



DENTSU MAKING THE SAME MISTAKE AS NOMURA

In opinion piece 35 back in September 2008 I wrote about the collapse of Lehman Brothers and I commented on Nomura Securities (the largest Japanese stockbroker) buying parts of the collapsed firm. I wrote the following:

I therefore worry about Nomura buying parts of Lehman. I think the cultures will clash and Nomura will struggle against Goldmans, Morgan Stanley, JPMorgan, Credit Suisse etc.

My prediction of a cultural clash appears to have been reasonably accurate.

Here is the headline from a Bloomberg report from February this year:

Nomura Reeling From Lehman Hangover as Shibata Vows No Retreat

(The full article is quite interesting and can be found at:

<http://www.bloomberg.com/news/2012-02-27/nomura-reeling-from-lehman-hangover-as-shibata-vows-no-retreat.html>)

Since a Bloomberg columnist wrote this article things have got even worse at Nomura. Mr. Shibata the Chief Operating Officer, along with the Chief Executive, resigned in July due to an insider trading scandal. The Telegraph reported the following:

THE chief executive of Nomura has resigned following leaks of insider information to clients of its brokerage unit.

The departure of Kenichi Watanabe and his top lieutenant, Takumi Shibata, who were the architects of Nomura's takeover of the Asian and European assets of Lehman Brothers, raises questions over the future of the bank's global expansion strategy.

Having been a client of Nomura for many years I think I gained the type of insight that allowed me to make predictions of cultural problems. I saw how the system of conformity, staff rotation, promotion by age rather than ability and discrimination against women worked. I have not seen any evidence to suggest that this culture has changed.

Many years ago I thought that Japanese companies like Nomura would see that overseas expansion was a recipe for disaster but to my dismay they seem destined to continue to make the same old mistakes and this is one of the many reasons why I have been cautious about the Japanese economy and stock-market.

The Nomura share price has reflected these troubles as the following chart shows:

Nomura holdings share price



It did not come as a big surprise to me when I heard that Dentsu (the biggest Japanese advertising agency) announced that it was buying Aegis the big British advertising agency. Once again I make the prediction that this will be an incredibly difficult merger to make work and once again I think they will end up like Nomura and regret this decision.

At the end of the day Dentsu has paid \$4.9bn dollars for the creative ability of the Aegis employees. They are not buying anything tangible because it is estimated that goodwill will represent \$4.3bn dollars of the purchase price. How can a company that comes from a culture where meritocracy does not exist hope to manage a company where creativity is a core ingredient?

I had a look at the Dentsu website to see if I could listen to any of their management team giving a presentation. Unfortunately Dentsu like so many other Japanese companies remains far behind in this regard. This makes me worried that their command of the English language is poor and I would guess that very few of the Aegis staff are fluent in Japanese!

I also tried to analyse the Board of Directors in order to see whether it follows the traditional Japanese approach of consisting entirely of Japanese men over the age of 40. Unfortunately neither the website nor the annual report has sufficient detail (and/or a picture) to enable me to conclusively say that this is the case (I can confirm however that there are no foreigners on the board).

I know that this is a recurring theme of any opinion piece I write on Japan but I just feel that it continues to act as a major constraint on the Japanese economy.

I am not alone in my concern that Dentsu might be destroying shareholder value with this acquisition. In a recent interview a well known fund manager at the firm Third Avenue said the following:

Let me tell you yet another worry I have. Japanese companies being increasingly seized by the fear that Japan is so permanently ex-growth given the fact that there are too many of these cash balances, given the fact that there are fewer and fewer growth opportunities in Japan, we start making crazy acquisitions outside Japan at very high prices. That is, for me, a much more scary thing than the other ones you mentioned so far. That scares me because Japanese companies historically have not been the stingiest of acquirers. They have not been willing to engage in some knock them out, drag them out, got to fight to save the last nickel. They just have not. They don't have it in them. They prefer to be viewed as friendly. Friendly takeovers sometimes are expensive takeovers, unfortunately.

I think Dentsu would be better off concentrating on maintaining their dominant position in the Japanese market and paying out a bigger dividend rather than buying Aegis. They are a cash rich company and they should continue to generate plenty of cash and yet their dividend yield is only 1.5%. Instead they are engaging in a risky expensive overseas acquisition. To me this is crazy but only time will tell if I am right.

Dentsu



