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# The power of private engagement

*The differentiating factor in shareholder engagements within Japan*

**Rivers of words have been written on how companies and investors can engage effectively. Yet, as an astute colleague of mine often remarks, investors do not engage with companies but with individuals.**

Perhaps such simple truth is the reason why psychotherapist Esther Perel, who shot to fame with TED Talks and her podcasts on couples and relationships, has recently launched a new podcast *How's Work?* exploring what makes great working relationships. She argues that communication is key: "Listen. Just listen. You don't have to agree. Just see if you can understand that there's another person who has a completely different experience of the same reality."

Both these comments spring to mind when I look at the results of a preliminary study carried out by Professors Marco Becht, Julian R. Franks, Hideaki Miyajima and Kazunori Suzuki on the engagements carried out by Governance For Owners Japan (GO Japan) since 2009. The study's working title is *Private vs. Public Activism in Japan: Agendas, Engagements and Outcomes* ('the study'). As a Japan specialist, Governance For Owners Japan works closely with clients' investment

**TABLE 1: SUMMARY OF GO JAPAN ENGAGEMENTS**

Year	Start	End	Outstanding balance	At least one outcome	No outcome for cases that ended (n=18)	Success rate
2009	10	0	10	9	1	90.0%
2010	7	0	17	6	1	85.7%
2011	2	0	19	2	1	100.0%
2012	1	0	20	1	#N/A	100.0%
2013	3	3	20	2	#N/A	66.7%
2014	3	1	22	3	#N/A	100.0%
2015	3	4	21	3	#N/A	100.0%
2016	5	4	22	4	1	80.0%
2017	2	3	21	0	#N/A	engagement in progress
2018	3	3	21	0	#N/A	engagement in progress
<b>Total</b>	<b>39</b>	<b>18</b>		<b>30</b>	<b>4</b>	<b>76.9%</b>

\* Engagements started in 2017 and 2018 are excluded from reporting success rate because it typically takes two years to obtain an outcome. Source: Becht, Franks, Miyajima and Suzuki (2019)

and ESG teams to identify companies not attracting the correct value in the market. We then engage with these companies to improve the business, which ultimately leads to an increase in market value.

Our engagement philosophy is straightforward: we pride ourselves in taking a culturally effective, constructive approach to engagement; we work with the company's top management team; and we do not believe that a hostile approach will be effective in Japan, at least not on a sustainable basis.

The purpose of the study was to show whether our style of private (i.e. confidential or 'behind closed doors') engagement generated better returns than more conventional, aggressive activism. Governance For Owners Japan shared data on all our corporate engagements since we started our business with the researchers. The study is noteworthy as access to private interventions data is rare and the effect of such interventions cannot be observed in studies that rely on public information alone.

Recent academic evidence prior to this study had already confirmed that hostile activism cannot be as successful in Japan as it is in the United States. In fact, in *Returns To Hedge Fund Activism: An International Study* – Becht, Franks, Grant and Wagner (2017), the authors concluded that: "Engagement outcomes, such as board changes and takeovers, vary across countries and significantly contribute to the returns to activism. Japan is an exception, with high initial expectations and low outcomes."

The preliminary results of the new academic study goes one step further and shows that 'private' engagement as practiced by us in Japan delivers abnormal ('excess') returns. Table 1 (below, left) shows that the success rate of engagements carried out by Governance For Owners Japan stands at 76.9 per cent.

Such rate of excess returns can be compared with that of more conventional activists, which have a success rate of 35.8 per cent (see Table 2, below).

This result is even more striking as both styles of engagements have almost identical mean cumulative abnormal returns (CARs) around the announcement of outcome.

In other words, in periods around the outcome announcement, the average share price improvement is about the same whether the engagement was carried out by Governance For Owners Japan or activist funds, as Table 3, below, shows. »

**TABLE 3: CAR AROUND OUTCOME ANNOUNCEMENT**

Period	GO Japan n=31	Activists n=43
-10 ~ +10	9.05% (2.13)*	8.63% (6.01)**
-2 ~ +2	6.57% (3.16)**	6.58% (9.02)**
-1 ~ +1	5.16% (3.21)**	5.55% (9.48)**

"Period" shows the trading days before and after the date of outcome announcement.

The first figure in each cell reports the cumulative abnormal returns (CAR) over the period, and the second figure in brackets reports t-statistics, where "\*" and "\*\*" showing that the statistic is significant at 5% and 1% level, respectively.

Source: Becht, Franks, Miyajima and Suzuki (2019)

**TABLE 2: PUBLIC ACTIVISM BY ACTIVIST FUND**

Start Year	Proposal	At least one outcome	Success rate	Board	Payout	Strategy	M&A	Removal of poison pill	Others
2000	1	0	0.0%	0	1	0	0	0	0
2001	2	1	50.0%	2	2	1	0	0	0
2002	0	0	#N/A	0	0	0	0	0	0
2003	10	4	40.0%	1	3	0	6	0	1
2004	12	2	16.7%	1	8	1	3	0	0
2005	17	8	47.1%	2	10	2	5	1	0
2006	5	0	0.0%	0	4	0	0	0	1
2007	9	3	33.3%	1	4	1	4	0	3
2008	4	2	50.0%	0	2	0	2	0	0
2009	1	0	0.0%	0	1	0	0	0	0
2010	0	0	#N/A	0	0	0	0	0	0
2011	0	0	#N/A	0	0	0	0	0	0
2012	1	0	0.0%	0	1	0	0	0	0
2013	7	4	57.1%	4	1	2	1	0	0
2014	7	3	42.9%	2	4	1	1	1	0
2015	8	5	62.5%	1	7	4	0	0	0
2016	8	4	50.0%	1	7	3	2	0	0
2017	12	3	25.0%	4	7	3	3	1	4
2018	16	4	25.0%	7	10	4	0	2	2
<b>Total</b>	<b>120</b>	<b>43</b>	<b>35.8%</b>	<b>26</b>	<b>72</b>	<b>22</b>	<b>27</b>	<b>5</b>	<b>11</b>

(c) Kazunori Suzuki, 2019 (This work is by JSPS Core-to-Core Program, A, Advanced Research Networks)

» When we consider why private engagement yields CARs as high as more aggressive activism, we need to address the nature of the exchanges that take place between investors and companies.

In the 2018 Summer Edition of *Ethical Boardroom*, I summarised the lessons investors can learn from companies that have implemented successful and sustainable organisational changes. I held it that the main takeaways were that it takes time and a large number of stakeholders need to be persuaded. Effective communication is clearly key.

In this article I address what effective communication between investors and investee company may look like and why 'private' engagement may engender the better returns outlined in the study. In my view, a constructive and culturally effective approach to engaging and a clear policy that all discussions are and will remain confidential are the essential conditions of any dialogue.

At Governance For Owners Japan, we believe that engagement with companies is best accomplished by experienced local professionals who are based in their home regions and understand local laws, local regulatory requirements and, most important, local culture. Engagement in a manner that is culturally acceptable in Japan is fundamental to our approach; we call this the 'Japanese way' of engagement. Physical proximity of our team enables

investors to follow market-specific developments closely and improve dialogue with investee companies.

However, many investors running global portfolios may not have the time or the resources to access their portfolio companies locally through local staff. They may thus engage infrequently and through the medium of English.

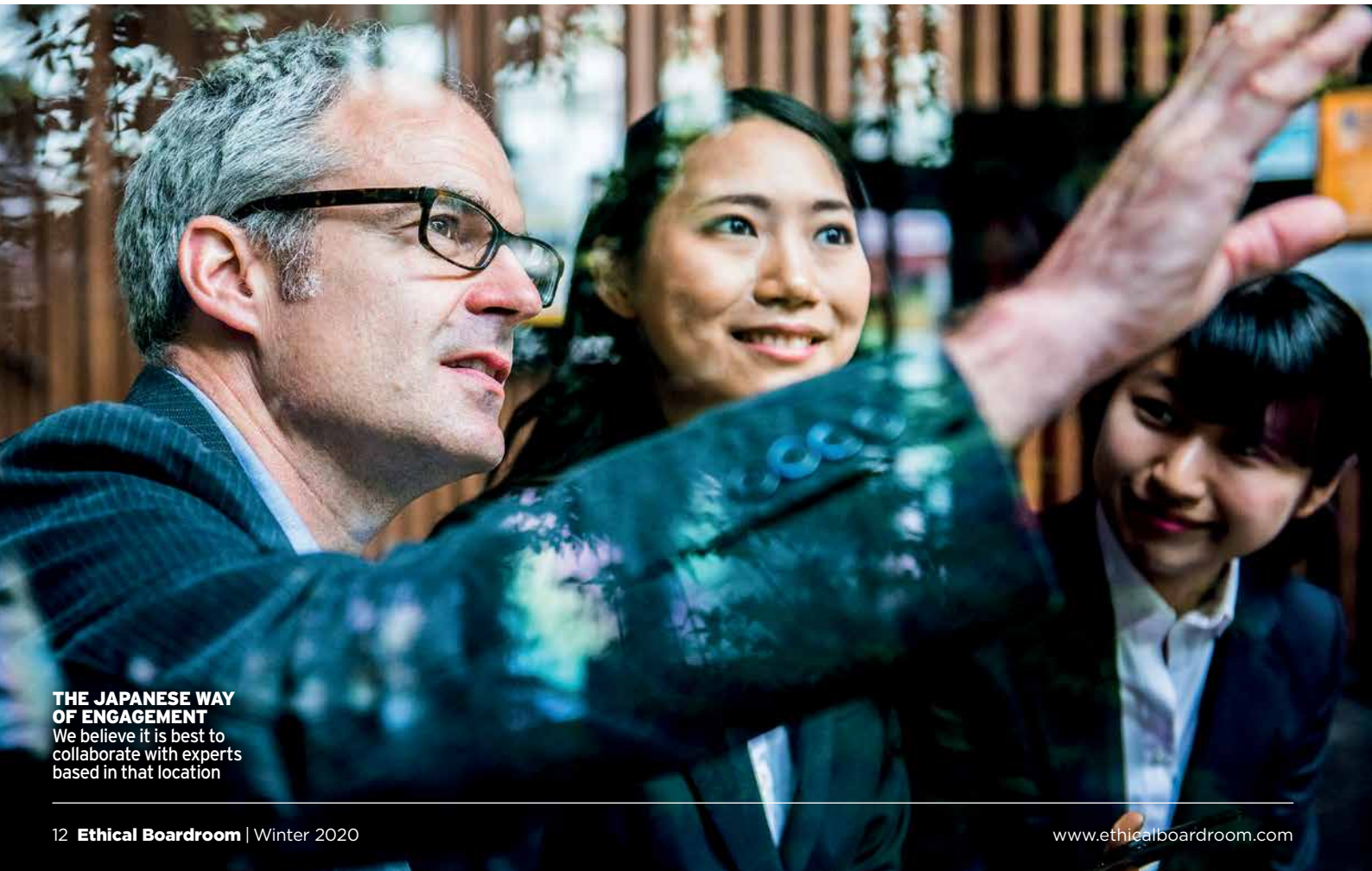
Because our approach emphasises dialogue with boards and management, we have found that a richer and more nuanced vocabulary makes us better at appreciating the perspectives of others and thus communicating ideas more effectively. Investors unable to devote the time and without the linguistic skills, struggle to understand why management may have a different view or timeframe as to how the business should be developed. You are also highly unlikely to establish effective communication channels with an investee company when only meeting management once a year. Regular contact is fundamental to building and

maintaining robust relationships. Even more importantly, if the management of a company is meeting an investor that has been known to go public, they will never really be willing to communicate in a productive and open manner.

We thus believe that the engagement model most likely to yield results is one where respecting confidentiality is essential. We want to encourage a constructive debate between us and management that may generate a change in corporate strategy. In our view, only a solid sense of security about the private framework in which discussions occur, can allow the frank and robust exchange of views that is essential to bring about change. Such solid sense of security can only be established if the manager of an investee company is clear that the investor will never go public if communication breaks down.

This is our promise to all the companies with which we engage in Japan and, as the study shows, our Japan-specific approach is also proving to be successful and value-adding for investors. 🌐

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**THE JAPANESE WAY OF ENGAGEMENT**

We believe it is best to collaborate with experts based in that location