# Speaker Series

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**Financial services**

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# Moment of truth

## Japan's non-life insurers and their foreign shareholders

**In September 2008, market forces sent the Steel Partners and TCIs of the world rushing for the exits, liquidating their Japanese positions. But a quieter and so far more-resilient class of foreign activist stayed, continuing to exert pressure on the local companies in their portfolios. The three largest non-life-insurance firms - Tokio Marine, MS&AD and NKSJ - are conspicuous examples of this. Foreigners hold 33.5% of their shares, meaning management is no longer in a position to turn a deaf ear.**

### Aches and pains

- The aches and pains of the non-life-insurance sector mirror those of Japan Inc.
- Between 2002 and 2009, the net premiums written by Japan's 26 largest non-life insurers steadily declined each year - from ¥9.251tn to ¥8.543tn.
- The greater problem has been that the non-life companies have ploughed their capital into "strategic investments", which brought down NAV by 50% in 2007-09.
- Under these pressures, the non-life companies - like their cousins in the banking industry a decade earlier - have sought safety in numbers, leading to consolidation.

### Promised reforms

- The fact that the plans of all three companies look eerily alike - down to small details such as 50% payout ratio, 7% ROE target and 30% of revenue to be derived from abroad - makes one wonder whether the commitment to reform is real or simply carefully orchestrated public relations.

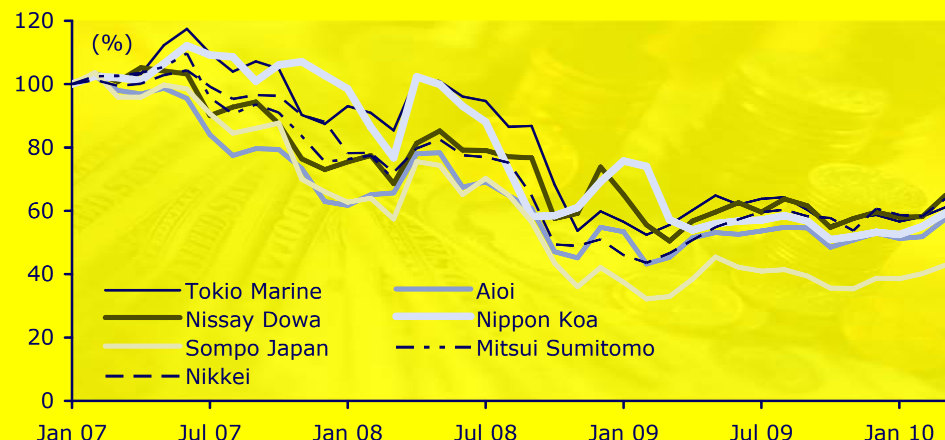
### Warren Buffett on cigars

- Graham-Dodd disciple Warren Buffett has in the past denigrated Japan as a field for what he calls "cigar butt" investing.
- In Buffett's words: a cigar butt found on the street with one puff left in it may not offer much of a smoke, but the "bargain purchase" will make that puff all profit.

### Non-life hereafter

- Whether the non-life sector poses a "puff of profit" or effects fundamental changes to corporate structures, foreign shareholders now have the muscle to push such firms in the right direction.

**Nikkei and stock prices**

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## Stephen Givens

Stephen Givens is a corporate lawyer who has spent his professional career structuring, negotiating and closing cross-border transactions involving Japanese companies. He has wide experience in cross-border mergers and acquisitions, corporate governance issues, public and private financing, strategic alliances and joint ventures. He grew up and was educated in Tokyo and has been based professionally in Tokyo since 1987. He is a Professor in the Law Faculty of Aoyama Gakuin University and Lecturer at Keio Law School. Before attending Harvard Law School, he was a graduate fellow in the Law Faculty of Kyoto University.

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# Foreword

**Shareholder activism has taken a backseat post-Lehman**

While 2007 witnessed a surge in the number of shareholder proposals from foreign investors, shareholder activism has since taken a backseat. As guest author Stephen Givens points out, 'a tsunami of market forces sent the Steel Partners and TCIs of the world reeling for the exits, liquidating their Japanese positions in September of 2008.'

Although out of the spotlight, shareholder proposals are still at work in Japan. According to proxy-advisory firm Glass, Lewis & Co, there were 19 companies facing shareholder proposals in 2010. Foreign investors have been net sellers of Japanese equities for the past two-and-a-half years, causing the market to underperform its Asian peers; Japanese corporate management understands that a shift in allegiances from business stakeholders to shareholders could indeed bring back overseas participation, but the pace of change is still a source of concern.

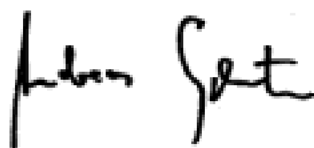
**Some have stayed**

Givens points out some foreign activists stayed however - the strong, silent type - continuing to exert pressure on their Japanese portfolio companies. With foreigners holding 33.5% of their shares, the three largest Japanese non-life insurance companies, Tokio Marine, MS&AD and NKSJ, found themselves sharing an unwelcome spotlight. Graham-Dodd disciple Warren Buffett has previously dismissed Japan as a field for what he calls "cigar butt" investing. In Buffett's words: 'A cigar butt found on the street with one puff left in it may not offer much of a smoke, but the "bargain purchase" will make that puff all profit.' Whether the non-life-insurance sector can provide a "puff of profit" or effect fundamental changes within the companies' corporate structures, foreign shareholders now have sufficient clout to push the non-life companies in the right direction. The cigar butt may have met its match.

**Changing dynamics**

The landscape of market ownership is quite different from the 1980s, when foreigners constituted a mere 5% of the market. Growing awareness about corporate governance coupled with Japan's home-grown shareholder engagement will also continue to force change in Japan Inc. A case in point, this year Yutaka Yamanaka, grandson of Hoya's founder, won 40% of votes at the annual shareholders' meeting for his bold 15-point reform proposal - a once-unthinkable affront to management.

In this report, Stephen Givens, a Harvard Law School graduate who has practised corporate law in Japan for more than 20 years and is currently a Professor of Law at Aoyama Gakuin University and Lecturer at Keio Law School, gives his insight into the current issues in the non-life-insurance sector and its foreign shareholders.



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# Foreign activists after the deluge

**Nikkei at 50% of July 2007 value**

In July 2010, the Nikkei hovered barely above 9,000, half its value in July 2007, a mere three years ago. It now seems like a distant time. Back in July 2007, the Japanese stock market was on a four-year run that had begun with the Nikkei under 8,000 in January 2003. In that now half-forgotten era, the headlines told of aggressive tender offers against Japanese companies launched by suspicious foreign funds and equally suspicious home-grown mavericks, not to mention a slew of demands by foreign "activist" shareholders.

Whether by coincidence or otherwise, the Nikkei peaked just at the time the Japanese establishment cracked down on the mavericks and activists. Murakami and Horie were arrested, convicted and put out of business. The Japanese courts issued the Bulldog Sauce decision branding Steel Partners an "abusive acquirer" whose shares could be coercively bought out and cancelled. TCI's application to increase its shareholding in J-Power from 9.9% to 20% was rejected as a threat to national security. Then, in September 2008, a tsunami of market forces sent the Steel Partners and TCIs of the world reeling for the exits, liquidating their Japanese positions.

**Foreigners own 33.5% of Japan's non-life insurers**

Little noticed amid the wreckage, a quieter and so far more resilient class of foreign activist has remained and continued to exert pressure on their Japanese portfolio companies. Although these activists have invested in a broad range of industries on a significant scale, their concentrated investment in the three largest Japanese non-life insurance companies - Tokio Marine, MS&AD and NKSJ - is striking. With foreigners holding 33.5% of the shares of Japan's non-life companies, management has had no choice but to listen to and to a great degree comply with their demands, in contrast to the uniform rejection of activist demands in the previous era of foreign activism.

In many ways, the uneasy relationship between foreign shareholders and the Japanese non-life companies is a dramatic microcosm of the ambivalent relationship between foreign investors and the Japanese equities markets as a whole. Like many Japanese companies in other industries, the non-life companies are at a critical crossroads, facing not only declining premium income in Japan as the population ages and domestic economy shrinks, but also suffering from sharp declines in net asset value as their own stock portfolios, heavily weighted toward shares of their own poorly performing Japanese insurance customers, have fallen in value.

**How long can 'long-term' investors wait?**

At the same time, the patience of even self-proclaimed "long term" foreign investors in the Japanese non-life companies, all of which have significantly underperformed the Nikkei during the past five years, may be finally coming to an end - unless the insurance companies are able to turn things around quickly. The extent to which the insurance companies swallow the prescriptions offered by their foreign shareholders, and whether the medicine actually works, are certain to be portents of larger changes in the environment for foreign investment in Japan.



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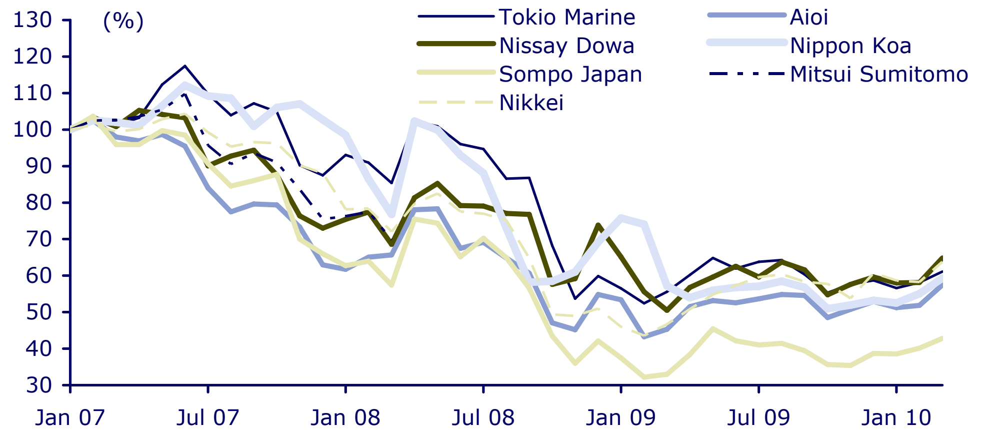
Non-life insurers have significantly underperformed Nikkei

Figure 1

**Nikkei and stock prices**




Source: Bloomberg, CLSA Asia-Pacific Markets

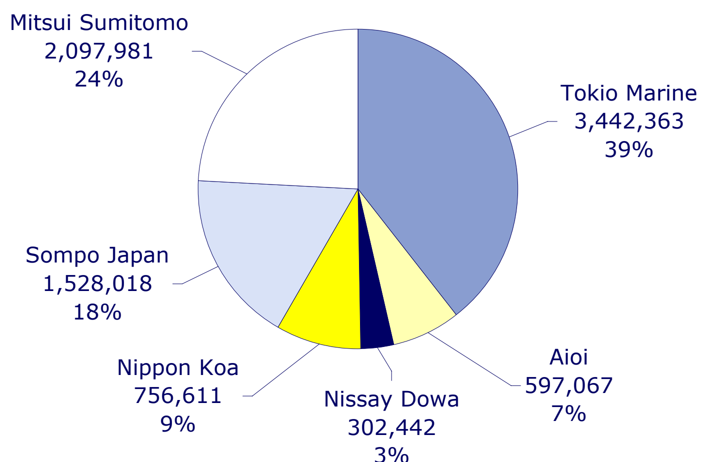
# Graham-Dodd meets Japan

Probably not by coincidence, the prominent foreign investors in the Japanese non-life companies share the same investment philosophy. A handful of funds that own about ¥270bn worth, or US$3.2bn, of the top three non-life insurers all espouse the "deep value" investment approach pioneered by Benjamin Graham and David Dodd in the 1930s and put into practice with spectacular results by Graham's student Warren Buffett.

Market capitalization pre-merger

Figure 2

**Market capitalization (Jan-07, ¥m)**




Source: Bloomberg, CLSA Asia-Pacific Markets

Value investors bought non-life shares through mid-2000s, but not Warren Buffett

These prominent "value" investors - conspicuously not including Warren Buffett himself - started building positions in Japanese non-life companies in the mid-2000s. Their investment logic, consistent with the Graham-Dodd "value" approach, seems to have been that the non-life companies were undervalued. Graham-Dodd teaches that value exists if a stock is trading at a one-third-or-more discount to its net asset value. The Japanese non-life companies have consistently traded at a discount to net asset value over the



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past decade, as has the composite Japanese stock market itself. One fund has argued that the non-life companies, because of their extensive holdings of Japanese stocks, are a cheap way to invest indirectly in the Japanese stock market itself.

An additional reason for the interest of foreign "value" investors in Japanese non-life companies may well have been that the master himself, Warren Buffett, built Berkshire Hathaway around a core of property and casualty insurance companies in the US. Buffett's famous annual letters to Berkshire Hathaway shareholders over the years (2001 and 2004 in particular) contain wisdom on running non-life companies successfully and using their capital to build larger, diversified empires. Property and casualty insurance is a business value investors feel they know something about.

**Warren Buffett on cigars**

The fact that Warren Buffett himself has stayed out of Japan, and his reasons for staying out, seem not to have moved the other Graham-Dodd disciples. Buffett has in the past denigrated Japan as a field for what he calls "cigar butt" investing. In Buffett's words:

A cigar butt found on the street that has only one puff left in it may not offer much of a smoke, but the "bargain purchase" will make that puff all profit. Unless you are liquidator, that kind of approach to buying businesses is foolish. In a difficult business, no sooner is one problem solved than another surfaces - never is there just one cockroach in the kitchen. Second, any initial advantage you secure will be quickly eroded by the low return than the business earns.

**Value trap or cigar butt?**

The experience of foreign activists such as Steel Partners in Japan may well bear out Buffett's warning. Steel Partners invested in cash-rich companies in sunset industries, demanding that the cash be paid out as dividends and non-performing assets be sold off. Steel Partners tried to act like a liquidator, only to find that it couldn't persuade other shareholders to go along and put the match to the cigar butt. Steel Partners found itself ultimately locked into companies at the end of their life cycles without being able to get that last puff out of the soggy cigar. As Buffett warned, it's great to buy cheap, but if the company is not fundamentally sound and has low earnings prospects, it will get even cheaper before you can make your exit.

Foreign investors in Japanese non-life companies may themselves be beginning to wonder if they might not have bought into very large and hard-to-light cigar butts. True, they bought in at discounts to net asset value. But so did every other investor that bought Japanese non-life companies during the last five years. In the meantime, the market capitalizations and net asset values of the non-life companies have continued to recede faster than the Nikkei itself.

## The non-life insurance sector

**Fortunes of non-life sector and Japan Inc intertwined**

The aches and pains of the non-life insurance sector mirror those of Japan Inc. itself. On the underwriting side of the business, premium income has slowly declined in step with the shrinking and aging of the Japanese domestic economy. Between 2002 and 2009, the net premiums written by Japan's 26 largest non-life insurers steadily declined each year from ¥9.251tn to ¥8.543tn. The decline in premium income, in turn, largely reflects downward drifts in the housing and automobile sectors: property and automobile insurance account for over 70% of premium income.



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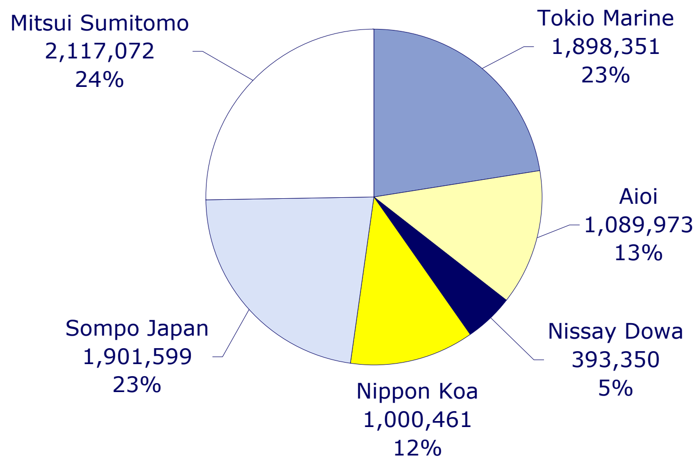
**Sales continue to decline with shrinking and ageing of the Japanese domestic economy**

Figure 3

**Gross sales (2006-07 accounting period, ¥m)**




Source: Bloomberg, CLSA Asia-Pacific Markets

**Strategic investments pose a larger problem**

Still, the slow but relentless decline in the primary insurance market is only one part of the problem. The insurance side of the business, as such, has continued to be modestly profitable. The larger problem has been that the non-life companies' capital has largely been invested in stock of the insurers' own corporate customers - ie, a cross-section of Japan Inc. itself. The investment portfolios of the insurance companies have been weighed down by so-called "strategic investments" - ie, legacy investments in customers that were designed to cement a primary business relationship without regard to the profitability of the investment.

**Some 30% of stock market represents crossholdings**

This type of cross-shareholding between and among customers and suppliers, lenders and borrowers, has been a defining characteristic of the Japanese stock market for decades. Over 30% of the stock market is controlled by so-called "stable shareholders", corporate shareholders that have some kind of parallel business relationship with the companies whose shares they own. Stable shareholders have, in turn, shielded Japanese management from pressure to generate attractive returns. The stable shareholders hold the shares not as financial investments, but as the price they have to pay to maintain a business relationship. It was the "stable shareholders", seeking to ingratiate themselves with their business counterparties, who voted against and defeated objectively rational proposals submitted by the foreign activists in the last decade.

**Holding customers' stock has significantly eroded net asset value**

As the fortunes of the non-life companies show, however, the implicit bargain between suppliers and customers - passive and uncomplaining investment and low returns in exchange for guaranteed business on soft and easy terms - may be approaching a tipping point. Holding a massive portfolio of their own customers' stock has had devastating consequences for the Japanese non-life companies' net asset values as the Japanese market collapsed starting in 2007. For example, in the two year period between 2007 and 2009, Tokio Marine's net asset value declined from ¥3.398tn to ¥1.628tn, and MS&AD's net asset value from ¥2.168tn to ¥1.011tn. The 50% decline was directly attributable to drops in the values of the companies' domestic stock portfolios, closely tracking the decline of the Nikkei from 16,000 in March 2007 to 8,000 in March 2009. Meanwhile, the return on equity figures for the non-life companies have been unspectacularly in the low single digits, again reflecting



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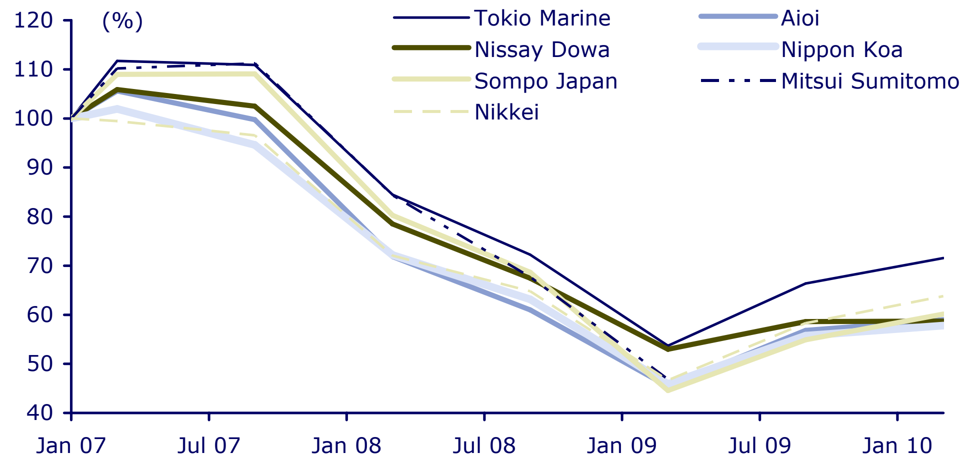
the low returns and payout ratios of the Japanese client companies in their portfolios. If the cost of doing insurance business with Japanese customers is losing corporate value in trillion yen units (¥1tn = US$12bn), the cost may simply be too high.

**Between 2007 and 2009, net assets halved**

Figure 4

**Net assets**

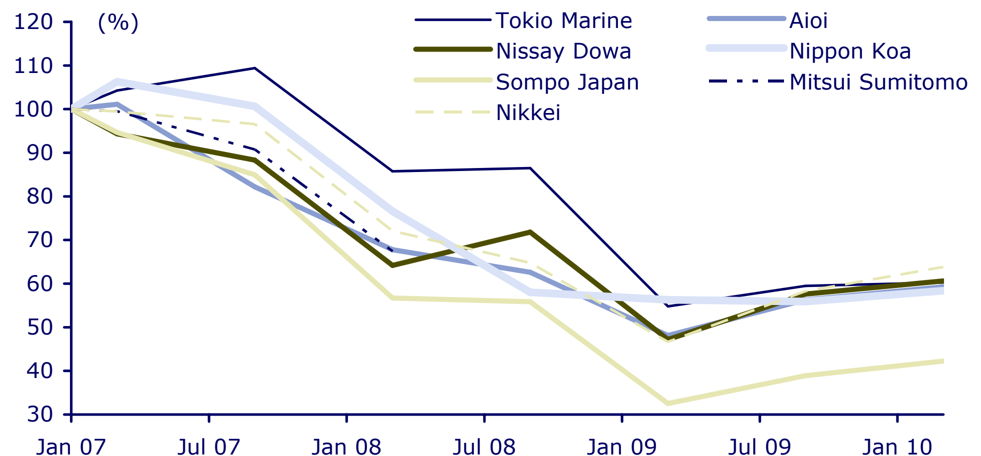



Source: Bloomberg, CLSA Asia-Pacific Markets

**So did share prices**

Figure 5

**Market capitalization**




Source: Bloomberg, CLSA Asia-Pacific Markets

**Resulting in consolidation in 2010**

Under these pressures the non-life companies, like their cousins in the banking industry a decade earlier, have sought safety in numbers, leading to consolidations in 2010 in the form of MS&AD (the amalgamation of Mitsui Sumitomo, Aioi and Nissay Dowa) and NKSJ (the amalgamation of Nippon Koa and Sompo Japan). The official rationale for the consolidations was to increase efficiencies and economies of scale. So far, however, the consolidated companies remain under holding company structures, with the component companies continuing to operate under their own names and under their former management. The extent and speed with which these disparate organizations that now find themselves operating under one roof can be turned into single-minded fighting machines is another question mark hanging over the industry.



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## Promised reforms

**Embracing the reform goals of foreign activists, or so it seems**

The three largest non-life insurers have all adopted business plans that now indicate they will implement the very reforms foreign activists asked for, but which were rejected, only a few years earlier. As described in more detail further on, the business plans that have been announced all contain the following commitments:

- A payout ratio of at least 50%, through a combination of dividends and stock buy-backs
- Achieving return on equity of 7% or more
- Reduction of "strategic investments"
- In the case of MS&AD and NKSJ, achieving efficiencies and cost savings from their mergers
- Aggressive expansion overseas, especially Asia, to counter the unfavorable demographics of the Japanese home market

**Mid-term plans look eerily alike throughout the sector**

The fact that the plans of all three companies look eerily alike down to small details -50% payout ratio, 7% ROE target and 30% of revenues to be derived from abroad are, for example, identical - makes one wonder whether the commitment to reform is real or simply carefully orchestrated public relations. The degree to which the non-life companies are in fact serious about making a sharp break with past practice and attitudes will be a litmus test, not only within the insurance industry, but more broadly with Japan Inc. as a whole. In particular, the open questions are whether the promised reforms will awaken a disciplined focus on investment returns, and trigger a larger unwinding of the cocoon of "stable shareholder" relationships woven throughout the Japanese stock market. If they do, and the foreign shareholders do not abandon ship before the promised changes take effect, Japan's market will have turned a major corner.

### 1. Payout ratio

**Excess cash is the hot topic**

The hottest point of contention between the non-life companies and their foreign investors has been what to do with the "excess capital" sitting on their balance sheets. With the return-on-equity ratios of the non-life companies in the low single digits, the foreigners have lobbied - to a great extent successfully - to have capital in excess of that required by the insurance regulators returned to shareholders in the form of dividends or share buybacks.

In 2009, for example, a major foreign shareholder went public and submitted a formal shareholder proposal to Mitsui Sumitomo Insurance demanding a special dividend of ¥40 per share, which would have released ¥5.5bn of over ¥200bn in excess capital sitting on Mitsui Sumitomo's books. The shareholder subsequently withdrew the proposal after Mitsui Sumitomo agreed to return an equivalent amount of capital to shareholders through a combination of dividends and buybacks and committed to a dividend payout ratio going forward of at least 40%.

That has to be chalked up as at least a modest victory for foreign investors, in light of the fact that all other foreign shareholder proposals (including a half dozen dividend proposals) that went to a vote during the preceding three-year period had been defeated. On the other hand, the incremental amount of cash Mitsui Sumitomo agreed to pay out was small - from the shareholder's



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point of view worth about US$10m as against a total of US$800m invested at the time. Meanwhile, during the last year, the stock price of MS&AD Holdings, Mitsui Sumitomo's successor following its merger with Aioi and Nissay Dowa earlier in the year, has fallen by 24%, as against a decline of 3% in the Nikkei during the same time frame - a loss of nearly US$200m in the value of the shareholder's investment. And obviously the amount of excess capital that MS&AD and its peers have to pay out is shrinking as the Nikkei declines.

**Balancing the payout ratio**

The three big non-life companies have all now conceded that a larger percentage of their annual earnings will to be paid out to shareholders. The business plans announced by all three companies target a payout ratio of 50% of earnings. As the shareholder of the preceding example has pointed out, however, even a payout ratio of 50% may be too low if it leaves accumulated capital and the remaining 50% of earnings generating returns that are lower than the cost of capital. Conversely, 50% may be too high if the earnings can be reinvested to generate better-than-average returns: Berkshire Hathaway has never paid a dividend and no shareholder has complained. The non-life companies' promise to pay out 50% of core profit to shareholders without regard to their expected or actual return on capital is in that sense meaningless and arbitrary. The shareholder's demand that Mitsui Sumitomo pay for its merger with Aioi and Nissay Dowa with cash instead of stock valued at a discount to net asset value was ignored, casting doubt on whether basic concepts of capital efficiency have yet to be fully accepted or understood.

## 2. ROE

**Acceptance of ROE**

All three of the big non-life companies have conceded that their low single-digit return-on-equity performance needs to improve. Acceptance of ROE as a valid and relevant performance criterion is in fact a huge breakthrough. When TCI demanded that J-Power set ROE and ROA targets in 2008, for example, J-Power responded that these were not relevant measures of performance. For years, Japanese companies have acted as if they were subject to different laws of physics in which ROE was not terribly significant. The cocooning effect of stable shareholder relationships, combined with the abnormally low cost of yen-denominated capital, made it possible to accept low returns on equity as a normal feature of everyday life.

**Wishful thinking about the future of the Japanese stock market**

The promised 7% ROE - to be achieved in two or three years, we are told - is certainly better than the insurers' ROE performance to date. If they can in fact achieve a consistent 7% yen-denominated ROE, foreign shareholders would certainly be willing to stick around and see half of earnings reinvested. The problem is that no-one has yet explained how the 7% target - or any other target - will be concretely achieved. The mystery is compounded by the fact that the insurers' ROE is in large part a function of the investment returns they get from their own portfolios. Thus, the 7% target can only reflect optimism (or wishful thinking) about the future performance of the Japanese stock market itself. The fact that all three insurers have pegged 7% as their target ROE rate intensifies suspicion that this number is a child of public relations and not hard-nosed math.



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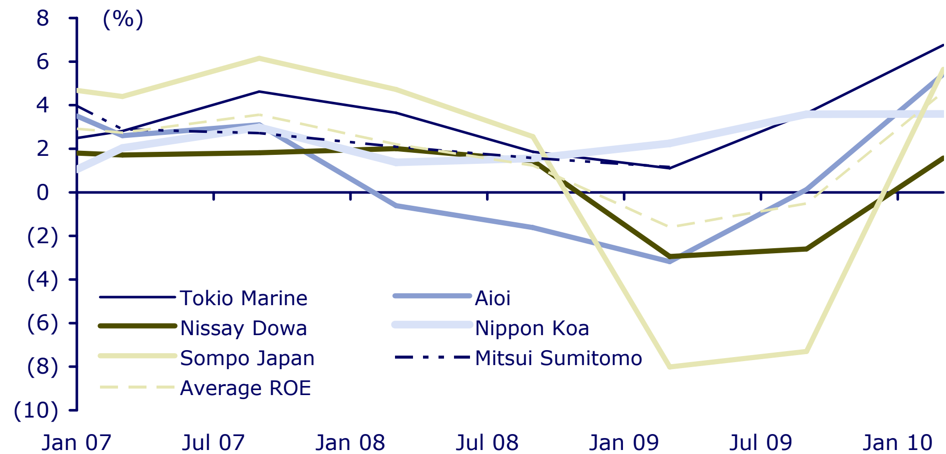
**Targeting ROE of 7%**

Figure 6

**ROE**




Source: Bloomberg, CLSA Asia-Pacific Markets

**What if they don't achieve the target?**

The fuzzy basis for the 7% ROE target in turn raises the question, "What if they don't achieve the target?" The logically consistent conclusion would seem to be to require acceleration the return of capital to shareholders over and above the 50% dividend payout ratio already promised. The position that the insurers have taken on the intertwined issues of return of capital and ROE would seem to entail acceptance of a large match at the end of the cigar if the ROE targets are in fact not met. If so this should make the insurers more attractive to cigar-butt investors. On the other hand, it is not entirely clear the insurers yet understand this logic, or will stand by their commitments if, two or three years down the road, the 7% target has not been met. It is unlikely that the management of the large insurers see their mission in life as overseeing the orderly downsizing and liquidation of their companies.

## 3. Divestment of "strategic investments"

**Cross-shareholdings**

Perhaps the potentially most profound reform promised by the non-life companies is to reduce the amount of "strategic investments" they hold. NKSJ has promised to sell off "strategic" holdings of ¥300bn by 2012. The ¥300bn reduction promised by NKSJ is small compared with a total securities portfolio valued at ¥4.48tn, but is large in relation to net asset value of ¥431bn. MS&AD, by contrast, has chosen a locution that merely suggests merely that it will not increase strategic holdings above current levels, promising that it will "restrain residual stockholdings."

Mason Hawkins of Southeastern has proposed that the Japanese insurers, in effect, erect a Chinese wall between the underwriting and investment sides of their business, with profitability being the sole criterion on either side of the wall. He argues that mutual back-scratching between the insurers and their customers has been a terrible deal for the insurers, resulting in devastating erosion of NAV as the customers' stock prices have declined. His solution is to break the implicit link between the underwriting and investment side of the business, and require each to be profitable on its own feet and on its own terms.



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The loosening of stable shareholder ties and sell-off of client and customer shares is occurring not just within the non-life companies, but across the banking and insurance sector as a whole. In fiscal 2009, banks and insurers sold about a net ¥1.46tn yen worth of portfolio stocks, while trading houses Mitsubishi Corp and Marubeni each sold off 4% of their domestic stock portfolios. Investment decisions are increasingly being based on asset efficiency rather than sentiment and fellow-feeling. Some banks are reported to have demanded specific quotas of business from clients as a condition of not selling their shares: no more unquantifiable fuzzy give-and-take.

**Unwinding stable shareholders will change market dynamics**

If the insurers continue to move in this direction it could have profound reverberations for the Japanese stock market as a whole. It would mean that corporate management could no longer count on "stable shareholders" to protect them from financially motivated foreign and institutional investors. The market would become more liquid and sensitive to normal market dynamics. Subtract stable shareholders from the equation and the Japanese stock market would have no choice but to begin to obey the normal laws of physics.

## 4. Merger synergies?

**Not overnight**

Despite their consolidation earlier in 2010, Nippon Koa and Sompo Japan remain separate companies under a holding company with Makoto Hyodo, the former president of Nippon Koa, and Masatoshi Sato, the former president of Sompo Japan, retaining their former positions. Mason Hawkins of Southeastern, a critic of Hyodo before the consolidation, has demanded that Nippon Koa and Sompo Japan be merged into a single entity under Sato's leadership, and aggressive action taken to make the unified business more cost-effective. NKSJ responds that the customer bases of the two companies are different and that it is in fact an advantage to keep them separate under their respective old managements. NKSJ management says there are no current plans to merge the two holding company subsidiaries. Meanwhile, MS&AD has scheduled Aioi and Nissay Dowa to be merged into a single entity later this year, but will keep Mitsui Sumitomo Insurance as a separate subsidiary.

Both NKSJ and MS&AD claim that consolidation with lead to nearly identical cost reductions and synergies, in each case worth ¥40bn in fiscal 2013 and ¥50bn annually thereafter. If true, this would significantly reduce in historical SG&A expenses (roughly ¥300bn annually) and could double the historical bottom line. The question is whether the constituent members of the consolidated entities and their leadership have the stomach to make deep and meaningful cuts in the ranks of their combined 70,000 employees to achieve and even exceed the projected cost savings. So far, neither company has indicated how deep the cuts will be. One assumes that preserving positions and jobs post-merger were unwritten conditions of the NKSJ and MS&AD consolidations. How ruthless management will be in making painful personnel cuts, one of the few areas that management can actually control to improve ROE, will be another indication whether the non-life companies are under enough stress to force them to play by a new set of rules. The obstinacy of the management atop NKSJ suggests, for now, that the head chopping will be less than ruthless.



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## 5. Overseas expansion

**Expanding overseas income to 30%**

The final initiative promised by the big three non-life companies is aggressive expansion overseas, so as to increase their foreign-source share of premium income to 30% or more. In recent months Japanese banks, securities companies, life insurers and beverage companies have also trumpeted foreign acquisitions as the way they will counter a greying domestic market. Foreign acquisitions are soup du jour this year.

Tokio Marine has been the boldest and quickest in making overseas acquisition, beginning with the purchase of Kiln, the fourth-largest Lloyds managing agency, in late 2007 for £442m (¥59.7bn) and US property and casualty insurer Philadelphia Consolidated (PHLY) for US$4.7bn (¥471.5bn) in 2008. Tokio Marine paid substantial premiums to acquire control of both companies; time will tell whether it paid too much. The price paid for PHLY, for example, was a 67% premium over the market price and 2.7-times net asset value. Unlike its rivals, Tokio Marine has put serious cash on the table to take control of serious foreign insurers.

**Expanding in Asia, elsewhere**

MS&AD and NKSJ, on the other hand, have made smaller and more tentative foreign acquisitions, typically in the form of minority stakes. In June 2010 MS&AD acquired a 30% interest Malaysia's second largest non-life company for US$479m and ¥2.4bn for a 7% interest in a Chinese life insurer, complementing Mitsui Sumitomo's earlier acquisition of Taiwan's second largest non-life company and Aviva's Asian non-life operations. NKSJ has announced that it will invest up to ¥200bn in foreign acquisitions through 2012 and views foreign operations as the future driver of growth and profit. So far in 2010 NKSJ has acquired Turkey's 11th largest non-life insurer for ¥28bn and Singapore-based Tenet for ¥6.4bn. Tokio Marine, MS&AD and NKSJ have 14,600, 6,600 and 4,000 foreign employees working outside Japan.

Beyond the worry that they are paying too high a price for foreign acquisitions, the biggest question for the non-life companies in their forays abroad is whether their domestic know-how adds any value outside Japan. More pointedly, can Japanese bosses effectively recruit and manage large organizations of Chinese, Southeast Asian and Turkish employees? Stopping at minority stakes seems a tacit admission that actually managing foreign insurance operations is beyond their competence.

**Why not hoard?**

Foreign shareholders are justified in worrying that the Japanese non-life companies may waste what capital they still have on foreign acquisitions that turn out to be ill starred. One of the major criticisms made by TCI against J-Power was that it was frittering away capital on minority interests in expensive, ill-understood foreign generation facilities, as a way of trying to overcome the fact that its domestic demand for power was no longer growing. The more rational course for Japan's insurers may be to lower their ambitions and to try to be cash cows in a slowly shrinking market, rather than throwing money away overseas in a desperate final spasm to restore growth.



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# A moment of truth

**Promised reforms**

Euphemisms are necessary lubricants in a society, like Japan, that abhors unseemly conflict. On the other hand, a policy of sweeping unpleasant truths under the rug and putting off unpleasant decisions invites systemic breakdown. Whether the reforms promised by Japan's non-life insurers are for real, or are merely *tatemae* (official window dressing), is now an edge-of-the-seat question, one that affects not just the non-life insurance industry but the future course of the Japanese equities market as a whole.

**Foreign shareholders have more leverage than they realize**

Foreign shareholders have the muscle to push the non-life companies in the right direction. Indeed the foreign shareholders have more leverage than they probably realize. Not only do they control one-third of the votes, but the prospect that they might actually sell out and abandon Japan, which in the recent past might have been occasion for a collective sigh of relief, would now be a devastating vote of no confidence that would send shock waves through the system. Moreover, with the stable shareholder system and mentality now under pressure, foreign shareholders can expect to find sympathetic fellow shareholders in Japan itself, and realistically hope to cobble together a majority "coalition of the willing". That would be a major tipping point that now seems within sight.



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