The start-ups that grew old

Japan's family firms not to be underestimated

Richard Kaye
Co-manager of the Comgest Growth Japan fund

Home of the world's oldest companies

Japan is the home of the world's oldest companies and boasts one of the highest concentrations of large family-run businesses on the planet. At the start of the 21st century, one third of all Japanese listed companies had some kind of family control[1] and that remains the case today.

Japan's tendency to corporate family ownership can be explained by its relatively recent industrialisation. First, an industrial and service infrastructure of family companies sprang up alongside and became symbiotic with the state-affiliated enterprises which pushed the country into economic modernity. Second, Japan's economic miracle of the 1970s is so recent that many founders from that era are still in charge.

We believe investors should pay close attention to these businesses, perhaps more than they do at present. We have observed many cases globally when family or founder-owned or run companies align well with shareholders' interests, and in Comgest's Japan portfolio we take that idea quite far. About one third of our holdings is from companies which fit that definition. Some examples are Fast Retailing, Nidec, Keyence, Softbank, Pan Pacific, Nihon M&A, Hoya, Obic, Peptidream, Kobe Bussan and Sushiro.

Simply put, we view these companies as having a 'Day Zero' mentality which translates naturally to capital discipline with a long-term mindset, through the pursuit of unique businesses. These are start-ups which grew old. They speak the language of the shareholders because they are run by a major shareholder. With not just skin, but blood sweat and tears in the game, they certainly seek returns but importantly, they also seek long-term survival. They are the original 'ESG' plays before ESG existed; they fulfil a sustainable social role and their capital allocation choices have rewarded our trust.

> **"A 'Day Zero' mentality translates naturally to capital discipline with a long-term mindset, through the pursuit of unique businesses."**
>
> Richard Kaye
> Analyst / Portfolio Manager, Japanese Equities

Hoya

Hoya Corporation, which has parried its core strength in glass processing into near dominance in disc substrates and semiconductor imaging materials, is a classic case. This family glassware business gained national renown from supplying US occupation authority buildings. The company's willingness to divest its legacy crystal ware business and the camera business, to which many Japanese companies are unprofitably wedded, or to build a contact lens retail network in Japan which draws on Hoya's ophthalmic presence but sells other companies' lenses because that is more profitable, all reflect this flexibility and almost ruthless pursuit of return. When we asked founding family member and (former) Chairman and President Hiroshi Suzuki, which businesses he kept and why, his answer was as if from a textbook: 'the company is not mine; any business can grow old and we constantly need to consider divesting'. The words are not from a book, though; they express how he really felt at the interstices of his organisation. Hoya's idiosyncrasy in pursuing return and in transparency manifests itself also in the fact that another family member regularly opposes the management at AGMs. As Mr. Suzuki has hinted wryly, a Hegelian dialectical approach to discussion has led to great decisions, but long and difficult meetings.

Obic

Obic is one of Japan's leading business software providers and the country's answer to Oracle for small companies. Since its creation in 1968 by Masahiro Noda, (who remains Chairman and 24% shareholder) it has insisted on keeping all operations home-grown: no sales agents, no mid- career hires. 'We are like the Chairman's children', say Obic staff. That may sound odd in the West, but it has created a consistent and reliable service provider in corporate Japan which is heading Japan's software solutions to address its labour shortage.

Nihon M&A Center

Similarly to Obic, Nihon M&A Center is an indispensable presence among small Japanese companies but as a succession advisory firm, is suffused with the founder culture of 10.4% holders Mssrs. Miyake and Wakebayashi. Nihon differs from Obic in its openness to outside talent but shares with Hikari Tsushin that ruthless focus on capital return, efficiency of process and gross profit per employee, traits one would associate with a shareholder-managed company. In one of our conversations with Mr Miyake, he explained how he regularly sells stock to colleagues to bind them more directly into the destiny of the company.

Permanent start-ups

These firms are not the sleepy, hidebound companies one might unkindly expect based on their ownership structure. Rather, as Japan's domestic investor base returns to its local market by increasing their allocation to Japanese equities after two decades' hibernation, these efficient capital allocators, these permanent start-ups, are a part of the investible universe which is naturally winning attention. Comgest is pitching its tent there, too.

FOOTNOTE

1 From 1962-2000: source Financial Times, "How Japan's family businesses use sons-in-law to bring in new blood", (https://on.ft.com/2Xrvftc).

COMGEST