RBC BlueBay
Asset Management

Engaging with Japan Inc on governance reforms

RBC Asian Equity team

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Corporate governance reform has been a major topic in Japan of late. A major global investment bank recently held its inaugural "Japan Engagement Partnership Day", intended to serve as a bridge between Japanese listed companies and international long only investors. RBC BlueBay Asset Management was one of three select investment managers invited as keynote speakers. Maya Funaki, Lead Manager for the Japan Equity strategy, and David Soh, Portfolio Manager and Head of Research for the Asian Equity team, presented to over 100 listed company CEOs and IR representatives on why "solving capital rigidity is the future" for Japan equities. They also discussed their investment process, unpacking how they integrate ESG into their investment decisions.

RBC Bluebay Asset Management as a firm has a long history of responsible investment, and our Asian Equity team has engaged with environmental, social, and governance ("ESG") issues since the investment track record began in 2014. We integrate material ESG factors when investing in Japan and convey our active stewardship views through thoughtful proxy voting and engagement with Japanese companies, based on a long-term mindset. We believe that, over time, this generates returns for our clients and helps our investee companies to increase their value.

We believe that the 'S' is a particularly pertinent issue in Japan, where there is a shortage of human resources, and the 'G' is important in creating a foundation for efficient capital policy. Employment rigidity, a structural problem in Japan, is improving thanks to the recent shortage of workers.

There is also an opportunity to improve 'rigidity' of capital; Japanese consumers and companies saved money in deflation but with inflationary pressures of late, the mindset appears to be shifting. We think this time may indeed be different for Japan.

A virtuous cycle with wage hikes, service industry-led inflation, inbound tourism led consumption, foreign investor flows, governance reform and valuation re-rating, among other factors, may pull the economy out of decades of deflation and restore an 'animal spirit' in both corporate culture and market sentiment. Low base effects on each of these variables make it more plausible.

Dividends and share buybacks are increasing but the average Return on Equity ("RoE") of Japanese companies is still low (below 10%)[1], only half that of Europe and the U.S.. In our talk, we urged the companies to not only consider improving shareholder policies, but to fundamentally revisit their business models to focus on enhancing RoE across all strategic levers (i.e. profitability, investment, and business portfolio restructuring). We also highlighted that valuation multiples, such as price-to-earnings ratios, were ~50% higher in the US S&P 500 Index than Japan's TOPIX index. This was to explain that this can be addressed through better investor communication, using measurable progress on long-term goals, while better aligning management incentives.

With a growing number of companies committing to governance reform targets publicly, market expectations are rising on Japan Inc. As this momentum continues, more companies are likely to believe that meaningful change is possible. We are encouraged by these structural changes, and we see compelling long-term opportunities to generate alpha in Japan equity. The second largest developed market economy in the world is under-owned and under-researched, making it a compelling stock picker's market historically. Winning business models or firms determined to make the most progress in their core operations and governance reform should outperform over time, making active management the best exposure to Japan equity over the long term.

[1] Nomura Research, as at 1 June 2023

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Maya is a portfolio manager on the Asian Equity team at RBC BlueBay (RBC Global Asset Management's business outside North America). She is the lead manager for the team's Japan strategy and is also the team's industrials specialist. Prior to joining the organization in 2015, Maya worked as an analyst at a multinational investment bank in the investment banking division. She started her career in the investment industry in 2011.

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