



IS JAPANESE REFORM FOR REAL THIS TIME?

In this opinion piece I give my annual update on Japan and what an interesting time to give an update given the dramatic recent moves in the Nikkei:



The market has moved because there is hope that Prime Minister Abe is going to succeed with his economic programme known as “Abenomics” but I am worried that this is just another false dawn. I would love to believe that he is in a position to reform the economy but something tells me that he has a real struggle on his hands. A few years ago many commentators hoped that Prime Minister Koizumi would achieve large scale reform but in the end he achieved very little. I genuinely hope I am wrong but I feel that the structural reform that Japan needs is only likely to happen after a crisis and even though Japan has gone through two decades of low growth I don’t think the current situation of 4% unemployment is creating a sense of full blown crisis. The majority of the population are just too comfortable to accept the pain of the radical changes that I think are necessary.

I know that structural reform is stated as a fundamental part of “Abenomics” but I think it will be incredibly difficult to overcome core aspects of Japanese culture in order to achieve that reform. In particular I think Japan needs to become more of a meritocracy but how fast can they overcome the culture of seniority by age and gender? I also think they need to encourage creativity and entrepreneurialism but how fast can they overcome a culture of conformity and group harmony? I also think they need to allow “creative destruction” but how fast can they overcome a culture of life time employment? This creative destruction would be driven by belief in the need to

generate adequate returns on capital invested but it would mean that whole towns built around certain commodity industries would face major dislocation and how do you do that with an electorate that does not want short term pain for uncertain long term gain?

I also believe that the additional long term economic challenges created by a rapidly aging population and an already precarious government debt position means that Japan will only get a temporary boost from the fiscal and monetary policy aspects of “Abenomics” and in order to prevent Japan sliding further down the global economic rankings they need to implement the structural reforms mentioned above.

My reason for believing that this structural reform is unlikely to happen is primarily down to the time I spent in Japan but it has been reinforced by the views expressed by Michael Woodford in his book “Exposure”.

Michael is well placed to comment on these cultural issues because he is the former President of Olympus. In his book one can read about his struggles but as it says on the cover of the book “*He also paints a devastating portrait of corporate Japan – an insular, hierarchy-driven culture that prefers maintaining the status quo to exposing ugly truths*”.

I highly recommend the book but if you don’t have the time to read it there is a great interview with him on YouTube where he talks in detail about a number of the issues I have described above: <http://www.youtube.com/watch?v=eEBIound460>

(Just to digress from the theme of this opinion piece I want to say that I personally found the most intriguing part of the interview to be a question near the end of the interview relating to the state of business ethics. The audience was asked if they thought most executives would do the same as Michael if they were put in the same situation and the audience said that they thought most would not..... If only there were a few more people in the world like Michael Woodford!)

The Activists are back

As well as “Abenomics”, Japan has seen the re-emergence of a foreign activist investor trying to bring about change at a Japanese company. I am referring to Daniel Loeb of Thirdpoint and his attempt to get Sony to unlock some of the value that he believes is tied up in the company. In particular he believes that spinning off 20% of their film and music division would act as a catalyst.

Activist investors have had a difficult time in Japan and I thought it would be many years before they tried to take on a Japanese company given the way Sapporo Brewery fought off Steel Partners but the cheapness of many Japanese companies is a major carrot to attract them.

Sony is seen as less traditional than Sapporo Brewery but at the end of the day it is still a Japanese company and if Loeb were to be successful it would force me to think long and hard about the long term implications. I wish him all the best but so far the Sony response has been typically Japanese in the sense that the board has stated that they will give his views due consideration!

In conclusion I just want to say that if “Abenomics” achieves structural change and if Daniel Loeb achieves success at Sony it would surely propel the Nikkei higher but unfortunately I think both will struggle so for the time being I have not increased my small exposure to the Japanese market.

OTHER TOPICS

David Harding

On May 9th I attended a Value Investing conference in London and I have to admit that the most entertaining and challenging presentation was given by David Harding of Winton Capital Management (I also have to admit that I had never heard of David even though he is well known in the hedge fund world). I say that his presentation was challenging because he appears to be making excellent returns from analysing trends and for the first time in my career I think I heard someone that might actually be able to do it. It might just be that David is the Ben Graham / Warren Buffett of trend following!

To get a flavour of what I heard there are a few clips of David on YouTube and here is a link to the one that best represents his style and thinking:

<http://www.youtube.com/watch?v=5r7fy57YXwg>

Rating Agencies

There are so many organisations to blame for creating the Lehman Crisis that it is hard to pick on any single group but I have to admit that an article in Rolling Stone Magazine gave a fascinating insight into the role played by the Rating Agencies. Once again I recommend this article to anyone interested in how another aspect of the financial system could become dysfunctional:

<http://www.rollingstone.com/politics/news/the-last-mystery-of-the-financial-crisis-20130619>

Buffett

Warren loves to buy great companies at good prices but I think many people were surprised when he got involved in the purchase of Heinz because there was a sense that the share price was no longer cheap. He is making a habit of surprising people because nobody expected him to accumulate a significant stake in IBM either.

In the past he seemed to wait for great companies to have a short term problem before buying rather than paying up for them but now he seems to be prepared to buy when things are going well.

It will be many years before we can pass judgement on this change of style and I hope he will live long enough to see the results. As a Berkshire shareholder I just hope we will look back on these purchases as another sign of his great ability to evolve his style.