AGENCY THEORY IN PRACTICE: A QUALITATIVE STUDY OF HEDGE FUND ACTIVISM IN JAPAN

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Abstract

We look at the reaction to hedge fund activism of managers and shareholders in Japanese firms and explore the implications of our findings for agency theory. We use a qualitative research design which treats the standard agency-theoretical model of the firm as only one possible approach to understanding corporate governance, to be tested through empirical research, rather than as an assumption built into the analysis. We find that Japanese managers do not generally regard themselves as the shareholders' agents and that, conversely, shareholders in Japanese firms do not generally behave as principals. Our findings suggest that the standard principal-agent model may be a weak fit for firms in certain national contexts.

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1. Introduction

Hedge fund activism is a relatively new phenomenon which has attracted growing interest from corporate governance researchers and practitioners. From the late 1980s, hedge fund activists in the USA pioneered focused forms of engagement with listed companies, publicly confronting their boards with proposals to release shareholder value through dividend increases, share repurchases, corporate restructurings and asset sales. The consensus of opinion among researchers was that these methods contributed to the realignment of managerial and shareholder interests, and consequent reduction of agency costs (Macey, 2008: 272). Although some studies found evidence of losses for bondholders (Klein and Zur, 2011), along with unclear implications for firm performance beyond a one- or two-year time horizon (Klein and Zur, 2009), others claimed to identify improved returns for shareholders and higher firm values over both the short and medium term (Brav et al., 2008; Bebchuk et al., 2013). Hedge fund activism subsequently spread to Europe, albeit in a somewhat less confrontational form (Becht et al., 2010).

After the USA and Europe, Japan was the third main site of hedge fund activism during the 2000s. In this paper we report qualitative evidence on the experience of hedge fund activism in Japan with the focus on the period up to 2008, when the full onset of the global financial crisis led the more prominent activist funds to wind down a number of their Japanese investments. By that stage, a mixture of managerial resistance and shareholder indifference was already making it hard for the funds to replicate the impact they had achieved elsewhere.

We use our account of the activist hedge fund episode in Japan to reassess the value of agency theory as the dominant frame of reference for corporate governance research. Agency theory 'asserts that principals (owners) must monitor and control agents (managers) to protect the owners' residual claims from the excesses of self-interested agents' (Bansal, 2013 :127). The practice of hedge fund activism is premised on this belief and on the related claim that, through such activism, the efficiency of the corporate sector of the economy will be enhanced. This was one of the main justifications offered for hedge fund activism in Japan during the 2000s: as an activist hedge fund manager put it to us in early 2008, 'hopefully Japan will see for itself that there is a lot of bottled-up inefficiency, capital inefficiency, operating inefficiency and that if it really wants a good future for its grandchildren, they need to change'.

However, despite this activism, neither management practice nor the practice of corporate governance changed greatly in Japan during the 2000s (Whittaker and Deakin, 2009). This was in large part because expectations generated by the application of agency theory to the Japanese case failed to materialise. As we shall see, the activists encountered managers who did not behave as agents, and shareholders who did not act as principals.

Our findings pose the question: if the standard agency model does not well describe the Japanese firm, what does? We will argue that certain features of the Japanese model, in particular the *internalist* orientation of its corporate governance arrangements (Buchanan, 2007), go a long way to explaining the limited success of activist hedge fund tactics in the Japanese context, and point to continuing Japanese divergence from the practice of 'shareholder primacy' (Hansmann and Kraakman, 2001) as it is recognised in America and, to a lesser degree, Europe.

In developing our argument, we first present some contextual information on hedge fund activism, briefly charting its origins in the USA in the late 1980s and its diffusion to Europe and Japan in the course of the 2000s. Next we consider theoretical perspectives on hedge fund activism, focusing on the principal-agent model which is the main lens through which not just researchers but also many practitioners have viewed this phenomenon. Then we discuss our methodology and present the case for using qualitative research in this context. In the following section we present our findings, focusing on two high-profile hedge fund interventions in Japan, Steel Partners' targeting of Bull-Dog Sauce and TCI's targeting of J-Power, and drawing on our interview material to probe actors' perceptions and interpretations of hedge fund activism in these and other instances. The final section provides an assessment of our results.

2. Context: the origins and diffusion of hedge fund activism

A hedge fund is an investment club governed by private contract and therefore beyond the scope of many regulatory requirements. Investors who accept increased market risk and an initial restriction on early withdrawal mandate fund managers, whose remuneration is linked to performance through bonuses, to exploit any legitimate opportunities for exceptional gains over an agreed benchmark, usually through a pre-advised investment strategy which may include borrowing or use of derivative instruments. Activist hedge funds are a distinct group within the hedge fund sector as a whole and, in terms of investment volume, were thought to constitute around 5% of the total in a J.P Morgan report dated 2006 (Kahan and Rock, 2007: 1046). Exact figures are difficult to calculate because funds can vary their strategies over time and do not disclose outstanding asset profiles. Moreover there is sometimes only a fine line between 'value funds' that amass shareholdings in expectation of predicted returns and 'activists' who try to precipitate those returns. The Alternative Investment Management Association, for example, generally avoids the expression ‘activist’ in its 2008 survey of the hedge fund sector and its strategies (AIMA, 2008). Nevertheless, we cite J.P. Morgan’s 5% figure as a plausible estimate that is probably still accurate: most hedge funds are not activists.

Activist hedge funds first emerged in the USA in the late 1980s. The literature on the US experience (see Bratton, 2007; Clifford; 2008; Brav et al., 2008; Greenwood and Schor, 2009; Kahan and Rock, 2007; Klein and Zur, 2009, 2011; Xu and Li, 2010) suggests that they typically operate by taking large but not controlling stakes in financially healthy and relatively small target companies, and then engaging directly with management on matters which include business strategy, capital structure, asset sales, and adherence to corporate governance standards. They are not short-term investors: holdings of up to four years are common. They call for the return of cash surpluses to shareholders in the form of increased dividends and share buy-backs, and encourage firms to increase their leverage. Because they do not normally seek control of their targets through hostile takeover bids, their strategy depends for its success on gaining the cooperation of management or that of other shareholders, or a combination of the two. They often seek to precipitate takeover bids by others (Greenwood and Schor, 2009).

The scale of hedge fund activism in the US context is significant, particularly in terms of the volume of interventions. In the most comprehensive study so far, Bebchuk et al (2013), building on an earlier database assembled by Brav et al. (2008), examined 2,040 activist interventions in the USA between 1994 and 2007, but this is only a sample drawn from a larger population of interventions, not all of which can be tracked precisely because of limits on disclosure rules and difficulties in distinguishing between activist hedge funds and more passive value funds. After a brief lull following the onset of the global financial crisis, activist tactics have resumed with a new level of intensity in the US context, with public confrontations between hedge funds and boards occurring at companies including Apple, T-Mobile and Hess in the first few months of 2013 (Priluck, 2013).

The scale of hedge fund activism in Europe is more limited than in the USA; using a mixture of public and proprietary data, Becht et al. (2010) analyse 362 interventions by activist shareholders of various kinds including activist hedge funds, focus funds, and other activists in fifteen European countries, including the UK, between 2000 and 2008. There were some high profile and controversial cases of interventions leading to takeovers and associated restructurings in Europe during the 2000s. The UK-based fund TCI (The Children’s Investment Fund) mobilised shareholders to persuade Deutsche Börse to withdraw from its plan to acquire the London Stock Exchange in 2005, and to devote resources instead to a series of share buybacks. In 2007 TCI acted as a catalyst for the sale of the Dutch bank ABN AMRO to a consortium comprising the Royal Bank of Scotland, Fortis and Santander, delivering an estimated 50% increase on the target's early 2007 share price. In the UK Nelson Peltz's Trian fund intervened at Cadbury Schweppes in 2007, pressing the board to sell its US drinks business in order to realise additional shareholder value, a disposal that was subsequently achieved, leading ultimately to the acquisition of Cadbury (as it had been renamed) by Kraft in 2010. Hedge fund activism continues to be a feature of European markets. Although European hedge fund interventions are generally thought to be less adversarial than in the USA, recent confrontational cases include those targeting UK-based asset manager F&C in 2010 and Dutch transport firm TNT in 2011 (Sassard and Cruise, 2013).

At first sight, the Japanese market looks much less promising than the USA or Europe as a site for hedge fund activism. In the course of the post-1945 reconstruction of the Japanese economy, the core employees of large Japanese companies came to see them as 'communities' which they joined for life (Dore, 1973: 222; Inagami and Whittaker, 2005: 1-5) and this communitarian ethic was reflected in corporate governance structures. Boards were overwhelmingly executive and internally appointed, and managers saw their role as 'working for the long-term prosperity of the firm (i.e. all its employees, present and future)' (Dore, 2000: 27), rather than for the maximisation of shareholder returns. A modification to Japanese corporate law, which allowed firms to set up a 'company with committees' structure, loosely based on what was seen as US practice, was introduced in 2003. This reform was intended to enhance the monitoring role of the board and to draw a clearer distinction between executive management and board supervision, requiring the apparent empowerment of external directors, but relatively few firms opted into it and it did not bring about a major shift in the role of external directors, who continued to be seen mostly as advisers to management (Buchanan and Deakin, 2008; Chizema and Shinozawa, 2012). Nevertheless, ownership structures were changing in this period, with a decline in the cross-shareholdings which had previously underpinned managerial autonomy and a related rise in overseas ownership of shares (Ahmadjian, 2003, 2007) and in engagement by overseas institutional investors (Jacoby, 2007a, 2007b). Hostile takeovers, while still very rare, were given a qualified legal endorsement by the Livedoor-Nippon Broadcasting judgment in 2005 (Hayakawa and Whittaker, 2009). Formally, at least, shareholders in Japanese firms enjoyed legal rights which were at least equal to those of their US counterparts (Siems, 2008). At this time, moreover, many listed companies had accumulated cash reserves while at the same time maintaining low dividend payouts and apparently having few plans to use this cash productively (Seki, 2005: 383). Thus the time may have seemed right for activist hedge funds to attempt to transplant to Japan the strategies which had been pioneered in the USA and then extended to Europe.

The first significant activist hedge fund to operate in the Japanese market was itself Japanese. Murakami Yoshiaki began investing in 1999 through M&A Consulting, widely known, in conjunction with a number of other entities, as the ‘Murakami Fund’. The Murakami Fund quickly obtained a reputation as a confrontational activist. By 2005 the Fund held positions in at least 52 companies (there are higher estimates), most of which had relatively high ratios of foreign ownership (Maezawa, 2005). In 2006 the Fund was wound up following an admission by Murakami of insider dealing, but by that stage several foreign funds had entered the Japanese market. The leading foreign fund in terms of interventions, Steel Partners, entered the Japanese market in 2002 through a joint venture with Liberty Square fronted by Steel Partners’ officers. Steel Partners had been seen as an investor in small companies in its US home market, but by 2007 it had begun to aim at larger targets there (Kruse and Suzuki, 2012: 591). In Japan, Steel Partners bought stakes in a series of mostly medium-sized listed firms and began pressuring them publicly for dividend increases and share buy-backs. Between 2002 and 2008 it made significant investments (above the 5% level requiring public disclosure) in at least 32 firms that we can identify from stock exchange disclosures and press reports. The second overseas fund that became prominent in the Japanese market during the period of our study was TCI which, as we have just seen, had already demonstrated an ability to extract value from larger companies in Europe. TCI confronted the management of two large companies in Japan, Chūbu Electric (from 2005) and J-Power (from 2006), to demand revision of their financial and managerial strategies. Although a number of outwardly similar funds were present in the Japanese market in this period, they all used a mixture of public and private dialogue with firms, and their interventions cannot be defined categorically as confrontational (Katelouzou, 2013).

At the end of 2007, there were 119 interventions in progress by firms defined by Thomson Reuters as ‘hedge funds’ of ‘active orientation’, excluding stakes held by funds in other financial companies purely for investment purposes. The total market capitalisation of these targeted companies (in which the funds held only minority positions) was less than 2% of the total capitalisation of the Tokyo and Osaka markets at that time. Moreover, many of these interventions were investments by value funds which did not seek to instigate change in their target companies or by hedge funds which did not engage in confrontational engagement. Thus, in quantitative terms, the impact of hedge fund activism on the Japanese market was scarcely significant; but as we shall see, it assumed a larger importance because of the high-profile nature of confrontational engagement and the public debate over corporate governance which it helped to trigger.

With the onset of the global financial crisis, the foreign funds pursuing strategies of confrontational investment began to wind down their Japanese investments. By January 2009 Steel Partners had reduced its holdings in 13 companies below the 5% level for mandatory disclosure, and by the end of 2010 its only significant investment was in the wig-maker Aderans, where, despite success in replacing the CEO and incumbent board, it had failed, over a seven year period, to change the company's strategic direction. TCI withdrew from Chūbu Electric in September 2007 and from J-Power in October 2008, in both cases after being rebuffed by management. TCI disclosed in 2011 that it had returned to the Japanese market with an intervention in Japan Tobacco ('JT'). In 2012 and again in 2013 TCI's demands for an increased dividend were rejected by JT's shareholders (FINalternatives, 2013). The US hedge fund Third Point made an investment through stock and derivatives in Sony in 2013, potentially amounting to a shareholding of around 6.5%, with a view to persuading the board to divest entertainment assets and use the proceeds to restore profitability at the company's electronics businesses, although without making any overt call for increased payouts. Sony's CEO agreed to consider this strategy but the board subsequently rejected it (Reuters, 2013a, 2013b). Overall, in contrast to the USA and Europe, hedge fund activism in Japan has to date had very little discernible impact on the strategies of target firms, and the number of publicised interventions there has dwindled to no more than a handful in the aftermath of the global financial crisis. While it seems that privately negotiated activism continues in Japan (Buchanan et al. 2012: 289-292), confrontational activism appears to have failed.

3. Hedge fund activism and agency theory

Agency theory provides the principal conceptual frame through which researchers and practitioners alike have interpreted the phenomenon of hedge fund activism. Agency theory posits the need for governance in any situation where the owner of an asset, the 'principal', delegates its use or exploitation to an 'agent', whose performance can only be incompletely observed by the principal (Ross, 1973). Governance, which takes the form of private contract supplemented by law and regulation (Williamson, 1986), has the aim of aligning the incentives of the parties in such a way as to maximise the value of their joint product. Agency theory, so defined, is capable of describing many different forms of concerted economic activity, of which the company limited by share capital is just one (Hansmann, 1996). In this case, where capital is provided by external investors in return for shares which carry a range of income, voting and control rights, it has become standard practice in the corporate governance literature to refer to the shareholders as ‘principals’ and the managers as their ‘agents’. Although this conceptualisation arguably conceals a more fluid and complex set of relations, both legally-structured and otherwise (Stout, 2012), it has proved influential not simply in framing the study of business firms in economics, management and finance since the mid-1970s (following Jensen and Meckling, 1976) but, with something of a lag, in shaping the meanings attributed by practitioners to terms such as ‘shareholder value’ and even ‘corporate governance’ itself (Pye, 2002; McNulty et al., 2013).

Viewing shareholders as ‘principals’ and managers as their ‘agents’ is not synonymous with the idea and practice of ‘shareholder primacy’, but it is linked to it. The link is made explicit by Hansmann and Kraakman (2001). They identify a ‘standard’, that is to say, shareholder-orientated version of agency theory, which has a number of connotations including the claims that ‘ultimate control over the corporation should rest with the shareholder class’ and that ‘the managers of the corporation should be charged with the obligation to manage the corporation in the interests of its shareholders’ (Hansmann and Kraakman, 2001: 440-441).

This theoretical perspective does not, strictly speaking, depend on characterising shareholders as ‘owners’ of the enterprise, an idea that corporate law scholars (Robé, 2011) and practitioners (American Bar Association, 2009) recognise to be inaccurate and imprecise, although, as we shall see below, this characterisation is widespread in practice. The more subtle notion that shareholders have a ‘residual’ interest in the income generated by the firm sometimes leads to them being described as ‘residual owners’ (Jensen and Meckling, 1976; Easterbrook and Fischel, 1991). This idea is mostly justified by agency theorists in efficiency terms. Two related claims derive from this view: an empirical claim to the effect that shareholder-orientated firms will displace others over time because they are more efficient (Fama and Jensen, 1983: 303; Hansmann and Kraakman, 2001: 450), and a normative claim to the effect that corporate law and managerial practice alike should respect the principle of shareholder primacy in order to enhance aggregate economic welfare (Bebchuk, 2005).

Relatedly, this branch of agency theory tends to see distinctive national approaches to corporate governance, in which the shareholder value norm is expressed incompletely or not at all, as evidence of inefficiencies which will be competed away over time. The ‘standard model’ therefore predicts the convergence of national systems around the norm of shareholder primacy: ‘at the beginning of the twenty-first century we are witnessing rapid convergence on the standard shareholder-oriented model as a normative view of corporate structure and governance, and we should expect this normative convergence to produce substantial convergence as well in the practices of corporate governance and corporate law' (Hansmann and Kraakman, 2001: 443).

This conception of agency theory has largely shaped the academic assessment of hedge fund activism. Of the criteria used to assess the impact of activist hedge fund interventions in empirical studies based on the US market, only one, abnormal returns to shareholders during the announcement period, is clearly positive across a number of studies (Brav et al., 2008; Klein and Zur, 2009). Bebchuk et al. (2013) report evidence of an improvement in target firms' operating performance, as measured by return on assets, over the medium term, as well as a positive stock market evaluation, as measured by Tobin's Q, and Brav et al. (2013) find evidence of an improvement in the productivity of targeted manufacturing firms. The impact of activist interventions on other constituencies, including banks, bondholders and employees, appears to be either negative or equivocal (Klein and Zur, 2011; Xu and Li, 2010; Brav et al., 2013). Studies nevertheless tend to see the overall impact of hedge fund interventions positively: 'hedge funds appear to address agency costs associated with excess cash balances by increasing dividends and the target's leverage' (Klein and Zur, 2009: 225); 'the presence of…hedge funds and their potential for intervention exert a disciplinary pressure on the management of public firms to make shareholder value a priority' (Brav et al., 2008: 1774). The view that US hedge funds 'actually deliver on their promise to provide more disciplined monitoring of management, to reduce the incidence of fraud on investors, and to improve actual operational performance' (Macey, 2008: 272) is characteristic of this literature.

There is evidence to suggest that a shareholder-orientated view of agency theory also informs the practice of hedge fund activism. Hedge fund activists challenge the identification of the company with its managers and employees, and invoke the rhetoric of shareholders as owners. According to the US hedge fund manager Barry Rosenstein, writing in the *Financial Times* in 2006, 'the portrayal of management as "defenders" of the corporation versus "attackers" fundamentally misrepresents the nature of these contests, which are not played out solely between management and activists but, rather, are campaigns between them for the support of the company's true owners, its shareholders' (Rosenstein, 2006). Hedge fund activists also see themselves as acting not simply to produce the best returns for their clients, but to improve the quality of management in the companies they invest in: one of our activist hedge fund interviewees told us, 'our standpoint is [that] we see what we are doing [as] aligned with a better Japan, although we are not doing it to make Japan better, but it is aligned with improving Japan and therefore we hold our heads up high and say this is something that is a win/win and not a win/lose', a view which also resonates with the idea of hedge fund activism as a force for cross-national convergence.

However, claims made for the diffusion of the shareholder primacy model are contested. Empirical studies in the law and finance field suggest that convergence of laws and regulations has been more formal than real (Armour et al., 2009), while the management literature suggests continuing diversity of corporate governance practice both within and between national systems (Aguilera and Jackson, 2003, 2010; Yoshikawa and McGuire, 2008; Judge et al., 2010). Without abandoning agency theory's emphasis on the role governance structures play in mitigating the effects of information asymmetries and other impediments to economic coordination, diversity in corporate governance can be explained by the role of institutional factors in shaping the representation and perception of actors' interests (Aguilera and Jackson, 2003) and by the embedding which occurs when principal-agent relations are located in particular social contexts (Wiseman et al., 2012). Thus the objective functions of the principal and agent are not pre-given but are a consequence of such factors as national institutional environments, which may display a certain stability or path-dependence (Aoki, 2001), and the life-cycles of individual firms (Acharya et al., 2011).

A more broadly-conceived notion of agency theory may help to explain why certain types of internal governance, for example monitoring of senior managers by their peers and subordinates, may be a viable alternative to monitoring by independent directors or external shareholders. Peer-based, internally-focused monitoring systems may be incentive-compatible where employees below the level of senior management have investments in firm-specific human capital at stake in the firm (Aoki and Jackson, 2008). Internal governance may also be more effective than external control in contexts where insiders have greater access to the information needed to observe and evaluate managerial performance (Acharya et al., 2011). These perspectives suggest counter-claims to those advanced by the 'standard' principal-agent model, namely that the shareholder primacy norm will not be universally observed at the level of managerial practice (Aoki, 2010: 13), and that there are limits to the convergence of national corporate governance practices around that model (Aguilera and Jackson, 2003: 462).

4. Methodology

Our approach in this paper is to assess the phenomenon of hedge fund activism in Japan using a qualitative research design. Qualitative research is helpful here because, among other things, it permits an intensive study of a discrete or bounded phenomenon without the need to come to a preliminary view on the nature of the material being explored or of the causal processes involved. As Poteete et al. (2010) put it in the context of their recent defence of multiple-methods research, issues which tend to be treated as assumptions in econometric analysis, such as the homogeneity of the categories or units of analysis under examination and the independence of observations of those units, can remain flexible and be treated as hypotheses in qualitative studies, to be refuted or confirmed on the basis of evidence as it emerges from interviews and documentary sources. In addition, qualitative research makes it possible to explore 'anomalies, multi-stranded relationships, or unanticipated patterns, that suggest the limits of general patterns and call simplistic relationships into question' (Poteete et al., 2010: 35). Thus the advantage of a qualitative approach, in the present context, is that we can treat some of the assumptions made by the 'standard' principal-agent model – in particular, the assumption that shareholders act as 'owners' and 'principals' with respect to managers who are constituted as their 'agents' – as claims, suitable for empirical testing through methods which emphasise 'narration, description, interpretation and explanation' (Pettigrew, 2013: 124).

During the six years from 2007 to 2012 we made 43 formal contacts with activist or value hedge funds, targeted companies, institutional investors, and other interested parties, in addition to having a number of shorter discussions by telephone. This total includes 13 repeat visits where we monitored the progress of interventions and other developments in the market. We spoke to partners and senior officers of six hedge funds operating in Japan, not all of whom would accept the description 'activist' but whose investments attracted attention in the Japanese press, and also to partners of two funds operating outside Japan. We spoke to CEOs, directors and other senior officers of five targeted companies, both during and following interventions. We also met senior representatives of seven institutional investors and their agents holding share portfolios in Japan, both Japanese and non-resident, and one operating exclusively outside Japan. We had further contact in Japan with providers of market infrastructure, associations, lawyers, commentators, civil servants, and untargeted companies (see the Appendix for a summary). These 43 interviews are the core of the material we present in this paper, although we also draw on some data from earlier interviews in Japan investigating corporate governance practices in general, conducted during the period 2003-6, where responses gave insights into the thinking of managers and investors.

We used an interview protocol that was designed to permit an open-ended, exploratory discussion. Our format was a generic set of interview questions, customised to the circumstances of the respondent company or organisation and focused on hedge fund activism, usually touching on specific aspects of transactions currently in progress for particular funds or targets. The final document in each case consisted of 10-20 open questions, expressed in a neutral manner but incorporating sufficient information on recent developments of perceived importance to the interviewees to reassure them that we were capable of an informed discussion. We used these questions to give initial structure to the interviews and to ensure that certain key issues were addressed, but we did not seek to prevent the conversation moving to related topics of especial interest to our interviewees. The majority of the interviews in Japan were conducted in Japanese but a small minority were in English. They were recorded and transcribed and the Japanese texts were translated into English. The average duration of interviews was about an hour, resulting in transcripts on average around 6,500 words in length. Material from the transcripts was coded in ATLAS.ti using emergent categories.

The language used by our interview respondents does not map precisely on to the conceptual categories of agency theory. We can nevertheless identify, from the interview responses, emergent themes, which throw light on the actors' perceptions. In this respect we are following the suggestion of McNulty et al. (2013: 192), drawing on Suddaby (2010), that qualitative research should aim to elucidate 'concepts or constructs that are grounded in actors' meanings'.

We also used public information from the press, company announcements, and official disclosures on the Japanese Financial Services Agency's Electronic Disclosures for Investors Network ('Edinet') system, which shows movements of 1% or more, either up or down, in shareholdings at listed companies above a 5% benchmark, to construct a wider dataset of hedge fund interventions. This allowed us to extend our study beyond the situations investigated through our interviews and to form a wider view of developments.

All the interviews were conducted on a non-attributable basis, whereby we undertook not to identify either the interviewee or the organisation without permission. We think this made it possible to have more candid and wide-ranging discussions than would otherwise have been the case. The interview material we obtained was very rich and detailed, but was also highly sensitive, both commercially and politically, and remains so today. The need to ensure confidentiality and anonymity prevents us from presenting our interview material in the immediate context of a discussion of particular hedge fund interventions. For this reason, the case study evidence we present in the next section is based only on publicly available data. Our interview material is presented in a separate section, in a way which does not permit identification of individual interviewees or organisations.

5. Case studies

We now present our findings. In this section we present two case studies, on Bull-Dog Sauce and J-Power. These cases are chosen not because they are necessarily more representative of general trends in hedge fund interventions than others that we could have chosen, but because they relate to two particularly high profile sets of events. It was these two cases above all others which triggered public debate over hedge fund activism in Japan during the 2000s (for example, *Nihon Keizai Shimbun*, Japan's leading financial newspaper, carried 280 articles on Bull-Dog Sauce and 670 on J-Power in its morning and evening editions during 2007, while these interventions were in progress). These two cases also exemplify the obstacles activist hedge funds faced in their attempts to induce changes in target firms.

5.1 Case study 1: Bull-Dog Sauce

Steel Partners appears to have begun to purchase shares in Bull-Dog Sauce, a medium-sized condiment manufacturer, from late 2002, according to the press release that accompanied its subsequent tender offer for the company in May 2007. From 2005 it began to press the board to take steps to realise shareholder value, through, among other things, an MBO. These approaches took place in private but were alluded to in later exchanges and appear to have been rebuffed, with the attitude of managers shifting from initial surprise that the company should have been made a target, through uncertainty over Steel Partners' intentions, to outright opposition once those intentions seemed clearer. In May 2007 Steel Partners submitted a hostile tender offer for the company. The board responded with a 'defence plan' under which it proposed to issue stock options to its existing shareholders, giving them the right to receive three additional shares, without payment, for each one already held. Under the plan, all shareholders except Steel Partners were to be allowed to convert their options into new shares; Steel Partners alone was to receive compensation in cash, thereby receiving the same financial value as the other shareholders, but seeing its stake in the company reduced from around 10.5% to around 3%. The plan had to be approved as a special resolution by two thirds of the voting rights. Around this time, the board published a letter from the company's employees, opposing the bid on the grounds that it would harm the company's relations with its customers. At a meeting in June 2007 between Steel Partners' managing partner, Warren Lichtenstein, and Bull-Dog Sauce's CEO, Ikeda Shōko, later described in the press, Lichtenstein apparently did not respond to a request from Ikeda for details of his post-acquisition plans for the business. He is reported to have shown no sensitivity to Bull-Dog's tradition as a manufacturer of sauces and to have concentrated instead on financial numbers, a response which led the company's lawyer to conclude that Lichtenstein 'was not out to improve Bull-Dog' (Asahi Shimbun, 2008).

Steel Partners applied to the Tokyo District Court for an injunction against the board's defence plan, but this was refused. Subsequent actions through the Tokyo High Court and the Supreme Court were equally unsuccessful. Steel Partners eventually received a special payment from the company in July 2007 of ¥2,300 million (approximately US$18.9 million at the prevalent exchange rate). The return on the investment was ostensibly good, but the litigation surrounding the Bull-Dog Sauce intervention marked the start of a public backlash against this kind of confrontational hedge fund activism. The judgment issued by the Tokyo High Court observed that although a joint-stock company was, in principle, a for-profit organisation that should maximise its corporate value and return part of the surplus as dividends to shareholders, such a company could not realise a surplus except through association with employees, suppliers and consumers. The judge adopted an expression used in the Livedoor-Nippon Broadcasting ruling of 2005 and stated that it was permissible for the board to treat an 'abusive acquirer', which threatened the health of the business, in a discriminatory way in order to protect the company (Tokyo High Court, 2007). The wording of this judgment was controversial in legal and financial circles (Miyake, 2007: 187-91, Nikkei, 2007), but it was upheld in the Supreme Court, which, while not emphasising the term 'abusive acquirer', confirmed that a bidder which had no long term plan for the target firm could be discriminated against in the course of a defensive rights issue which a relevant majority of the other shareholders had voted to approve (Hayakawa and Whittaker, 2009). Steel Partners had limited recourse to tender offers in Japan after this point.

The events surrounding the Bull-Dog Sauce intervention illustrate important aspects of the Japanese environment that differ from those of the USA, where Steel Partners had established its reputation. Steel Partners had begun its investments in Japan in 2002, concentrating initially on smaller companies with cash surpluses where the boards were unused to dealing with assertive shareholders. Bull-Dog Sauce had much in common with these targets but by 2007 the shock of activism had lessened and features of the environment which were not conducive to activist tactics began to assume greater prominence. At Bull-Dog Sauce, Steel Partners was dealing with a board composed of internal appointees who had few concerns for their reputation beyond their standing in the company; it was difficult to embarrass them by criticising their style of management as long as they were seen as being devoted to their company's success. This board was focused on internalised corporate value and a long-term view that outweighed shareholder value or even immediate financial considerations. The majority of the shareholders, who were not pure portfolio investors but companies with which Bull Dog Sauce had long-term business relations, appeared to support the board's position, as witnessed by the approval of the defensive action against Steel Partners by 88.7% of votes, representing 83.4% of registered shareholders. As Xu and Tanaka observe in their study of this case, 'in the struggle for control of Bull-Dog Sauce, the decisive factor had nothing to do with the existence of the defence mechanism or the courts' judgments: cross-shareholdings determined from the outset that Steel Partners would lose' (Xu &Tanaka, 2009: 10, 14). At the AGM, only Steel Partners' lawyer expressed the opinion that the large sums spent on the defence, not to mention the cash payment earmarked for Steel Partners, could have been used better to the benefit of the business and its shareholders. At Bull-Dog Sauce there were no independent directors to argue for greater distribution to shareholders and to support Steel Partners' demands. The courts effectively endorsed this situation. The comments of the Tokyo High Court judge, while criticised for their emphasis on the controversial idea of an 'abusive acquirer', were in tune with public sentiment as evidenced by press comment at the time: the company was more than a commodity to be traded at will by shareholders for their particular benefit. Steel Partners' inability or unwillingness to put together a long-term plan for the business and its willingness to leave existing management in place was seen not as the rational policy of a professional investor but as denial of the responsibility expected of a prospective owner, and hence as proof of 'abusive' intent.

5.2 Case study 2: J-Power

TCI's intervention in J-Power, a large electrical utility, began with share purchases in late 2006. This shareholding had risen to 9.9% by March 2007, just short of the 10% threshold beyond which TCI, as a non-resident investor, would require official permission to increase its holding in an energy-related business categorised as of national strategic importance. During the spring of 2007 TCI mounted a campaign of financial arguments for restructuring, which included a proposal to double the existing annual dividend. This was voted down at the company's AGM in June, but more than 30% of the shareholders supported it, a high figure given that J-Power had significant cross-shareholdings which in practice guaranteed a certain level of support for its board.

TCI then intensified its campaign. In early 2008 it announced its intention to increase its stake in J-Power to 20% and subsequently submitted a detailed management plan calling for greater geographical diversification of the company's operations and the sale of its cross-shareholdings. In April 2008, a joint committee of the industry and finance ministries advised TCI informally not to increase its holdings beyond 10%, on the grounds that to do so would undermine J-Power's investment plans (which then included the construction of a new nuclear power plant) and put the nation's power supply at risk. In May 2008 TCI made a number of allegations of misconduct against J-Power's board, including charges that the company had unjustifiably reduced tariffs to customers, leading to a decline in earnings, and that it had unpublished commercial agreements with its cross-shareholding counterparties. In the same month, the ministries formally prohibited any increase in TCI's holdings beyond the 10% threshold. The announcement by the ministries' advisory committee made clear that TCI was considered to be short-term in outlook and unsuitable as a major shareholder in a business of national importance. TCI made a further attempt to change J-Power's dividend policy at the June 2008 AGM but this was voted down. TCI was reported to have won between 20% and 40% of the vote on its various motions, but was opposed by a majority of shareholders, presumably stiffened by the votes of cross-shareholders and other trade relationship shareholders (FT, 2008a, 2008b).

In October 2008 TCI sold its 9.9% stake back to J-Power, taking advantage of a corporate restructuring that, under Japanese law, enabled dissenting shareholders to return shares at a negotiated off-market price. This sale was estimated by the press to have represented a loss to TCI of some ¥12,500 million (approx. US$124.4m) (FT, 2008c, Nikkei, 2008). TCI's intervention did have a limited impact on J-Power: during 2009 the board formally announced its intention to implement defensive action against any harmful acquisition attempt in the future and the proportion of foreign shareholdings in the company stabilised at below 20%, half the level prior to 2007.

TCI's strategy at J-Power was distinct from that of Steel Partners at Bull-Dog Sauce. Where Steel Partners had identified a cash surplus and low market valuation at its target, TCI followed the pattern of its European successes by analysing the details of a large and complicated organisation to identify what it believed to be weaknesses in strategy and financial structure, and then sought the support of like-minded investors to compel the board to change its policies. Although J-Power's directors were probably more sophisticated in their financial knowledge than those of Bull-Dog Sauce and although they were certainly more familiar with international investors' thinking because of their company's privatisation exercise in 2004 and subsequent annual information meetings, certain common elements are evident. Once again, the activist hedge fund faced internal appointees who valued their record to the company above the opinion of external investors. Even though J-Power's board probably had a much keener awareness of the need to reward shareholders than had been the case at Bull-Dog Sauce, they still prioritised internalised corporate value and long-term returns over immediate shareholder value. Although some of the foreign shareholders probably voted with TCI on at least some of its AGM motions, there were still sufficient shareholders which valued business relationships or simply shared the board's longer-term vision to block calls for increased dividends. TCI's disagreement with the ministries only served to add another level of rejection. As with Bull-Dog Sauce, the independent directors who in an American or British context might have argued for the right of shareholders to higher short-term payouts were simply absent, although J-Power subsequently did appoint an external director, implying that some of the shareholders which had supported management considered this desirable.

6. Interview-based evidence on the perspectives of activists, managers and shareholders

We now draw on our interview data to complement the narrative account just given of these two high-profile activist hedge fund interventions. As explained above ('Methodology'), we conducted interviews with a number of funds and target companies, as well as with untargeted companies and other relevant actors including institutional investors, lawyers and associations. The sample of interviewees includes many of those who played a central role in the Bull-Dog Sauce and J-Power cases, but it also ranges more widely to incorporate some who were involved in other interventions, and includes a minority who commented as observers rather than as direct participants. We draw on this wide range of interviews in the account which follows. For reasons of confidentiality, we do not indicate whether a particular respondent was involved in either of the Bull-Dog Sauce or J-Power interventions.

To facilitate the presentation of our interview material, we reproduce in Table 1 a selection of quotations from our interviews which are characteristic of the responses of fund managers ('activists'), corporate executives ('managers') and domestic Japanese investors ('shareholders') respectively on three emergent themes which are relevant to their interpretations of hedge fund activism: managerial accountability, shareholder value, and time horizons.

TABLE 1
Actors' interpretations of hedge fund activism

Actors:	**Activists**	**Managers**	**Shareholders**
Themes:			
Managerial accountability	*Japanese managers should not identify the company with themselves* 'I think people use the wrong language: "the company"? no: "I am the company" - so I am very careful about my language. I'm not fighting [the target company], I'm fighting [the target company's] management. Management is fighting [the target company]. So management is entrenched and they can't be changed. That's the real issue.' *Japanese managers do not enough pay attention to shareholders' interests* 'Shareholders are not all that highly regarded and shareholder views are not highly regarded because [managers] think they don't need to [listen]. There is no incentive to listen to shareholder views: you don't unless you have to.' *Japanese shareholders do not give sufficient support to the hedge funds in holding management to account*	*Management is responsible to multiple stakeholders* 'I always say that there are broadly speaking three sets of stakeholders in our company: one is the shareholders, another is the customers, and the third is the employees, including the management. I think the most important element of managing the company is to keep these three - this triangle - in balance. In order to maintain that stability and proceed with both growth and stability in balance with one another, a company, for example, that just pays attention to its shareholders and continually applies its profits to those shareholders will end up withering away at some stage in the future.' *Management aims to cultivate a supportive shareholder base* 'Whether they are foreigners or not, what's important is what sort of shareholders they are. Are they hedge fund-related? Are they shareholders	*Japanese firms are not run primarily with shareholder returns in mind* 'There is a perception gap between the typical notion of how a company should be managed. On the one hand probably hedge funds, or typical foreign investors, expect that the companies should be managed to maximise the profits for shareholders' return, but on the other hand I sense that the traditional Japanese companies, or managers of traditional Japanese companies, think that a company should be managed to increase employment, provide continuous novel products to the marketplace, and profit making is just a condition to fulfil those social responsibilities.' 'I think people like to see a company being managed more efficiently, and a company becoming more profitable, and serving shareholders' wealth, you know, serving shareholders better, but I think that sometimes society, probably Japanese society, puts emphasis on other aspects of benefit the company brings in. So as long as a hedge fund or a fund manager is creating efficiency for

	‘Activism only works when you have pressure from shareholders, so in Japan that is the number one thing: you have enough shareholder votes and you win... But the trouble is, the shareholders are not motivated and that is where there is a big difference between Japan and other countries… You have a large section of shareholders and domestic investors, particularly maybe the life insurance companies, who regularly vote with the company.’	who practise activism? Are they institutional shareholders who go for growth or value: what you might call “orthodox institutional shareholders”? ...If they are orthodox institutional shareholders then even if they are foreigners I think we can expect them to hold our shares without problems in the belief that our company will grow.’ *Management has autonomy to decide strategy* ‘Right from the start, [we] had been considering increasing the dividend year by year and raising it like this in line with the company’s performance, but our basic policy was to raise the dividend in a way that was as stable and sustainable as possible, not by raising it on one occasion only to lower it if our results deteriorated.’	society, creating wealth for society, in a socially acceptable way, that I think will be acceptable. But sometimes when they buy a company, lay off people and just [consider] the financial shareholders’ benefit, that is not acceptable socially.’
Shareholder value	*Japanese shareholders do not care about shareholder value* ‘There [is] now more acceptance of shareholders at companies but still a lack of understanding among	*Managers are unwilling to prioritise shareholder interests* ‘In a sense we can understand [the activists] very well at the level of their general conversation...but we do not	*Japanese institutional investors prioritise business relations over share returns* ‘The domestic institutional investors are subsidiaries of financial institutions that have relationships with corporates. So, in

managers of what a public company [is] and how it should act.'

'Domestic shareholders in Japan don't think the same way [as in the USA or Europe], they are not profit minded, they are not motivated by shareholder value, not motivated by shareholder return.'

Japanese institutional investors are hindered by having dual financial and business interests

'[We] spoke to some Japanese institutions about [some of our holdings] and the institutions expressed themselves willing to meet and to listen to what [we] had to say but they were mostly hindered by their double roles as both investors and business partners to the target companies.'

'[Japanese shareholders] are very conflicted on the many outcomes which are mutually exclusive, so it is a tough one for them. I don't think they are aligned with us and more likely they are just aligned with the company - they don't care about the share price.'

think in terms of deciding the way we manage or our dividend policy just on the basis of shareholder value.'

Managers do not associate releasing cash to shareholders with improving the efficiency of the firm

'We realise that, obviously, [they] chose [our company] as an investment target purely as a means to raise their own returns and that all this talk of "improving the company" was just talk… Now I ask myself exactly what were all those demands for capital efficiency that they developed over the past two years, or what they meant by talking about improving governance.'

Managers resist calls to release cash where this will harm the firm's business

'They are logical and they have extremely logical demands and ways of developing the situation and ways of saying things, but at the end of the day they are seeking a quick profit....but because they aim for very fast realisation of profit in a short space of time, in order to achieve this they say what we consider to be pretty unreasonable things.'

that delicate circumstance, if the targeted company is a business counterpart of a financial institution, if there is some company that confronts activists, and those activists come to you to ask for support but you are a subsidiary of a financial institution that has a relationship with the targeted company, you have no way to support [the] activists, otherwise the salespeople of the financial institution come to you and become very [annoyed with] you. I think that's a typical case.'

Japanese shareholders prioritise long-term relations with the company over short-term gains

'For ourselves or some other institutional investors, if I sell this share to [a hedge fund], if we think of a 10 years result, which is better? To keep these shares by gaining the 3 or 4 very small percentage of the return every year for 10 years? But if we sell to [a hedge fund] they will give us a rather big initial return for our sale. But they don't know the company, they don't know how to run it, and in 3 years time they might fail. So in 10 years return I think it's better to keep it for ourselves, not to sell to them.'

Time horizons	*The long term is a sequence of short terms* 'To call the funds "short term" is to have a massive neglect for why you have a stock market in the first place. The stock market is to trade, so people are trading every day and if you take the logical conclusion, if you push their logic to the very end, which is that if everybody is "long term" – meaning they don't trade their shares - then there is no stock market. Your country goes to pieces.'	*Firms should be managed for the long term (at least 3-5 years ahead)* '[They] tell us suddenly to double the dividend, they tell us to make a share buy-back, or else, irrespective of the fact that we consider ourselves to be one of the firms within our sector that, in a sense, makes the greatest use of financial leverage and in effect frequently has recourse to liabilities, they tell us to borrow even more loans: from our point of view as we seek to manage in a long-term, stable manner, this suggests that these people are only thinking in terms of about three or five years, so we feel that there is simply no common ground, you see.'	*Japanese shareholders seek to build relationships with managers and invest for the long term* 'If you ask me, whether there is general acceptance of activists in Japan, I don't think [so] for ourselves [life insurers], [or] for the pension funds… they will put some question marks still on the approach of the activist fund…The long-term investment or the long-term management view is to know the company much better…Unless [the hedge funds] have that kind of approach, ourselves or the pension funds will not so much easily accept those ideas.'

We first consider responses indicating attitudes to the theme of managerial accountability. The activists took the view that Japanese managers were wrong to identify the firm with themselves when they talked about defending the firm against activism: as one fund manager commented, 'I think people use the wrong language' when they say 'I am the company'. This was related, according to the activists we spoke to, to a tendency on the part of managers to disregard the views of shareholders (managers 'think they don't need to listen', said a hedge fund respondent) and thereby to reject any notion of accountability to shareholders as a group ('management is entrenched and they can't be changed', according to one activist).

Managers took a diametrically opposed view. Managers did not see themselves as having a specific responsibility to shareholders. They saw accountability in terms of commitments to multiple constituencies with an interest in the firm. Their job was to maintain a balance between what one executive referred to as 'three sets of stakeholders', shareholders, customers and employees, in order to ensure the 'growth and stability' of the firm over time. Rather than viewing their role in terms of serving shareholder ends, they thought that shareholders *should support them* as long as they were visibly serving the goal of maintaining the firm over the long term. To this end, management had a duty to cultivate a supportive shareholder base, one which would 'hold our shares without problems in the belief that our company will grow'. As one executive put it, 'we want a particular kind of investor'. This company was engaging in an investor relations campaign in order to attract what this respondent referred to as 'the investors we want as shareholders'.

What is perhaps most surprising and striking, from the point of the standard agency-theoretical model, is that domestic Japanese shareholders shared the perspective of managers on the issue of accountability. They understood very well the view of the activists that listed companies should be managed to maximise shareholder returns, but accepted in practice that Japanese firms were run in order to return value to workers and customers as well (to 'increase employment' and 'provide continuous novel products to the marketplace', as one shareholder we spoke to put it), and that being profitable was just a means to these ends ('a condition to fulfil those social responsibilities'). Accordingly, one of the shareholders we interviewed considered that for managers to consider just 'financial shareholders' benefits' would not be 'socially acceptable' in Japan, and hence impracticable as a basis for his own approach to corporate governance.

In relation to the second theme, that of shareholder value, we again see tensions between the views of the different groups. The activists complained of what a hedge fund manager called a 'lack of understanding' of the principles of finance, not just on the part of corporate executives, but also on the part of shareholders who were, according to one hedge fund interviewee, ‘not profit minded’ and ‘not motivated by shareholder value’: they simply ‘don’t care about the share price’. Shareholders were, as one activist put it, ‘conflicted’, that is, ‘hindered by their double roles as both investors and business partners to the target companies’.

Managers, on the other hand, were explicit in their rejection of the logic of shareholder value. Even a core issue of financial strategy such as dividend policy was not decided, according to one executive we interviewed, ‘on the basis of shareholder value’. According to a manager we spoke to from a target firm, references by the hedge funds to improving the capital efficiency of the firm through asset divestments and share buy-backs was ‘just talk’ since ‘at the end of the day they are seeking a quick profit’. Although managers accepted a need to raise dividends (conceding the general pressure to raise returns from pension funds and other shareholders) they insisted that they alone should determine the timing and extent of any increase. In similar vein, an association official, commenting on the views of managers, told us, ‘if shareholders demand unreasonable dividends or changes in the management, then I think that this becomes a scenario where they are acting as hostile acquirers rather than as shareholders’.

Shareholders’ views on shareholder value are again revealing. Some investors we spoke to recognised the possibility of a conflict of interest or ‘delicate circumstance’ in the terms suggested by the hedge funds: as one put it, if ‘you are a subsidiary of a financial institution that has a relationship with the target company, you have no way to support the activists’. Others, however, offered a different rationale for their scepticism towards activism, one based on the inability of the hedge funds to offer a viable long-term plan for the companies they were targeting: according to one shareholder, ‘they don’t know the company, they don’t know how to run it, and in three years’ time they might fail’, so, with a ‘ten-years result’ in mind, ‘it’s better to keep it to ourselves’. A not atypical view from our shareholder respondents was ‘our investment is five-ten years’ with the result that ‘we can probably accept some bumpy earnings for the next couple of years if we really believe the management can do the right thing for the shareholder’.

The third linked theme to emerge from our interviews is that of time horizons. The activists we spoke to did not deny the importance of a long-term perspective, but argued that the long term was, at the end of the day, simply a series of short terms: as one of them put it, a stock market is about ‘trading every day’ so if you take the logic of long-termism ‘to the very end’ then ‘there is no stock market’ and ‘your country goes to pieces’.

By contrast, for managers who sought 'to manage in a long-term stable manner', as one of them put it, even a three to five year time horizon was too short to provide 'common ground' with the activists. 'Managers understand shareholders', we were told by an executive at a market infrastructure entity, as those with long-term holdings, so that 'they just do not consider people who are doing it for the sake of short-term profit to be shareholders at all', while a senior corporate officer commented, 'we don't want to manage with any sort of short-term selling and buying of shares that threatens to disrupt the company, with things taken to extremes whereby other shareholders wonder what is going on'.

Shareholders mostly agreed with the managers' position on time horizons. They were not necessarily opposed to the idea of dividend increases, but they stressed the need for sustainability of financial returns over the medium to long term, and expressed their willingness to oppose demands for dividend increases from hedge funds where these would result in short-term gains only. Thus they would not 'easily accept' departing from the 'long-term investment view' of getting 'to know the company much better', as one of our shareholder interviewees put it.

7. Discussion

The qualitative research we have presented casts light on the reasons for the limited impact of hedge fund activism in Japan. These can be summed up in the generalisation that in Japan shareholders do not act as principals and managers do not act as their agents. What we mean by this, firstly, is that Japanese shareholders do not regard themselves as fulfilling the roles that the 'standard' agency model ascribes to shareholders. In particular, they do not see themselves as 'owners' either of the enterprise itself or of the 'residual' or surplus generated from production. As our interview materials indicate, they do not view the company as being managed for the purpose of maximising shareholder value. The case study evidence points the same way: in publicly rejecting the hedge funds' calls for the divestment of corporate assets and for increased dividend payments in the high-profile Bull-Dog Sauce and J-Power cases, domestic Japanese shareholders displayed a very different logic from that associated with shareholder behaviour in the standard model.

Nor do Japanese shareholders generally see their role as disciplining managers. When pressed to do so by the hedge funds in the cases we have examined, they explicitly adopted a stance that was, on the contrary, supportive of management. The interview materials suggest that domestic Japanese shareholders do not see management as accountable solely or principally to them. On the contrary, they accept that managers should serve the well being of multiple constituencies, including workers and customers, and should be held to account accordingly.

Conversely, Japanese managers do not view themselves as acting on the shareholders' behalf, in the sense of being accountable to them above other corporate constituencies or groups. As we see from both the case studies and the interview evidence, when the activist hedge funds first attempted to assert the logic of shareholder primacy in their dealings with target companies, the initial reaction of managers was often one of bewilderment and surprise. This later gave way to open resistance as managers mobilised the support of domestic shareholders and all other resources available to them to oppose the activists. As our interview materials suggest, managers in companies targeted by hedge funds thought that shareholders, far from taking the opportunity provided by the hedge funds to hold them to account, should actively support them in their strategy of resisting the funds. Relatedly, the Japanese managers we interviewed rejected the logic of shareholder value, explicitly framing their responses to the hedge funds by reference to the need to maintain a 'balance' between shareholders, customers and employees.

Overall, we think that there is evidence of what one of our respondents referred to as a 'perception gap' in the views of the hedge funds, on the one hand, and of managers and shareholders in the firms they targeted, as well as more generally, on the other. The hedge funds articulated their position in terms of the logic of shareholder primacy which informed their strategies and practices, but this logic was explicitly rejected by managers and shareholders. Japanese managers in the targeted firms did not see themselves as 'charged with the obligation to manage the corporation in the interests of its shareholders' (Hansmann and Kraakman, 2001: 441), any more than domestic Japanese investors in these firms would have accepted the proposition that 'ultimate control over the corporation should rest with the shareholder class' (Hansmann and Kraakman, 2001: 440).

If the standard principal-agent model, with its stress on shareholder primacy, holds little sway in Japan, what alternative model sustains the distinctive governance practices and structures of the Japanese firm? Drawing on our case study findings and interviews as well as the wider literature on corporate governance in Japanese companies, we suggest that the critical feature of governance in the Japanese firm is its *internal orientation*. This has a number of features.

Firstly, notwithstanding some signs of the emergence of a labour market for top executives, the large majority of senior managers in Japanese firms still achieve their position through internal promotion, with the result that management structures in Japanese firms are characteristically coalitions of insiders (Olcott, 2009). This arrangement encourages peer-based monitoring among senior managers: the typical Japanese CEO 'gets to the job after several years as one of five or six colleagues – nearly all people who have been his/her colleagues for all their working life – continually under observation by superiors and peers as potential competitors for the career-culminating honour of being chosen for the top job' (Dore, 2009: 391).

Secondly, external directors generally do not play a significant role in monitoring management. Most boards remain dominated by executive managers who, as explained, generally have long experience of working within the organisational structure of the firm. Even in the case of companies with committees, external directors are generally seen as advisers on matters relating to their specific area of expertise; they are not treated as representatives of outside capital (Buchanan and Deakin, 2008).

Thirdly, many domestic shareholders in listed Japanese firms have an internal orientation. Many invest primarily to maintain business relations with the investee company, and see financial returns as a secondary consideration. Foreign shareholders, by contrast, tend to invest for returns, and the growth in the size of their holdings is, in general, associated with increased sensitivity of management to financial criteria, as well as with greater recourse to downsizing and asset disposals (Ahmadjian, 2007). However, in the activist hedge fund interventions we studied, foreign shareholders were not sufficiently influential or numerous to bring about a change in corporate strategy of the kind favoured by the activist hedge funds. In the J-Power case (where AGM voting results suggest that at least some foreign investors supported the board), a formal cap on the extent of any individual foreign holdings further helped management to resist pressure from hedge fund activists.

In the paradigmatic Japanese firm, issues of monitoring, accountability, and related agency costs are not absent. However, monitoring is generally carried out by insiders: senior managers and other employees who have the opportunity to monitor top executives from a position of inside knowledge, and long-term shareholders whose business ties to the firm put them in a position to make informed judgments on managerial performance.

This model of internal governance is stable for two interlocking reasons: insiders have both the incentives and the means to engage in effective monitoring. Senior managers and employees, on the one hand, and long-term shareholders, on the other, make asset-specific investments in the firm. These investments and the resulting lock-in effects give them strong incentives to expend resources on monitoring senior executives over extended periods of time. Their status as insiders also gives them access to the information they need to make monitoring effective over long periods. From an agency cost perspective, internal governance along Japanese lines is both incentive-compatible and efficient in terms of the resources devoted to it. This results in the type of highly stable, robust Japanese firm in which, as our materials indicate, managers and domestic shareholders think in terms of extended time horizons on matters such as dividend policy and investment strategy.

The account we have just given is consistent with developments in the study of agency theory. In their recent reformulation of agency theory, Acharya et al. (2011) point to the need for a model which can explain the stability of governance arrangements in the many publicly listed firms where, the rhetoric of shareholder primacy notwithstanding, shareholders have little control over boards, boards are poorly informed with relation to top managers' decisions, and outside equity can at best exercise 'the crude but basic property right to take over the firm', leaving it with little or no operational influence (Acharya et al., 2011: 691). They argue that peer-based monitoring among managers is efficient where the CEO and senior managers together contribute to the creation of firm value. Their model posits multiple residual claimants, in which 'anyone who shares in the quasi-rents generated by the firm has some residual claims' and 'there is no easy equivalence between maximizing shareholder value and maximizing efficiency' (Acharya et al., 2011: 692).

Our findings also tally with what is known, more generally, about the evolution of corporate governance practices in Japan when viewed in a comparative perspective. Recent studies emphasise dual elements of continuity and change in Japanese corporate governance and managerial practice (Aoki et al., 2007; Whittaker and Deakin, 2009). Japanese corporate governance has been exposed to multiple pressures for change, including a growing role for overseas share ownership and regulatory and legal changes drawing on foreign models. Some of the imputed mechanisms of governance associated with the Japanese model in the immediate post-war decades, such as monitoring by banks or business groupings, have diminished in influence (we encountered very little evidence of either in our case studies and interviews), while a significant segment of the listed company sector, including the most technologically advanced and export-orientated firms, may be moving to a 'hybrid' model combining communitarian aspects of corporate organisation with the use of financial criteria to benchmark the firm's performance and greater transparency with respect to shareholders (Jackson and Miyajima, 2007; Aoki, 2007). Yet these changes do not signify a shift in the Japanese model of the kind that would imply convergence on American or, to a lesser degree, European practices. As other studies have shown in the context of engagement with Japanese firms by overseas institutional investors (Jacoby, 2007a, 2007b), and as our own research reported above confirms, the Japanese system tends to reject direct transplants of corporate governance practices originating in other contexts. Growing accommodation of shareholders' interests in Japan is likely to take the form of an emphasis on dialogue and deliberation behind the scenes, rather than the public and often confrontational encounters between activists and managers that continue to be a feature of the US market.

8. Conclusion

In this paper we have presented the results of qualitative research into hedge fund activism in Japan. Hedge fund activism is a phenomenon which researchers and practitioners alike have associated with the 'standard' agency-theoretical claim that listed companies will be more productive and successful when managers act as 'agents' and shareholders as their 'principals'. Activist hedge funds, from Japan and overseas, entered the Japanese market in the early 2000s with a view to implementing a strategy, informed by this belief, which had worked well in the USA and also in Europe to some extent, which they thought would benefit firms and the wider economy in Japan, while generating returns for their investors. Specifically, funds pressed boards at small, cash-rich firms to distribute reserves to shareholders through higher dividends or share repurchases, and called on boards of larger companies to divest surplus assets and take on more debt to finance growth. The funds saw themselves as asserting ownership rights of shareholders which had lain dormant in Japan, while imposing capital market disciplines on managers and employees, in a way that would improve firm performance.

The response of Japanese boards to activist hedge fund interventions was firstly one of surprise, but soon turned to resistance. Other constituencies, including domestic shareholders as well as courts and government officials, supported management in its resistance to the hedge funds' demands. By early 2008 the influence of the funds had peaked and in the aftermath of the global financial crisis they wound down their Japanese investments. As the initial shock of the crisis has abated, confrontational hedge fund activism has revived in the USA and to a lesser extent in Europe, but not in Japan.

Our qualitative research design enabled us to treat the view that managers act as the agents of shareholders as a claim open to empirical testing through direct access to the meanings and interpretations of actors, rather than as an assumption embedded in formal economic models and statistical testing. We found that Japanese managers see themselves as responsible for preserving and growing the firm over the long term, and reject the idea that they should act primarily as the representatives of the shareholders. More surprisingly perhaps from the point of view of the 'standard' model, domestic Japanese institutional shareholders largely share this view. They see their role as an inherently supportive one. While many were investing for financial returns as well as to maintain business links, they took a long-term view of their investments and opposed the funds' aim of realising shareholder value in the short term through increased dividends and share repurchases.

Our findings have implications for agency theory and for comparative corporate governance research. They do not imply that agency costs, and the related need for mechanisms of accountability and monitoring, are absent from the Japanese firm. They do suggest that internal governance, based on peer-based monitoring among senior managers and informed oversight by other insiders including employees and long-term shareholders who are often business partners, is a viable alternative to external monitoring based on independent boards and the exercise of control rights by outside capital. In its own national context, at least, the Japanese model is stable, and while Japanese corporate governance exhibits elements of both continuity and change, it is unlikely to converge on American or European practice.

Our findings are necessarily limited by the nature of the qualitative methods we employed, by our use of a single country case, Japan, and by our focus on a particular episode, the hedge fund activism of the 2000s in Japan. Clearly, there are limits to how far our findings should be extrapolated beyond Japan, while even within Japan it is not the case that all listed companies exhibit the characteristics of the firms whose experiences we have reported. At the same time, our research has provided an in-depth analysis of events of considerable significance for corporate governance policy and practice, within and beyond Japan, using a methodological approach which was appropriate for the issues which were being researched, and producing evidence of a kind which remains rare in this field, given the difficulties which researchers face in accessing key corporate governance actors involved in commercially sensitive transactions, difficulties which are certainly no less of a barrier in Japan than in other countries.

Our work also has the potential to advance corporate governance research in several ways. Firstly, at a theoretical level, it prompts the question of whether the concept of internalism, as recently explicated by Acharya et al. (2011) and as applied in this paper, could provide a basis for analysing the diversity of corporate governance forms both within and across national systems, in a way which addresses the limitations not just of the 'standard' agency-theoretical model (as Hansmann and Kraakman, 2001, term it), but of alternatives to that model, such as stakeholder theory (Blair, 1995) and stewardship theory (Donaldson and Davis, 1991), which have challenged but failed to displace the 'standard' approach. Secondly, our work opens up new avenues for empirical work to explore the application of the internalist model to firms outside Japan, as suggested by Acharya et al. (2011). There may also be much to be gained from exploring the idea that shareholders in jurisdictions apart from Japan do not readily see themselves as ‘principals’ or ‘owners’ of the enterprise, as recent research suggests may be the case in the United Kingdom (Tilba and McNulty, 2013). Thirdly, our methodological approach, which stresses the value of qualitative, longitudinal research in understanding a complex phenomenon such as hedge fund activism, can be seen as a contribution to debates over the diversity of research methods in the social sciences (Poteete et al., 2010), and, in particular, the value of multiple-methods approaches to corporate governance research (Buchanan et al., 2013).

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Appendix

Research Interviews 2007-2012, analysed by categories, individual entities contacted, and number of meetings held

Categories	*Entities*	*Meetings*
Targeted companies	5	8
Activist and value funds	8	8
Operating in Japan	*6*	*6*
Not operating in Japan	*2*	*2*
Institutional investors and agents	8	11
Insurance companies	*2*	*2*
Pension funds	*3*	*4*
Agents (includes fund managers, proxy services and other agents)	*3*	*5*
Market infrastructure, Associations etc.	4	8
Other meetings	5	8
Totals:	30	43