" more than one hundred entries (and nearly the same number of western publications on the related topic "M&A and Takeovers"), see H. BAUM/L. NOTTAGE/J. RHEUBEN/M. THIER, Japanese Business Law in Western Languages: An Annotated Selective Bibliography2 (Buffalo, N.Y., 2013) 314 ff. (and 305 ff. respectively); most of these publications were written within the last ten years.

2 B. ARONSON, The Olympus Scandal and Corporate Governance Reform: Can Japan Find a Middle Ground between the Board Monitoring Model and Management Model?, in: ZJapanR/J.Japan.L. 35 (2013) 85, 87.

3 Cf. The Economist, 31 August 2013, p. 48.

this being Japan, served with *non* suspended sentences for lesser crimes.[4] Who needs, one is tempted to ask, a change in corporate governance when the initiative comes from those standing outside the established circles?

This "clash" of different conceptions of the company is what caught the authors' interest. The first concept they define is the "shareholder primacy" model advocated by (mostly, but not exclusively non-Japanese) activist hedge funds. Here the company is seen as property. This shareholder-centric conception is contrasted with Japan's traditional firm-centric view of the company as an "enduring organization". This second, community oriented corporate concept (the "community firm") traditionally pays more attention to insiders than to outsiders. The firm-centric perspective leads the management to concentrate on the long-term survival of the company as an organization rather than on shareholders' interests.

Given the inherent tension between the two different conceptions of the company and their two "diametrically opposed approaches to corporate governance" it comes as no surprise that the confrontational activities of hedge funds targeting Japanese companies they accused of squandering shareholder value were (and are) regarded in Japan's business circles as controversial to say the least. An early Japanese example of an activist hedge fund adopting an aggressive way of doing business was the Murakami Fund mentioned above before it hit the rocks.

The authors use this unusually intense conceptual clash that took place in Japan in the early years of the new millennium,[5] the "tournament of corporate governance beliefs", as a means to highlight the strengths and weaknesses of each model. They apply an institutionalist theoretical perspective and use a combination of various methods including qualitative, quantitative and narrative tools for their empirical research. The first part of the book establishes a comparative theoretical framework by discussing, among others, the different historical experiences with corporate governance and with the development of the hedge fund industry in the US, the UK, Continental Europe, and Japan. The second half concentrates on the central empirical analysis of the hedge fund activities in Japan between 2000 and 2008.

Events in this period are meticulously chronicled. The detailed analysis greatly profits from the first hand information the authors were able to collect in numerous interviews with important actors from both sides of the battle line[6] and by making use of publicly available information in the press coverage. Special attention is paid to the highly publicized intervention of the US owned hedge fund Steel Partners in the traditional Japanese

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4 The rise and fall of *Murakami* and his Fund is discussed at pp. 154–165; see also S. OSAKI, The Murakami Fund Incident and the Regulation of Collective Investment Schemes, in: ZJapanR/J.Japan.L. 25 (2008) 89.

5 The German reader is sometimes reminded of the epic takeover battle between Vodafone and Mannesmann 1999/2000 that was generally perceived as a clash of business cultures.

6 The impressive number of interviews is listed in the appendix (Tables A.1 and A.2).

sauce maker Bull-Dog Sauce and the ensuing fight with the latter's management that lead to a famous decision of the Japanese Supreme Court in 2007 dealing with shareholder rights in a takeover setting.[7] A second case covered in great detail is the confrontation between the British hedge fund TCI and J-Power, a major Japanese utility company.

Both of these prominent attempts to transplant shareholder primacy oriented hedge fund activism in Japan failed in the end, as did less prominent ones. This experience contrasts sharply with that made in the US market where shareholder primacy is taken for granted based on the widely accepted concept of shareholder value as a public good. Though the later idea is (perhaps) meeting with a slowly growing following in Japan – at least the term is widely used there by now – and though some of the funds proposals were correctly perceived as addressing genuine problems of Japanese public companies, the fundamental conceptional differences prevailed and the aggressive attempts of enforcing shareholder value were in unison rejected by Japanese business circles, bureaucracy, and politics. The uncompromising nature of the hedge funds' approach and their confrontational style surely did not help in Japan. The authors emphasize a fundamental and "striking lack of common ground or even shared language" between the funds and the targets' senior managers. This corresponds with their observation that even Japanese portfolio investors without close links to the targets, which might have profited as shareholders from joining the funds especially with respect to badly run firms, mostly failed to back the fund's proposals against managerial insiders. If one assumes that these investors as a rule will not act against their own interests they must have seen more value in supporting management strategies as the authors rightly point out. Obviously, the portfolio investors shared the view that the primary benchmark for a company is its competitive position in the product markets rather than a capital markets oriented benchmark like, for example, in the US.

Given the growing criticism in the UK and the US about short-termism caused by the later benchmark the community conception of the firm may perhaps not be as outmoded as is sometimes assumed. One leading Japanese company law expert recently indicated, only half jokingly, that a country like Japan that is home to more than 900 companies that are older than 200 years and to some further 430 companies with histories exceeding 300 years as well as to about 10 companies that are for over 1,000 years in business may have a different view on takeovers to enhance shareholder value than some younger economies.[8]

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7 See E. TAKAHASHI/T. SAKAMOTO, Japanese Corporate Law: The Bull-Dog Sauce Takeover Case of 2007, in: ZJapanR/J.Japan.L. 25 (2008) 221; N. HANSEN, Japans's First Poison Pill Case, Bulldog Sauce v. Steel Partners: A Comparative and Institutional Analysis, in: ZJapanR/J.Japan.L. 26 (2008) 139.

8 T. UEMURA, Corporate Governance and the Capital Market (Especially Takeovers), in: Baum (ed.), Germany and Japan: A Legal Dialogue Between Two Economies (Cologne 2012) 71, 82.

However, if anything, the Olympus scandal has shown at least that the lack of supervision of a largely autonomous senior management is a critical corporate governance weakness inherent to the community firm. Similarly, the tragedy at TEPCO's Fukushima nuclear power plant raised serious concerns about the now technically bankrupt company's corporate governance structure as did a couple of other less tragic but nevertheless serious corporate scandals that hit well known Japanese companies in recent years.[9]

One of the study's central conclusions is the observation that corporate governance mechanisms meet with sharp limitations outside their own institutional environments that had shaped these in the first place. "National corporate governance systems are distinct to their particular environments and therefore not easily exportable" – in other words they are indeed path-depending. This is no new insight of course, however, rarely has it been shown in such a well researched and documented manner with Japan as a highly informative example as in the book presented here. The once fashionable notion of the end of history in corporate law seems more passé than ever for everyone following the authors' argument.

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9 See, e.g., ARONSON, *supra* note 2, at 86.