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Abstract

This paper examines active ownership in Japan by an equity ownership service, Governance for Owners Japan (GOJ). GOJ engages with portfolio companies on behalf of Japanese and international institutional investors. The engagements are exclusively private and are not observable to the public. We use the stated objectives of the interventions to measure the incidence of success, and the stock market response to the public announcement of engagement outcomes. We find a high rate of success and average cumulative abnormal returns (CARs) of about 2.6 percent between -5 and +5 trading days of an event date in response to outcome announcements. Since there is more than one outcome per engagement, the average CARs per engagement is 6.5 percent. Target companies were more likely to adopt recommendations proposed in GOJ's private engagements than in a sample of public activist engagements over a similar period.

Keywords: Corporate Governance, Active Ownership, Investor Stewardship, Private Engagement, Hedge Fund Activism, Corporate Governance Code
JEL Classification: G23, G34, G38, K20

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1. Introduction

Using a proprietary dataset, this paper examines the effectiveness of private engagements with the boards of Japanese listed companies by an active ownership service on behalf of Japanese and international institutional investors. We measure the incidence of success and the stock market response to outcome announcements. We define a private engagement as a series of interactions with a listed company that is not disclosed to the stock market or the media. In contrast, public activism is disclosed by the activist, the target company or the regulatory authorities. Studies of private activism are rare, and to our knowledge this study is the first one for Japan.

Japan's system of corporate governance heavily relies on the board of directors, who are mainly promoted within the firm, and frequently supported by insider ownership.[1] While shareholder rights are strong in law, their application remains weak. The agenda of a typical shareholders' meeting includes only three types of resolutions: the election of directors, the appointment of the auditor and the proposed dividend.[2] Shareholders delegate virtually all major decisions, including strategy, to the board. In addition, Japan has a tradition of "stakeholder capitalism" that puts significant emphasis on life-long employment and protection of other contractual parties.[3] In this setting, directors see themselves as having a duty to multiple corporate constituencies, not just to shareholders.[4]

Recent reforms aimed at revitalising the Japanese economy have included a number of measures to shift the emphasis of corporate governance from insiders to shareholders. These

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[1] Franks, Mayer, and Miyajima (2014).

[2] Even this is an exaggeration since in one third of listed firms shareholders delegate the dividend decision to the board, in which case it does not require their approval.

[3] See, for example, Allen, Carletti, and Marquez (2015) and Yoshimori (1995).

[4] Corporate law in Japan is the result of a transplant of German business law in 1898 and specific rules of U.S. corporate law post-WWII, in particular with respect to directors' fiduciary duties. The orientation of Japanese corporations to multiple constituencies is probably more cultural than legal; see Kanda and Milhaupt (2003).

include amendments to company law intended to foster board independence and more monitoring by shareholders. The Japanese stewardship code in 2014, which was revised in 2020, commits the signatories "to enhance the medium- to long-term investment return [..] by improving and fostering [..] corporate value and sustainable growth through constructive engagement, or purposeful dialogue, based on in-depth knowledge of the companies and their business environment." The 2020 revision of the code further added "consideration of sustainability [..]".[5] The code also calls for more monitoring and constructive engagement by investors.[6]

Previous research has shown that public activism has not been particularly successful in Japan.[7] According to one study, between 2000 and 2010, the probability of obtaining an outcome in an activist campaign was relatively low by international comparison; the unconditional probability of achieving at least one outcome per engagement was only 18% in Asia, compared with 50% in Europe and 61% in the United States.[8] In Japan aggressive activists have focused on a small number of target companies and have been relatively successful by Asian standards. The probability of have a proposal accepted was 35-37% between 2000 and 2009.[9] However, even in the most public and hardest fought cases, the incumbent management was often able to successfully resist the activists. For example, in 2008 the UK activist, The Children's Investment Fund (TCI), with a stake of around 10% in J-Power, demanded the company increase its payout

[5] https://www.fsa.go.jp/en/refer/councils/stewardship/index.html

[6] Stewardship engagements between shareholders and boards have been encouraged by the Japanese Government since 2013. The first stewardship code was published in 2014 by the Financial Services Authority (FSA), the Japanese securities regulator. Japan has also introduced a corporate governance code in 2015. Both codes rely on the "comply or explain" principle first introduced in the UK.

[7] Hamao and Matos (2018), Buchanan, Chai and Deakin (2012, 2018).

[8] Becht, Franks, Grant and Wagner (2017), pg. 2934. The total number of engagements in Japan was 184 (Table 2, pg. 2941).

[9] See Hamao and Matos (2018) for the period 2000-2009. The activists in their sample engaged with 88 firms and made 234 proposals; 88 proposals were adopted (38%); see Table 6. In our activist sample there were 62 proposals and 21 were accepted during the same period (34%); see Table 6.

and appoint two directors nominated by them. The confrontational engagement failed, mostly due to the activist's inability to garner the votes of some foreign investors, most Japanese institutional investors and a lack of support from the Japanese Government.[10] The success rate has not increased over time, although the shareholdings by overseas asset managers in Japanese companies has continued to grow over the past decade, accompanied by an increase in activism.[11]

What explains the historically high degree of support of Japanese investors for incumbent management, that often extends to foreign shareholders? The traditional explanation is one of conflicts of interest, arising from cross holdings between institutional investors (trust banks and insurance firms and firms) and business dealings between asset managers and corporations. While the cross-shareholdings that previously characterized the Japanese market have largely been dismantled, the personal and business connections have often endured.[12] Another explanation is behavioral. In Japan there is a cultural aversion to "losing face" (*mentsu wo ushinau*, see Haugh 2005). Giving into the public demand of activists is seen as a humiliation, even when directors privately agree with those demands. Equally, Japanese investors are averse to contributing to the humiliation of elected directors, especially in the context of a corporate governance system that relies so heavily on delegated powers.

To make active ownership operational and signal the Japanese government's commitment to greater engagement between the company and its shareholders, the Japanese Government Pension Investment Fund (GPIF) has significantly increased its holdings in Japanese equities and

[10] Buchanan, Chai and Deakin (2012).
[11] See Table 6, Panel B for 2011-2019.
[12] Domestic investors are less independent than foreign investors (Ferreira and Matos 2008).

the GPIF was one of the first institutional investors to adopt the Japanese stewardship code, actively encouraging engagement between shareholders and boards.[13]

The adoption of the corporate governance and the stewardship codes in Japan have not been accompanied by much direct evidence of how "constructive engagements" and "purposeful dialogues" work in practice; nor is there any evidence as to whether private engagements have been successful. The lack of data particularly on private engagements means that we cannot observe how such engagements are conducted. Moreover, we are aware that many cases of public activism have been preceded by a failed private engagement. However, some activists have learnt from past failures. Elliott purchased a large stake in SoftBank and engaged in quiet activism with the founder and chairman. They suggested that the low share price and large discount to net asset value, could be boosted by the use of large cash holdings to repurchase Softbank's shares. They also suggested in private a more diverse and independent board of directors. These discussions only became public through a leak to the press. Even then, in public Elliott were respectful and cordial. The response by Softbank was positive and the company largely adopted the proposals of Elliott.[14]

This paper provides a study of private engagements in Japan. It relies on data from the Japan Engagement Consortium (JEC), a stewardship service provided by Governance for Owners Japan (GOJ) that made its engagement data available under a non-disclosure agreement. GOJ was set up in 2007 to be a joint venture between GO Investment Partners Group LLP in the U.K. (GOP),

[13] In 2014 GPIF raised its weight in domestic stocks from 12% to 25%, while Bank of Japan has increased its ETF purchases over the past 10 years, and they now account for 8% of the market capitalization of the Tokyo Stock Exchange.

[14] "Masayoshi Son Again Pulled SoftBank From the Brink. This Time He Had Help, The Wall Street Journal, Nov. 11, 2020, https://www.wsj.com/articles/masayoshi-son-softbank-elliott-management-11605069825. "Activist investor Elliott now owns 3% of SoftBank", Nikkei Asia, February 7, 2020, https://asia.nikkei.com/Business/SoftBank2/Activist-investor-Elliott-now-owns-3-of-SoftBank.

an independent investment manager, and Tokio Marine Asset Management Co., Ltd. (TMAM), the asset management firm of Tokio Marine Holdings, Inc., one of the largest insurance company groups in Japan. During our sample period, JEC had a number of clients, including 3 overseas pension funds and 2 Japanese institutional investors.

One of the main objectives of GOJ is to foster long-term shareholder value through private dialogue. GOJ was one of the first companies to pursue this active ownership strategy. GOJ serves as an agent for investors, not as a principal. Its purpose is to engage companies on behalf of the JEC members. The decision to engage with a particular company is taken by GOJ but after consultation with consortium members. To be selected for engagement at least one consortium member must hold shares in the target. An agenda is agreed after preliminary meetings have taken place with the prospective target company. The service heavily relies on personal meetings, reputation and discretion. There is an explicit understanding that contacts with the target companies are kept private.[15]

GOJ is remunerated on a fixed fee basis which is unrelated to the share performance of the companies they engage with. During our sample period, JEC foreign members included the Universities Superannuation Scheme (USS; a UK private pension scheme), and AP4 (The fourth Swedish national pension fund).

The main research questions addressed in this paper are, how are those private engagements conducted, what proportion lead to outcomes and how does the stock market react to those outcomes? In judging the success of private engagements, we also compared them with

[15] However, this did not preclude the owners of the stake voting against the company at the AGM.

public activism. The main benchmarks are the nature of the engagement objectives, the rate of successful outcomes and the stock market reaction to those outcomes.

2. Data and Methodology

GOJ supplied the authors with a full set of quarterly client reports until the end of 2019. The reports contain the name of the target company, the engagement agenda, meeting notes, and outcomes that were achieved. GOJ also supplied quarterly reports of client holdings in the target companies. Data on stock price returns and ownership were obtained from Nikkei NEEDS Financial Quest and Nikkei NEEDS Cges (Corporate governance evaluation system), respectively.

The client reports are very detailed and contain the motivation for the engagement, the engagement agenda and GOJ's own evaluation of "success". The client reports were hand coded and converted into a panel dataset at the agenda item level. The panel was supplemented from external information, including news sources, so as to capture public announcements that provided independent confirmation of the success of an engagement. Stock prices for the portfolio companies and the Nikkei benchmark index were used to calculate abnormal returns around the announcement of outcomes.

3. Private Engagements

Figure 1, Panel A shows a cohort chart of JEC's engagement activities for the 39 target firms JEC intended to engage between January 2008 and January 2019. A grey bar shows the preliminary contact period by GO Japan to assess the feasibility of engagement. A blue bar shows 39 actual engagements (and their length) under the JEC program. We see that the longest engagement extends over a period of 10 years. Most engagements started before 2014 are complete; most engagements started after 2014 are still ongoing. In Panel B, we provide a histogram of the duration of the engagements. The average length of an engagement is 5.1 years, and the median is 4.6 years. This period is much longer than for our public activism sample.

Table 1 reports the annual number of engagements that were started or ended in any one year. As shown in Panel A, GOJ started 40 engagements between the inception of the JEC service in 2009 and 2019, and just over half were still ongoing at the end of 2019. Since an engagement that started in 2019 does not yet have actual engagement records, we focus on the 39 engagements that began before the end of 2018. The engagement targets had an average level of foreign ownership of approximately 30%, which is typical for the Japanese market (Panel B). Foreign ownership is an important factor since foreign institutional investors are more likely to bring pressure on Japanese companies for governance changes.[16]

In Table 2, we report engagement objectives by category. In total there were 156 engagement objectives ("agenda items") for the 39 engagements. The maximum number of agenda items for any one engagement was 6, the minimum was 2. The nature and relative frequency of JEC's "demands" or "suggestions" is indicative of JEC's engagement style, but also illustrates the type of change JEC believes could be value enhancing.

The table shows that GOJ pursues a broad set of objectives separated into seven categories: (i) balance sheet improvement (cash balances, unwinding crossholdings) and increasing payout, (ii) board composition, director skills and independence, (iii) improvement in disclosure, (iv) environment/social (ES), (v) remuneration, (vi) removing takeover defences, and (vii) strategy. The agenda goes beyond the items that are typically discussed with a portfolio company by

[16] Miyajima and Ogawa (2016) report that institutional investors influence the choice of board composition so as to reduce its size and to encourage the appointment of independent outside directors.

stewardship specialists working for asset managers; they bear similarities to those of a focus fund.[17] Strategy features most prominently on the GOJ agenda (49 cases), and they include a wide range of subjects, such as business growth, restructuring and profitability improvement. In the board category, agenda items include board independence, diversity and director skills. Perhaps not surprisingly, executive remuneration hardly features on JEC's agenda. It is well documented that executive compensation in Japan is much lower than in other OECD countries. [18] Hence, when remuneration does feature, JEC links it to share price performance. In contrast, remuneration is a major agenda item in private engagements for institutions in the United Kingdom and elsewhere.[19]

Asset efficiency /cash balance/ payout refer to inefficient usage of assets, and relate to suggestions for increases in dividends and share repurchases. The removal of takeover defences is an important request because it opens up the company to unsolicited bids and, a refusal to remove might be interpreted as management entrenchment. The strategy and performance category contains a broad range of items, such as business strategy and restructuring, including a greater business focus, but also the exercise of greater caution when making corporate acquisitions. Disclosure includes disclosing (or setting) target financial ratios (ROE, ROIC or profit/sales ratio), and a more open discussion of environmental and social (ES) issues.

To obtain a better understanding of the JEC engagement process, we describe one of the 10 interventions started in 2009 and were completed by the end of 2019. The case study also documents how we link the engagement agenda to outcomes and returns. It illustrates that while

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[17] See Becht, Franks, Mayer Rossi (2009). The overlap is not completely surprising since GOJ and its parent Governance for Owners Group (now called GO Investment Partners Group) were set up by the same team that set up the Hermes Equity Ownership Service (EOS). The team also managed the Hermes UK Focus Fund before departing to set up Governance for Owners.
[18] Kubo (2012).
[19] See Becht, Franks and Wagner (2020); Hoepner, Oikonomou, Sautner, Starks and Zhou (2020); Dimson, Karakas and Li (2015).

GOJ cannot be classed as a traditional activist because its primary responsibility is to exercise a stewardship function, nevertheless, its remit does include issues that are pursued by an activist. As a result, we find it useful to benchmark the long run performance of a JEC intervention to the returns for a successful hedge fund activist campaign. We show, however, that hedge fund activists have a much lower success rate in Japan when compared with the European Union, the United Kingdom or the United States.

4. Case Study – Beverages Group

GOJ engaged with a global beer, drinks business starting in May 2009 and ending in March 2016. The company's shares were widely held throughout the engagement period with overseas institutions holding just under 30 percent. 2 of GOJ clients held an aggregate stake of around 0.25%; additional stakes in the company were held as part of investments in Japanese index funds.

In 2009, GOJ considered the company to be undervalued. They attributed this undervaluation to a lack of clear strategic direction, an inadequate focus on profit margins, and overpayment for foreign acquisitions. GOJ initially put three issues on their engagement agenda: (i) re-examination of overseas expansion plans, (ii) a review of the soft drink business, and (iii) the removal of takeover defences which were due for renewal in March 2010. The takeover defence had previously been adopted in 2007 with shareholder approval.

Over the period 2009 to 2015, GOJ had 16 private meetings with the drinks company, one approximately every 5 months. The meetings were attended by representatives of the company's management, investor relations and the legal department. All three engagement items were discussed. The GOJ meeting notes record that the company representative welcomed the meetings because it gave them the opportunity to familiarize themselves with how domestic and particularly foreign investor clients of GOJ perceived them.

The takeover defense was also due for renewal at the March 2010 AGM. Notwithstanding GOJ's objections during previous meetings, the renewal of the takeover defence was proposed and approved, but with a relatively low level of shareholder approval (69%). In subsequent meetings, which were attended by an executive vice president, GOJ continued to encourage the company to remove the takeover defence, while also continuing the discussion about strategy. Further meetings took place in August and November on the same topics, and continued into 2011 with four meetings, including one in September where GOJ submitted a memo to explain why abolishing the takeover defence would be well received by institutional investors.

In September 2012, GOJ met the president of the company, together with two representatives of their overseas clients. The three engagement issues were discussed. Regarding the takeover defence, the president said that he preferred to renew the defense to protect the company from corporate raiders who might destroy the company's corporate values. However, the company had set up a special project team to discuss its renewal due in March 2013, and it was subsequently allowed to lapse at the March 2013 AGM. The decision was announced on February 13, 2013 and was associated with 3-day (between day -1 and +1) and 11-day (between day -5 and +5) cumulative abnormal returns (CARs) of 7.0% and 14.1%, respectively, around the announcement date.

GOJ and the drinks company met again in April 2013. The company representative thanked GOJ for the letters received from their international clients, which expressed their appreciation for the company's decision to withdraw the takeover defence. The discussions about strategy continued. The last meeting took place on April 2, 2015.

The strategy agenda resulted in a number of other outcomes and 2 were announced publicly: (i) In 2012 the company announced the acquisition of a Japanese beverage company; the

11-day CAR around the announcement date was -2.1%, and (ii) In 2012, the company announced a joint venture with an Indonesian company; the 11-day CAR was 1.0%. The cumulated abnormal returns for all the announced outcomes of 9.2 percent may underestimate the total returns from the engagement because not all the outcomes, particularly with respect to strategy, were easily identified. The group structure was streamlined but the changes that occurred between 2009 and 2015 are not easily captured by individual outcome events announced to the market. The total buy-and-hold abnormal returns (BHAR) in excess of returns of the TOPIX Index over the engagement period was 120%.

The drinks company case is a typical example of GOJ's private engagement style. The dialogue with the company through the JEC service was invisible to outsiders and there were no public disagreements with JEC consortium members or with other shareholders. Most of interactions were with management and in a limited number of cases with the highest-ranking executive board member (the President).

5. Engagement Outcomes and Returns

In section 3 we described the entire duration of an engagement. This section extends the analysis to the full sample of engagement outcomes. For 32 of the 39 engagements i.e.82% of engagements, there were 80 outcomes announced to the stock market. As in Section 3, we classify these outcomes into the seven groups described earlier. We do not report ES outcomes because there is only one.

In Table 3, Panel A, we report the mean excess returns for each type of engagement outcome and their statistical significance. The mean CARs for all outcomes (n=80) are 1.1 percent (significant at the 10 percent level) for the 3-day window, and 2.6 percent (significant at the 5 percent level) for the 11-day window around the announcement date. The mean of 11-day period CARs for sub-samples classified by the type of engagement is positive and statistically significant for defence removals (at 5 percent level), board (at 5 percent level), and for strategy (at 10 percent level). In Panel B, we report the CARs summed over multiple outcomes for a single engagement (n=32). Since there are multiple outcomes for some engagements, the average CAR per engagement increases to 6.5 percent (significant at the 5 percent level) for the 11-day period between -5 and +5.

The evolution of the cumulative average abnormal returns (CARs) for the 80 outcome events is shown in Figure 2. The total CAR for 41-day period between days -20 and +20 is about 4.1%, including a run-up effect of about 2% that begins 20 days prior to the announcement (Figure 2, Panel A). Most of the runup is associated with disclosure improvement and defence removal announcements (Figure 2, Panel B). The CARs for board restructuring events are 2.5% before the announcement, rising sharply to over 4% on the day the transaction is announced. Surprisingly the abnormal returns for balance sheet and payout is not statistically significant and is smaller compared with those for other categories. The CARs for disclosure improvement announcements show an unusual pattern where the runup is positive at 6%, significantly negative at the time of the announcement and shrinks to less than 3% 20 days after the event.

To attempt to capture the returns for engagement outcomes that are not announced to the market, including those on strategy, succession planning or restructuring occurring over a lengthy period, we estimate buy and hold returns over the entire engagement period, or to the end of the sample period for the engagements that are still ongoing. We exclude engagements that were started after 1 January 2018 and which had a duration of less than two years, on the grounds that outcomes are unlikely to occur over such a short period of time. This reduces the sample size from 39 to 36 engagements.

There are important qualifications to this analysis. First, GOJ is not responsible for stock picking, its clients are. Second, performance estimates that include periods of years, compared with short windows of weeks or a month that characterise event outcomes, are very noisy in a statistical sense. Third, while GOJ may well have had a positive impact on the stock market performance of the stocks held by its clients, outperformance of say 3 or 4% per year may likely be influenced by other events affecting the company. To give some perspective, the average annual standard deviation of returns on the stock due to market and idiosyncratic movements is likely to be around 20 percent per annum, compared with returns over an outcome event of 4%. Finally, it is not obvious which benchmark to use in the calculation of abnormal returns, for example a single market factor benchmark such as the TOPIX index or a three or four factor model that includes both the market factor as well as market to book and size. Nevertheless, we believe it is still worth reporting these results.

6. Public Activism Objectives and Outcomes

In this section, we examine the objectives and outcomes for public hedge fund activism with those of GOJ over the period 2001 to 2019.[20] The purpose is to compare the nature of proposals, success in achieving outcomes and the stock market reaction when successful outcomes are announced to the market. Appendix 1 describes the constructions of the public activism dataset for 34 hedge fund activists with at least one engagement in Japan. In Table 4, we compare the number and the characteristics of the companies engaged by GOJ with the targets of public

[20] Previous studies of public activism focused on the period 2000-2009/2010, so the result are not directly comparable; see Becht, Franks, Grant and Wagner (2017) and Hamao and Matos (2013).

activism. GOJ engages companies with larger market capitalisations than those of public activists, 364 billion versus 47 billion yen. Since larger companies tend to have a higher level of institutional ownership, we find higher institutional ownership for the GOJ engagements.

In Panel A of Table 5, we list the total number of public engagements by hedge fund activists over the whole 20-year period (n=135). In Panel B, we report the number of proposals, the nature of the proposal and the proportion of successful outcomes. Hedge fund activists primarily focus on restructuring, takeovers and playout. Board change also features prominently, but are often an intermediate goal to achieve the pay-out or restructuring objective. Panel C shows that the average success rate is about 33 percent over the period. Surprisingly the success rate has remained stable since 2011, despite an increase in foreign institutional ownership, and policy reforms in the Japanese market. There are several interesting observations. First, the more recent activist cases are still ongoing and therefore, the success rate is likely to increase for this cohort. Notwithstanding, the success rate of public activism is significantly lower than that of the quiet activism practiced by GOJ, although there may be cases of private activism that are not reported and are therefore not included in our sample.[21]

In Table 6, we report the CAR around the public disclosure of a public activist stake. The average 11-day CAR (day -5 to +5) around the disclosure date is approximately 5.7% which is consistent with previous research on public activism. The market anticipates the cases with an outcome, since the disclosure returns are 7.5% for the 47 engagements that have an outcome ex-post which is higher than for those engagements without an outcome (which are 4.8%). The final column of Table 6 adds the disclosure returns for the 47 cases with their outcome abnormal return

[21] GOJ cannot engage with any company listed on the Japanese market because it does not make investment decisions; its choice set is limited to the union of the portfolios held by its institutional clients.

which gives a substantially higher total return of 16 percent for engagements with outcomes. However, we do not know from these statistics what returns accrue for those engagements where there are no outcomes.

7. Conclusion

Historically, corporate governance in Japan has not been focused on shareholder value. This has been attributed to corporate culture, ranking employees above financial investors, insider (cross) shareholdings, government policy and the reluctance of Japanese financial institutions to criticize management, publicly or in private.[22] One result is that historically public shareholder activism was confined to a small number of companies and had a relatively low chance of success.

GOJ took a different approach. First, it engages with companies quietly, promising no public announcements, even when the company refuses to engage. GOJ emphasizes active ownership and stewardship and constructive engagement. Its agenda is close in spirit to the Japanese corporate governance and stewardship codes, emphasizing long-term value creation. In contrast, public hedge fund activists in Japan have largely focused on takeovers and corporate restructuring. Second, GOJ does not own any stock in the companies it engages, but acts for third parties who are institutional shareholders. Third, GOJ is remunerated on a fixed fee basis and does not need to produce immediate results.

In this study, we have examined 39 engagements of GOJ, analyzing both the process of engagement and the extent to which they achieve their stated objectives. We find that in more than three-quarter of cases (32 out of 39) GOJ achieved at least one of the desired outcomes. The success rate was also high in terms of the number of agenda items; GOJ considers that 70% of 156

[22] Some have even attributed this unwillingness to links with organized crime. See, for example, Milhaupt and West (2000).

items were resolved satisfactorily. We could independently link 80 items to a publicly observable outcome announcement; the associated announcement returns were significantly positive. The cumulative abnormal returns for an 11-day window were 2.6 percent on average.

The evidence suggests that 'quiet engagements' have much to offer in Japan. GOJ’s engagement style seems successful across a broad range of companies and a broad range of engagement items. However, GOJ’s ability to achieve outcomes cannot be extrapolated to the whole market. GOJ chooses its engagement with the expectation of being able to achieve an outcome, so its success is endogenous. We do not know how successfully quiet activism would be if we had been able to choose GOJ’s engagement targets randomly. Nevertheless, the evidence suggests that quiet activism is potentially conducive to bring about the type of change set out in the Japanese corporate governance and stewardship codes. Quiet activism has the advantage that it is more in keeping with Japan’s traditional approach to corporate governance.

Private activism is no substitute for public hedge fund activism. Hedge fund activists often pursue restructuring, mergers, takeovers or larger pay-outs. The chance of success is smaller than for private activism, but when hedge fund activists succeed the outcome returns are large, as one would expect in takeover situations. Japan might well require more restructuring and the rewards for bringing about successful takeover outcomes are so large that public activism in Japan is likely to persist.

Existing institutions matter. In the United States and the United Kingdom, activism has made widely held companies even more shareholder value oriented. In these countries, the current emphasis is on making companies more accountable to responsible investors and employees. Japan has only recently begun to move from its traditional insider-oriented governance model to one which places more emphasis on outside shareholders. The success of quiet engagement documented in this paper is encouraging and suggests that corporate Japan is paying more attention to at least one type of shareholder engagement.

Appendix 1 – Hedge Fund Activism Dataset Construction

This appendix describes the construction of the dataset that underlies the comparison between JEC engagement outcome announcement returns with similar outcome events for public interventions by hedge fund activists. We obtain the name of activist funds from the Activist Insight global hedge fund activism database. Activist Insight classifies activist categories as primary focus, partial focus, occasional, or concerned shareholders. After examining the activities and characteristics of names appearing in Activist Insight and cross-checking the activities of reported funds by newspaper articles, we identify 34 activist funds from primary focus, partial focus and occasional categories.

After having identified activists, we search for activism cases from three sources. The first is the Activist Insight database described above. Activist Insight for the most part records public activism since 2012 in Japan, according to various news sources as well as the Web sites of activists and target firms. We identify 59 target firms of activists from Activist Insight.

The second source is the EDINET and EOL Databases, where we search for *tairyo-hoyuu-hokokusho, or* "Statement of Large-Volume Shareholdings" ("Statement" hereafter), where a shareholder of a public company must submit to regulatory authority (Finance Bureau) and publish that he holds equal to or above 5 percent of a publicly listed company. Statement is an equivalent of 13-D regulatory disclosures in the U.S. that an investor is required to submit when he/she holds more than or equal to 5 percent of voting rights of a listed company.[23] We identify 304 Statements submitted by 34 activist funds above. We trace the shareholding until the activist submits a "Change Report" (*henko-hoyu-hokokusho*; "Report" hereafter) that its shareholding has declined

[23] A large shareholder who publishes Statement must further submit Change Report every time his shareholding changes more than 1 percent, until when his shareholding becomes less than 5 percent.

below 5 percent. We calculate the cumulated balance of Statements that are still in effect (meaning shareholdings still above 5 percent) at the end of each year.

The third source is Nikkei Telecon newspaper article database, where we check whether a company about which an activist fund had submitted Statements received any proposal from the fund. This is necessary to identify the activist proposals before 2012, when Activist Insight started its record in Japan. We also check for the voluntary announcement of shareholding by an activist when his shareholding has not yet arrived at the 5 percent threshold of Statement.

Combining the above three sources, we noticed that an activist fund recorded in *Activist Insight* initiates a public activism with a few percentages of shareholdings, way below the threshold of 5 percent where a report is required. There are cases where (1) Statement had been submitted when the activist initiated an activism, (2) Statement had been submitted, but the activist did not initiate an activism and (3) Statement had not been submitted when the activist engagement was initiated.

As reported in Table 5 Panel A, we report that out of 339 target companies to which Statement has been submitted, 135 firms received a proposal from the activist (category (1)), while remaining 204 firms did not receive any proposal (category (2)). During the first wave between 2000 and 2010, 11 funds made proposals to 62 target companies with 21 cases (34 percent) with at least one outcome. There is a higher proportion of the request for an M&A (21 percent, mainly a pressure to conduct an MBO) than in the latter period (7 percent). During the second period since 2011 onwards, 21 funds made proposals to 73 target companies with 24 cases (33 percent) with at least one outcome. The distinct feature of the second period is that there is a higher proportion of proposals regarding the board seat/structure and strategy (mainly asset/division sales), proposed to 33 percent and 25 percent of target firms, respectively (compared with 15 and 8 percent, respectively, in the first period). We also note that the acceptance rate to obtain at least one outcome is similar at about one-third in both periods.

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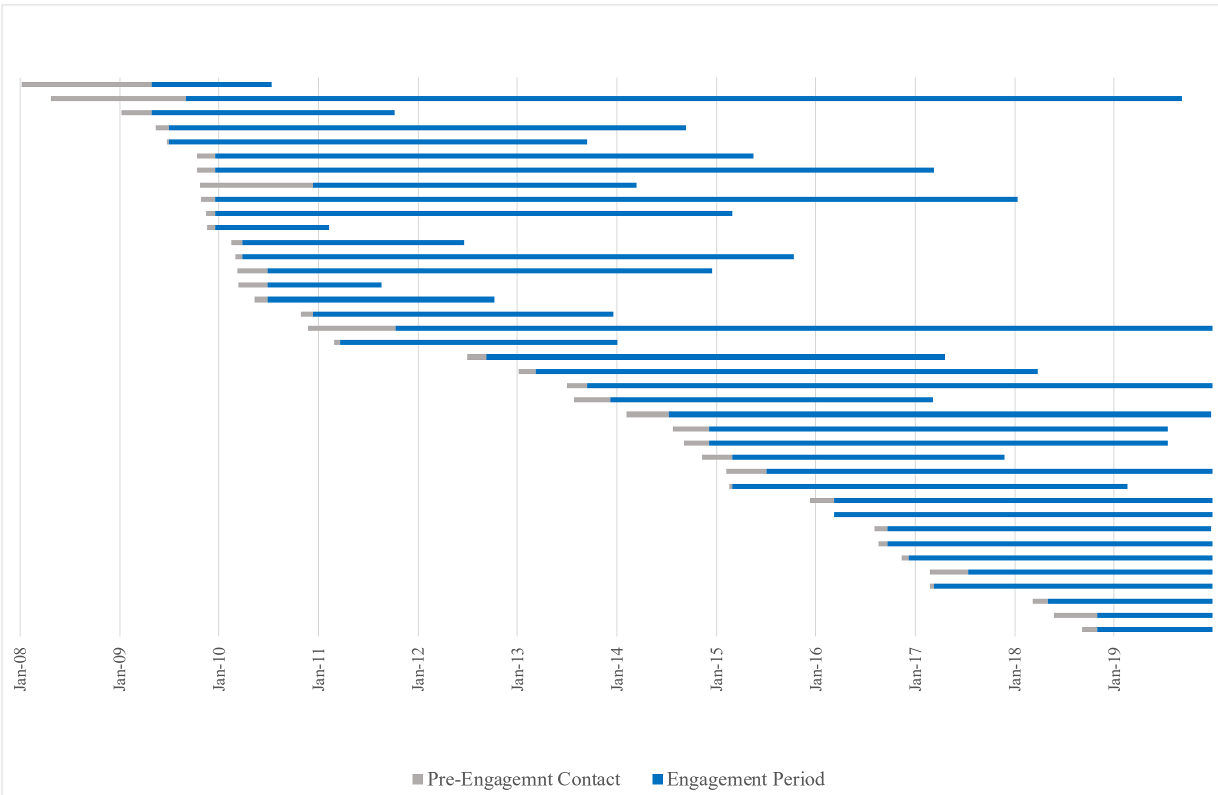
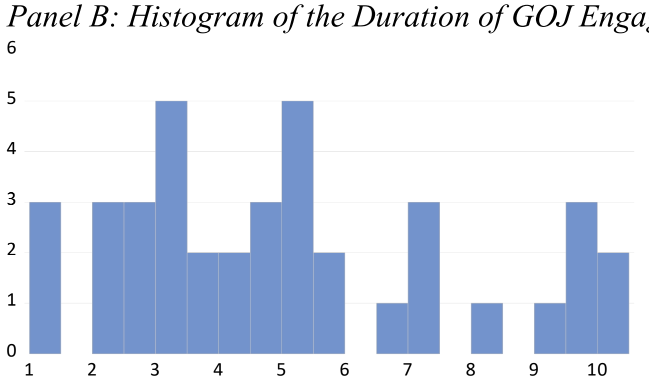
Figure 1: Time Chart of JEC Engagement

This figure shows engagement durations for 39 JEC target companies. The grey bars show the pre-engagement period between a first discussion among consortium members and the date of first contact with the target. During this period JEC staff undertakes preparatory work. The blue bars show the actual engagement period. The longest engagement extends over 10 years. Bars that extend to the right side of the graph show engagements that are still ongoing.

Panel A: Cohort Chart of GOJ Engagements



Panel B: Histogram of the Duration of GOJ Engagements

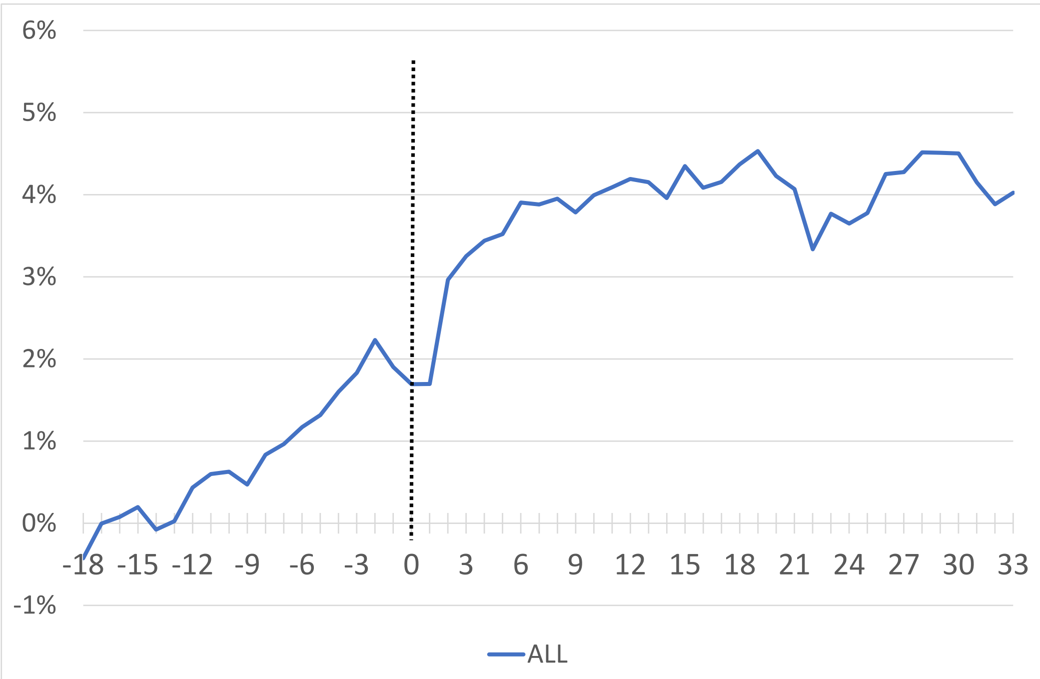


Series: DURATION	
Sample 1 39	
Observations 39	
Mean	5.071444
Median	4.621918
Maximum	10.04110
Minimum	1.147945
Std. Dev.	2.643329
Skewness	0.519817
Kurtosis	2.259509
Jarque-Bera	2.647397
Probability	0.266149

Figure 2. Engagement Outcomes Abnormal Returns Over Events

The figure shows cumulative abnormal returns around the announcement of an engagement outcome. Panel A shows the average abnormal return across 80 outcome events. Events are treated independently, even when they were part of the same engagements. Panel B splits the events into seven categories: board, strategy, payout, disclosure, remuneration and the removal of takeover defense.

Panel A – All Outcome Events



Panel B – Outcome Events by Category

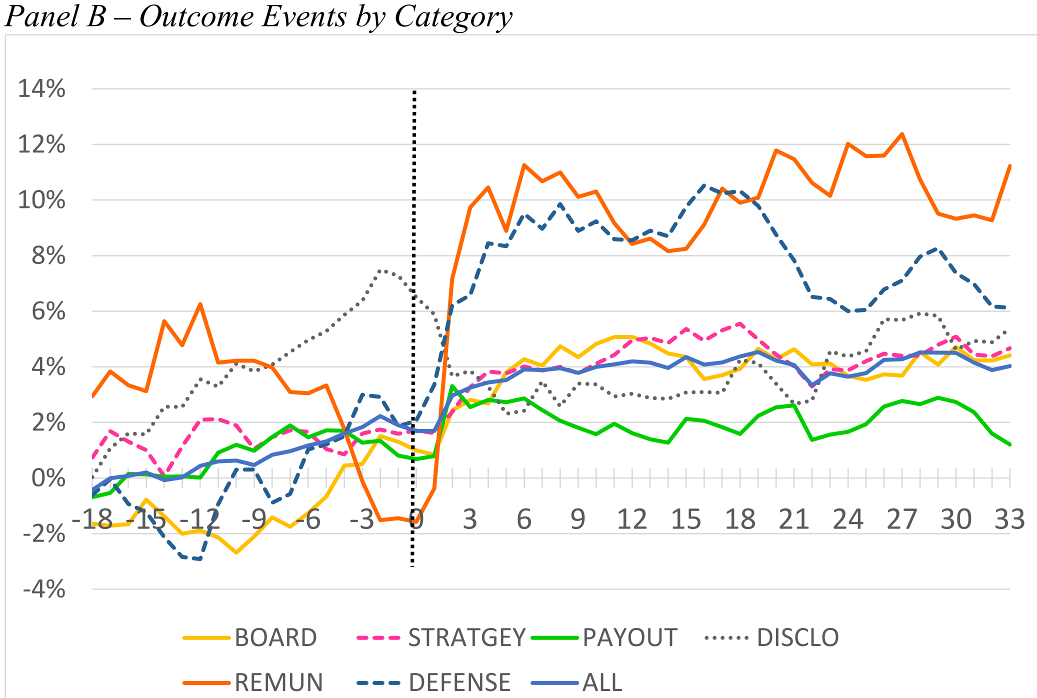


Figure 3. CAR Engagement Outcomes Over Engagements

The figure shows the cumulative average abnormal return across engagements. It sums the abnormal returns for multiple outcomes per engagement and then computes the average across engagements. There are engagements with no outcomes. These are excluded.

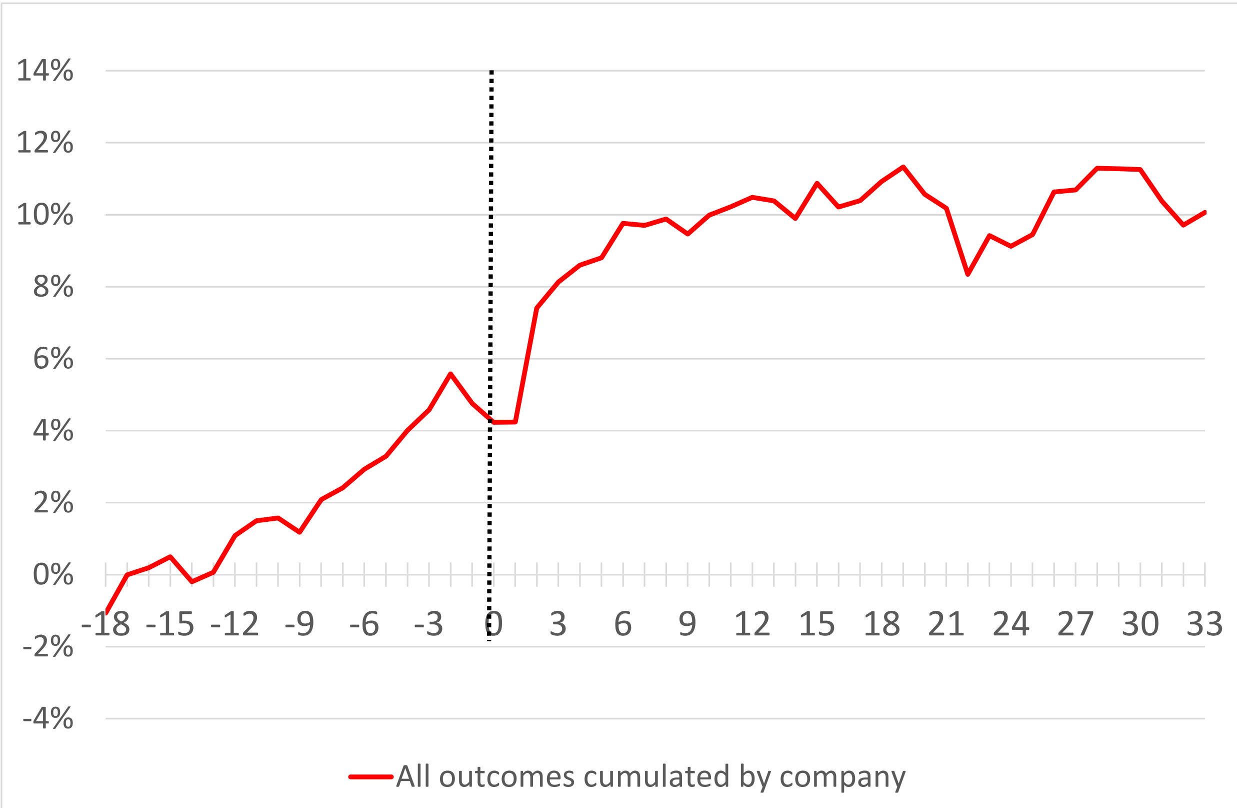


Table 1: JEC Engagement Targets

The table shows the characteristics of JEC's engagements and targets. Panel A shows the evolution of GO Japan's JEC engagement activities from 2009 to the end of 2019. The total number of engagements started was 40 of which 22 engagements were completed by 31 December 2019. Panel B reports two characteristics of the target firms at the start of the engagements; the markets capitalization in JPY billion and the fraction of voting shares held by overseas investors. Just for comparison, we show the corresponding market cap. of top 20% largest companies by market cap. within those included in TOPIX Index.

Panel A – Number of engagements over time

Year	Start	Exit	Ongoing
2009	10	0	10
2010	7	0	17
2011	2	0	19
2012	1	0	20
2013	3	3	20
2014	3	1	22
2015	3	4	21
2016	5	4	22
2017	2	3	21
2018	3	3	21
2019	1	4	18
Total	40	22	

Panel B – Target Company Characteristics

	Mean	25%	Median	75%	Min	Max
Mkt cap. at start (in billion yen)	904.0	209.9	364.2	1,103.5	34.2	5,501.6
Foreign ownership	30.3%	24.5%	30.3%	36.3%	9.3%	58.4%
Meeting Frequency (in months)						

TOPIX top 20 percentile	Mean	25%	Median	75%	Min	Max
Mkt cap. in 2008 (in billion yen)	674.5	239.5	335.8	3,788.5	143.2	10,016.4
Mkt cap. in 2012 (in billion yen)	723.7	248.3	347.3	5,085.5	149.3	13,809.2
Mkt cap. in 2016 (in billion yen)	1,179.6	410.8	584.5	8,267.3	237.1	22,442.9

Table 2: GOJ Agenda Items

The table shows the GOJ's agenda items that have been grouped into 7 categories. There are at least two agenda items per engagement and for each agenda items there can be multiple discrete outcomes. GOJ makes self-assessment of its engagement agenda, where it assesses whether it partially or fully achieved it. We count as an outcome only if an engaged company made a public announcement of an outcome in line with the agenda raised by the GOJ.

Category	Sub-category	N	GO Japan's Self-Assessed Achievements	Outcome	Self-Assessment Prob.	Outcome Prob.	Average Years until Outcome
Asset Efficiency/Cash Balance/ Payout		29	24	20	82.8%	69.0%	3.2
	Payout policy	7	7	7	100.0%	100.0%	3.1
	Reduction of cash balance	6	5	4	83.3%	66.7%	2.5
	Reduction of equity holdings	7	7	6	100.0%	85.7%	2.8
	More efficient capital management/allocation	7	3	1	42.9%	14.3%	3.1
	Reduction of treasury stocks	2	2	2	100.0%	100.0%	4.5
Board		31	25	22	80.6%	71.0%	2.9
	Board indepenence/diverity	28	24	21	85.7%	75.0%	3.0
	Board members' skills/qualifications	2	0	0	0.0%	0.0%	#N/A
	Board governance (misconduct prevention)	1	1	1	100.0%	100.0%	2.1
Disclosure Improvement		22	17	11	77.3%	50.0%	3.2
	Target ratio (ROE/ROIC/Cost of capital etc.)	11	9	6	81.8%	54.5%	3.7
	Improved business plan/strategy disclosure	8	6	3	75.0%	37.5%	2.4
	Better investor relations	3	3	2	100.0%	66.7%	3.3
Enivironment / Social		8	4	1	50.0%	12.5%	2.1
Remuneration		6	1	2	16.7%	33.3%	1.2
Removal of Takeover Defense		11	4	4	36.4%	36.4%	2.2
Strategy		49	34	20	69.4%	40.8%	2.6
	Business growth (domestic/international)	23	17	10	73.9%	43.5%	1.9
	Restructuring/divestment	12	9	6	75.0%	50.0%	3.5
	Profitability improvement	10	5	3	50.0%	30.0%	2.2
	Mergers and acquisitions	2	2	1	100.0%	50.0%	1.4
	Others	2	1	0	50.0%	0.0%	#N/A
Total		156	109	80	69.9%	51.3%	2.9

Table 3. GOJ outcome and share price reaction

This table shows the share price reaction of GOJ target companies when they announce an action that is in line with the agenda of GOJ. Panel A shows the average CAR by type of agenda. There are targets which responded to several different agendas, in which case the CARs for each outcome announcement is treated individually (n=65) to calculate the mean CARs in column (“All outcomes”)."
Panel B shows the mean aggregate CARs summed over multiple outcomes of an engaged company (n=34). ***, ** and * means that the average CAR is significant at 1%, 5% and 10%, respectively.

CAR Period	Asset/Cash/Payout (n=20)		Board (n=22)		Strategy (n=20)		Disclosure (n=11)		Defense removal (n=4)		Remuneration (n=2)		Others (n=1)		All outcomes (n=80)	
	CAR	t-stats	CAR	t-stats	CAR	t-stats	CAR	t-stats	CAR	t-stats	CAR	t-stats	CAR	t-stats	CAR	t-stats
[-20~+20]	2.69%	1.00	4.63%	1.53	4.02%	1.51	2.66%	0.64	7.82%	1.70	11.47%	2.19	6.02%	n/a	4.07%	2.94***
[-5~+5]	1.23%	0.65	4.94%	2.61**	2.97%	1.95*	-2.87%	-1.65	8.29%	4.08**	7.92%	1.43	-3.17%	n/a	2.59%	2.57**
[-2~+2]	1.27%	0.50	1.30%	1.27	1.53%	1.72	-3.64%	-2.57**	3.67%	4.03**	11.25%	4.44	-0.04%	n/a	1.02%	1.53
[-1~+1]	2.62%	1.53	1.13%	1.33	0.78%	0.98	-3.61%	-2.75**	4.35%	3.12*	8.61%	22.12**	-2.71%	n/a	1.06%	1.74*

Panel B: Aggregate mean CARs by engaged company

CAR Period	Aggregate CARs (n=32)	
	CAR	t-stats
[-20~+20]	10.18%	2.47**
[-5~+5]	6.47%	2.36**
[-2~+2]	2.56%	1.77*
[-1~+1]	2.65%	1.78*

Table 4: Comparative statistics of target companies of GO Japan and public activism (in billions yen)

This table shows the descriptive statistics of sample target firms of GOJ engagement and of public activism between 2000 to 2010, and 2011 and 2019. We show the mean and the median market capitalization, percentage of institutional ownership and foreign ownership for each sample group.

		GO Japan (2009-2019: n=39)	Activism (all: 2000-2019:n=132)	Activism (2000-2010: n=62)	Activism (2011-2019: n=70)
Market cap.	mean	904.0	401.4	150.5	623.7
	median	364.2	47.9	49.9	47.1
Institutional ownership	mean	43.9%	28.2%	21.2%	34.3%
	median	45.5%	28.9%	22.1%	33.0%
Foreign ownership	mean	30.3%	23.4%	20.6%	25.9%
	median	30.3%	21.4%	19.5%	22.7%

Table 5. Proposals by activist hedge funds

The table reports the number of proposals by activist funds and the category of proposed agenda in line with that by Becht et al. (2017). Panel A shows the time series of the number and the outstanding balance of "Statements" and the number activist proposals made of the Statement publication cases (total 111). Panel B shows the detailed statistics for activist's proposals including those without Statement publication (n=132), and its acceptance rates. Acceptance rate is calculated according to the start year, by dividing the number of "With outcome" firms for the year with the number of proposals. Panel C reports acceptance rate of 2 sub-periods between 2000 and 2010 and between 2011 and 2019.

Panel A: Year-by-year statistics

Start Year	New ≥ 5%	Exited < 5%	Outstanding Statement cases	Proposal made	% of proposal
2000	1	0	1	1	100.0%
2001	2	0	3	2	66.7%
2002	1	1	3	0	0.0%
2003	17	1	19	10	52.6%
2004	30	5	44	13	29.5%
2005	29	4	69	15	21.7%
2006	15	8	76	5	6.6%
2007	52	14	114	11	9.6%
2008	27	34	107	4	3.7%
2009	3	27	83	1	1.2%
2010	8	19	72	0	0.0%
2011	7	8	71	0	0.0%
2012	8	8	71	1	1.4%
2013	14	9	76	6	7.9%
2014	19	17	78	6	7.7%
2015	23	13	88	10	11.4%
2016	16	18	86	9	10.5%
2017	27	20	93	14	15.1%
2018	25	10	108	16	14.8%
2019	15	16	107	11	10.3%
Total	339	232		135	

Panel B: Type of proposals by activist hedge funds

Engagements				Agenda Items for Activists						Outcome of Activists					
Start Year	No.	With at least one outcome	Success Rate	Board	Payout	Strategy/ asset sales	M&A/ Against-M&A	Abolish takeover defense	Others	Board	Payout	Strategy/ asset sales	M&A/ Against-M&A	Abolish takeover defense	Others
2000	1	0	0.0%	0	1	0	0	0	0	0	0	0	0	0	0
2001	2	1	50.0%	2	2	1	0	0	0	0	1	0	0	0	0
2002	0	0		0	0	0	0	0	0	0	0	0	0	0	0
2003	10	4	40.0%	1	3	0	1	0	1	1	2	0	1	0	0
2004	13	3	23.1%	2	8	1	3	0	0	1	2	0	0	0	0
2005	15	8	53.3%	3	8	2	4	1	0	2	4	0	2	0	0
2006	5	0	0.0%	0	4	0	0	0	1	0	0	0	0	0	0
2007	11	3	27.3%	1	5	1	3	0	3	0	0	0	3	0	0
2008	4	2	50.0%	0	2	0	2	0	0	0	1	0	1	0	0
2009	1	0		0	1	0	0	0	0	0	0	0	0	0	0
2010	0	0		0	0	0	0	0	0	0	0	0	0	0	0
2011	0	0		0	0	0	0	0	0	0	0	0	0	0	0
2012	1	0	0.0%	0	1	0	0	0	0	0	0	0	0	0	0
2013	6	3	50.0%	3	1	1	1	0	0	1	0	1	1	0	0
2014	6	2	33.3%	1	4	0	1	1	0	1	1	0	0	0	0
2015	10	6	60.0%	3	8	5	1	0	0	2	3	0	1	0	0
2016	9	4	44.4%	0	8	3	0	0	0	0	4	0	0	0	0
2017	14	3	21.4%	5	8	4	1	1	4	1	0	0	0	0	2
2018	16	5	31.3%	8	11	5	1	2	1	1	3	0	1	0	0
2019	11	1	9.1%	4	5	0	0	2	1	0	0	0	0	0	1
Total	135	45	33.3%	33	80	23	18	7	11	10	21	1	10	0	3

Panel C: Statistics for sub-periods

Sub period	Proposal	With outcome	Acceptance rate	% board on sub-period proposals	% payout on sub-period total	% strategy on sub-period total	% M&A on sub-period total	% abolish defense on sub-period total	% others on sub-period total
2000~2010	62	21	33.9%	14.5%	54.8%	8.1%	21.0%	1.6%	8.1%
2011~2019	73	24	32.9%	32.9%	63.0%	24.7%	6.8%	8.2%	8.2%
2000~2019	135	45	33.3%	21.5%	59.3%	17.0%	13.3%	5.2%	8.1%

Table 6. CAR around publication of Statement and outcome announcement of public activism

This table shows the share price reaction of a target of the public activist (1) when the news of the first publication of Statement of Large-Volume Shareholdings ("Statement") is submitted and when there is an outcome for the activism. The first column shows the mean CAR around the publication of Statement for 132 cases, which may or may not have a subsequent outcome. The next two columns report mean CARs for the publication of Statement without any subsequent outcome (n=85) and with at least one subsequent outcome (n=47), respectively. The last column reports the aggregate CARs for those with an outcome, which is the sum of Statement publication CAR and outcome CAR.
***, ** and * means that the average CAR is significant at 1%, 5% and 10%, respectively.

CAR Period	All Statement publications (n=132)		Statement publication for sample without outcome (n=85)		Statement publication for sample with outcome (n=47)		Statement publication CAR plus outcome CAR (n=47)	
	CAR	t-stats	CAR	t-stats	CAR	t-stats	CAR	t-stats
[-20~+20]	7.42%	4.93***	4.12%	2.76***	13.31%	4.32***	22.32%	4.62***
[-5~+5]	5.74%	6.32***	4.76%	4.60***	7.51%	4.37***	15.95%	5.42***
[-2~+2]	3.58%	4.72***	2.59%	3.17***	5.37%	3.55***	12.26%	5.84***
[-1~+1]	2.85%	5.29***	1.86%	3.46***	4.64%	4.14***	10.28%	5.79***