Mini-Case

Governance and Activist Investors Outside of the United States

Governance in Japan, Germany, and China has been changing as "western" governance systems have increasingly been adopted. Traditionally, boards of directors in these nations have largely been composed of insider manager directors. In 2015, Japan adopted a new governance code that strongly emphasized the importance of firms to elect many more independent outside directors. Activist shareholders and a strong market for corporate control have traditionally been absent in Japan. More recently, shareholders have been more active and the most successful ones have been labelled "engagement" funds. The change is signaled, for example, by the Japanese Government Pension Investment Fund choosing an activist investor, the Taiyo Pacific Partners LP—a U.S. based engagement fund—to manage some of its $1 trillion in assets. Furthermore, the Japanese Financial Services Agency has introduced a "stewardship code" that calls on investors to "press for greater returns." As such, the Japanese environment is becoming more oriented toward "shareholder rights," although the approach comparatively is not as "activist" as found elsewhere in the world.

Besides a new brand of activism in Japan, activism is spreading around the globe including Germany. Again, a revised governance code pushed for more shareholder-friendly governance arrangements, including an emphasis on outside directors and stronger emphasis on executive long-term incentive compensation. With stronger emphasis on shareholders' rights, activist funds pursued more activity. Cevian Capital, an activist fund, is involved in ownership with ThyssenKrupp and Bilfinder. Likewise, Elliott Management, another activist fund, is involved with Celesio and Kabel Deutschland. Although management teams are quite suspicious of activists in Germany and other continental European countries, "Germany is an area where activists may look because of its protections for minority investors in takeover deals." However, research shows that activist investors have less influence on top management teams because of restrictive governance regulation. For example, one study found that activist investors' involvement did not lead to increased CEO turnover.

Although some activism has taken place in mainland China, firms in Hong Kong have been targeted more by activist funds. Hong Kong-listed companies have been loosening rules for foreign ownership and, therefore, companies have been paying more attention to what investors think in regard to governance and transparency. In mainland China, however, often shares are mostly owned by parent business group firms as well as the government or, because they are often younger, they are still owned by the firm's founders. As such, there is less potential influence for foreign investors on company decisions. However, the Shanghai-Hong Kong Stock Connect program has accelerated opportunities for activists on the mainland. Through the Connect program, foreign financial institutions can have direct access to mainland China's capital markets. This means that foreign ownership will have more activist influence because of shareholder voting rights in local mainland China-listed firms. Also, many home-grown Chinese activist funds thrived due to their recent investments in the technology sector with the success of Alibaba, Tencent, and many other high technology firms.

But how do owners from emerging market countries and countries with significant government ownership influence the firms they invest in overseas? Interestingly, sovereign wealth funds, many from emerging economies, are playing a dominant role by investing in developed economies as well as other emerging economies. In their own way, they are playing an activist role. For example, since the global financial crisis, many German firms have sought investment from sovereign wealth firms from Gulf States in the Mideast. In particular, many German major automobile firms have recruited Gulf Cooperation Council (GCC) sovereign wealth fund investments during the stresses of financial restructuring spurred by the financial crisis. These sovereign wealth funds are long-term investors and reduce the possibility of a hostile takeover, which has become a more prominent feature in the German corporate governance landscape.

Sovereign wealth funds are also taking active roles in climate change. For instance, the Norwegian sovereign wealth fund is divesting its assets in coal and other fossil fuels. Its strategy is to focus its wealth to have an influence on salient sustainability issues, such as climate change.

Another example is the acquisition activity of Brazilian multinationals, which have been supported by its sovereign wealth fund, the Brazilian Development Bank (BNDES). BNDES has been "involved in several large-scale operations and helped orchestrate mergers and acquisitions to build large 'national champions' in several industries." For example, "BNDES helped rescue Brazilian meatpacker JBS-Friboi, which aggressively expanded internationally by acquiring large U.S. producers Swift and Pilgrim's Pride, among others. In summary, western governance devices and shareholder activism have been spreading globally, and owners in emerging economies are participating in the market for corporate control and in restructuring investments, especially sovereign wealth funds that also exercise influence in developed as well as developing countries. These funds often focus to support government strategies, such as in China's energy sector, where the Chinese government is seeking to acquire more energy assets and natural resources to support its economy. Sometimes these sovereign funds also support government positions, such as Norway, which is using assets to emphasize sustainability, an important social and political movement.

Sources: M. Almadi & P. Lazic, 2016, CEO incentive compensation and earnings management, *Management Decision*, 54(10): 2447–2461; J. Braunstein, 2017, The domestic drivers of state finance institutions: Evidence from sovereign wealth funds, *Review of International Political Economy*, 24(6): 980–1003; L. Fletcher & E. Johanningsmeier, 2017, Hedge funds prosper on China tech but bubble fears emerge, *Wall Street Journal*, www.wsj.com, September 12; N. Hasegawa, H. Kim, & Y. Yasuda, 2017, The adoption of stock option plans and their effects on firm performance during Japan's period of corporate governance reform, *Journal of the Japanese and International Economies*, 44: 13–25; T. Kaspereit, K. Lopatta, & D. Onnen, 2017, Shareholder Value Implications of Compliance with the German Corporate Governance Code, *Managerial and Decision Economics*, 38: 166–177; K. Nagata & P. Nguyen, 2017, Ownership structure and disclosure quality: Evidence from management forecasts revisions in Japan, *Journal of Accounting and Public Policy*, 36(6): 451–467; O. Noreng, 2017, Norway's diversification, *World Oil*, 238(12): 23; M. Stancati & M. Farrell, 2017, Saudi Sovereign Wealth Fund sets growth targets, *Wall Street Journal*, www.wsj.com, October 26; X. Geng, T. Yoshikawa, & A. M. Colpan, 2016, Leveraging foreign institutional logic in the adoption of stock option pay among Japanese firms, *Strategic Management Journal*, 37(7): 1472–1492; B. Alhashel, 2015, Sovereign wealth funds: A literature review, *Journal of Economics and Business*, 78: 1–13; K. Narioka, 2015, Activist investors in Japan find some doors cracking open, *Wall Street Journal*, www.wsj.com, January 29; S. G. Lazzarini, A. Musacchio, R. Bandeira-de-Mello, & R. Marcon, R. 2015, What do state-owned development banks do? Evidence from BNDES, 2002–09 *World Development*, 66: 237–253; A. Musacchio & S. G. Lazzarini, 2014, *Reinventing State Capitalism: Leviathan in Business, Brazil and Beyond*, Cambridge: Harvard University Press; X. Sun, J. Li, Y. Wang, & W. Clark, 2014, China's sovereign wealth fund investments in overseas energy: The energy security perspective, *Energy Policy*, 65: 654–661.

Case Discussion Questions

1. Why are many countries adopting "western" governance systems similar to those found in the United States and the United Kingdom that are more shareholder friendly?
2. What particular governance devices are helping or hindering good governance in these countries that are changing their governance systems?
3. How do sovereign wealth funds affect governance of firms in home and foreign countries?
4. What would you recommend to improve the governance systems in Japan, Germany, and China, respectively, given the governance devices described in Chapter 10?