RICHARD KAYE

THE START-UPS THAT GREW OLD

JAPAN'S FAMILY FIRMS NOT TO BE UNDERESTIMATED

ESG Insight
Governance

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HOME OF THE WORLD'S OLDEST COMPANIES

Japan is the home of the world's oldest companies and boasts one of the highest concentrations of large family-run businesses on the planet. At the start of the 21st century, one third of all Japanese listed companies had some kind of family control[1] and that remains the case today.

Japan's tendency to corporate family ownership can be explained by its relatively recent industrialisation. First, an industrial and service infrastructure of family companies sprang up alongside and became symbiotic with the state-affiliated enterprises which pushed the country into economic modernity. Second, Japan's economic miracle of the 1970s is so recent that many founders from that era are still in charge.

Investors should pay close attention to these businesses, perhaps more than they do at present. We have observed many cases globally when family or founder-owned or run companies align well with shareholders' interests, and in Comgest's Japan portfolio we take that idea quite far. About one third of our holdings and, in our opinion much of the fund's long-term outperformance, is from companies which fit that definition. Some examples are Fast Retailing, Hikari Tsushin, Nidec, Keyence, Softbank, Pan Pacific, Nihon M&A, Hoya, Obic, Zozo, Peptidream, Kobe Bussan and Sushiro.

— **A 'Day Zero' mentality translates naturally to capital discipline with a long-term mindset, through the pursuit of unique businesses**

Simply put, we view these companies as having a 'Day Zero' mentality which translates naturally to capital discipline with a long-term mindset, through the pursuit of unique businesses. These are start-ups which grew old. They speak the language of the shareholders because they are run by a major shareholder. With not just skin, but blood sweat and tears in the game, they certainly seek returns but importantly, they also seek long-term survival. They are the original 'ESG' plays before ESG existed; they fulfil a sustainable social role and their capital allocation choices have rewarded our trust.

HOYA

Hoya Corporation, which has parried its core strength in glass processing into near dominance in disc substrates and semiconductor imaging materials, is a classic case. This family glassware business gained national renown from supplying US occupation authority buildings. The company's willingness to divest its legacy crystal ware business and the camera business, to which many Japanese companies are unprofitably wedded, or to build a contact lens retail network in Japan which draws on Hoya's ophthalmic presence but sells other companies' lenses

Source: Hoya company website

[1] From 1962-2000: source *Financial Times*, "How Japan's family businesses use sons-in-law to bring in new blood", (https://on.ft.com/2Xrvftc).

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— "The company is not mine. Any business can grow old and we constantly need to consider divesting"

because that is more profitable, all reflect this flexibility and almost ruthless pursuit of return. When we ask owner and founder President Suzuki which businesses he keeps and why, his answers are as if from a textbook: 'the company is not mine; any business can grow old and we constantly need to consider divesting'. The words are not from a book, though; they express how he really thinks at the interstices of his organisation.

Hoya's idiosyncrasy in pursuing return and in transparency manifests itself also in the fact that another family member regularly opposes the management at AGMs. As Mr. Suzuki has hinted wryly, a Hegelian dialectical approach to discussion has led to great decisions, but long and difficult meetings.

HIKARI TSUSHIN

— A seemingly unemotional approach to capital discipline

Another company, Hikari Tsushin, a dominant office supplies provider for Japan's tangled web of micro companies has a similarly unemotional approach to capital discipline, which reflects Chairman Shigeta's focus as a 52% shareholder. Its preferred expression of this approach is Subscriber Acquisition Cost (SAC) yield, and across its business lines of telephone contracts, water servers, photocopiers and customer database systems it has transparent metrics for lifetime contract value, churn and return. It agilely quits low-return projects, like fiber optic resell where the regulator effectively stymied its room for maneuver and candidly recognises mistakes like its internet investment twenty years ago or its development of a life insurance agency. It continually incubates small affiliate companies where it gradually takes a larger stake and has a constant pipeline of new and high SAC-yield projects which fit the changing needs of its client landscape.

OBIC

Source: Obic company website

Obic is one of Japan's leading business software providers and the country's answer to Oracle for small companies. Since its creation in 1968 by Masahiro Noda, (who remains Chairman and 23% holder) it has insisted on keeping all operations home-grown: no sales agents, no mid-career hires. 'We are like the Chairman's children', say Obic staff. That may sound odd in the West, but it has created a consistent and reliable service provider in corporate Japan which is heading Japan's software solutions to address its labor shortage.

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— Suffused with the founder culture

NIHON M&A CENTER

Similarly to Obic, Nihon M&A Center is an indispensable presence among small Japanese companies but as a succession advisory firm, is suffused with the founder culture of 12% holders Mssrs. Miyake and Wakebayashi. Nihon differs from Obic in its openness to outside talent but shares with Hikari Tsushin that ruthless focus on capital return, efficiency of process and gross profit per employee, traits one would associate with a shareholder-managed company. Just recently we spoke with Mr Miyake, and he explained how he regularly sells stock to colleagues to bind them more directly into the destiny of the company.

Source: Nihon M&A company website

— Efficient capital allocators

PERMANENT START-UPS

These firms are not the sleepy, hidebound companies one might unkindly expect based on their ownership structure. Rather, as Japan's domestic investor base returns to its local market by increasing their allocation to Japanese equities after two decades' hibernation, these efficient capital allocators, these permanent start-ups, are a part of the investible universe which is naturally winning attention. Comgest is pitching its tent there, too.

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Richard Kaye joined Comgest in 2009 and is a Tokyo-based Analyst and Portfolio Manager specialising in Japanese equities. With a wealth of experience in Japanese equities, Richard became co-lead of Comgest's Japan equity strategy upon joining the Group. He started his career in 1994 as an Analyst with the Industrial Bank of Japan and then joined Merrill Lynch in the same role in 1996. In 2005 he moved to the Wellington Management Company in Boston as a Portfolio Manager of Japanese TMT stocks. Richard graduated from Oxford University where he majored in Oriental Studies.