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JAPANESE INVESTMENT IN AUSTRALIA — LESSONS LEARNT

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Landmark Transactions

Landmark transactions in this second wave include:

- **Kirin's** acquisition of **National Foods** (2007), **Dairy Farmers** (2008) and **Lion Nathan** (2009)
- **Asahi's** acquisition of **Schweppes** (2008)
- **Nippon Paper's** acquisition of **Australian Paper** (2009)
- **Mitsubishi's** acquisition of **United Utilities Australia** (now called **TRILITY**) (2010)
- **Sekisui House's** acquisition of **AV Jennings** (2010)
- **Dai-Ichi Life's** takeover of **Tower Life** (2011)
- **Fuji Xerox's** acquisition of **Salmat's** business process outsourcing business (2012)
- **Mitsubishi UFJ Trust Bank's** joint venture with **AMP Capital** (2012)
- **NTT Communications'** acquisition of **Frontline Systems** (2013)
- **Japan Post's** record-breaking $6.5bn takeover of **Toll Holdings** (2015)
- **Recruit's** takeover of **Chandler Macleod** (2015)
- **Nippon Life's** acquisition of **NAB's** life insurance business (80%, 2016)

SECOND INVESTMENT WAVE

Australia and Japan share an enduring history of business collaboration that has created significant value for both economies. From its need for secure energy, minerals and food supply, Japan became Australia's leading export destination in 1966-67 and remained so until 2009-10. Today, Japan is Australia's second largest foreign direct investor and trading partner.

Japanese investment into Australia commenced in the 1960s and was primarily achieved through minority interests in primary production joint ventures. As the relationship matured, the last decade has seen a distinct 'second wave' of direct investment in the Australian domestic market. These recent 100 per cent acquisitions have targeted revenue and profit growth as Japanese investors seek a natural hedge to Japan's demographic challenges of an ageing and declining population.

Learning

The economic opportunity for both countries from the second investment wave is immense. The potential learnings are also invaluable. Which factors were key to success, and are there other factors that could help maximise value from an Australian investment?

To test this question, Herbert Smith Freehills spoke with more than 30 leaders of Japanese and Australian businesses at the forefront of the second investment wave. Leaders were asked what factors they see as critical to extracting maximum value from an Australian investment.

The responses identified a number of 'success factors' considered crucial to extracting value. Unsurprisingly, Japanese and Australian businesses were seen as already adept at implementing many of these:

- **long term planning and available capital**
- **an early circle of trust**
- **robust and flexible corporate governance**

At first glance, these elements might seem typical to any cross-border investment — however, they take on a unique form in the Australia-Japan business context.

Responses also pointed to areas where investors and their Australian counterparts could give more focus to maximise value from an investment.

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SUCCESS FACTORS

Advantages from long-term planning and available capital

Two key post acquisition benefits from Japanese investment stood out:

The rigour of long-term planning a Japanese parent company brought to the Australian business

The disciplined approach to planning (sometimes with strategic horizons of 20 years or longer) caused the Australian business to think more strategically. This was especially true for companies which had been ASX-listed and focused on reacting to short-term market pressures. Some respondents also observed the longer term focus was attractive to both existing employees and talented people wanting to join the business.

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Availability of attractively priced debt

Funding coordinated centrally from head office in Japan immediately improved operating returns.

Coupled with a strong parent company balance sheet providing equity to finance growth, this allowed for business expansion both organically and by acquisition.

Shinrai kankei – the circle of trust

A common observation was a relationship of trust entrenched among Japanese and Australian management at an early stage of engagement was key to bridging inherent differences in language, culture, time zone, operating assumptions and business style.

Three factors were regarded as key:

Leveraging the collective '*sempai*' experience of the bilateral business community

A mentor relationship with an individual senior statesperson or a masterclass from specialists with a proven track record engaging with Japanese businesses were both identified by Australian business executives as helpful when contemplating engagement with a Japanese business partner.

These helped to informally or formally fast track the Australian business' understanding of the Japanese counterparty's business plan, motivations and cultural perspective.

On the Japanese side, there was less evidence senior management drew on external guidance prior to or during an investment. Japanese acquirers tended to focus on understanding the financial and operational aspects of the Australian business. After the initial acquisition phase, sometimes steps such as training on Australian workplace regulation and culture were taken. Feedback suggested that there was some value to be gained from this type of training earlier in an acquisition process.

Internal 'bridging champions'

The role of a visionary leader in the Australian operations with an understanding of the Japanese shareholder's objectives was one of the main keys to successful integration of the Australian business.

Leaders also said the appointment of a coach to guide senior management in Australia and Japan on expectations around communication and codes of conduct was invaluable. Often the shareholder representative director or another secondee from Japan to the Australian business was best suited for this role, due to their familiarity with the culture and processes of both organisations.

Test driving the relationship

A minority shareholding can provide a sheltered environment for management within the 'circle of trust' to become familiar with the strategy, business plan and practices of a shareholder business, without the market pressure for rapid positive results associated with an upfront 100 per cent acquisition.

An initial minority shareholding in the Australian business has often served as a proving ground for parties to test the compatibility of a relationship. According to Lion CEO Stuart Irvine, a high degree of trust now exists across the global Kirin and Lion business — helped by the longer term relationship formed from Kirin's initial minority 46.13 per cent shareholding in Lion Nathan acquired in 1998. Kirin completed the takeover in 2009. Similarly, Dai-Ichi Life's initial 29.7 per cent shareholding in TAL acquired in 2008 prior to takeover in 2011, allowed relationships of understanding and trust to develop.

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> Well-developed governance principles clearly delineating authority were a factor of success.

Robust and flexible corporate governance

For a business to succeed in the bilateral context, it must have a corporate governance culture that balances the needs of Japanese investors — which identified transparency and control as priorities — with those of Australian business, who in many cases saw flexibility and clarity of purpose as paramount.

Respondents cited four main factors as fundamental to establishing this equilibrium:

Clear and decisive direction on strategic vision at an early stage

Australian respondents valued Japanese management who had a clearly communicated strategy for the business post acquisition and drove the process of testing that strategy with local management from an early stage of the acquisition process.

Firm, dynamic stewardship from senior Japanese management who were visionaries in their field also had a significant positive impact on being able to move swiftly from first engagement to completion of initial integration.

If the investor approached the acquisition with a 'launch and see' approach, it risked creating a period of strategic vacuum post acquisition. In the instances where this did happen, there was a loss of momentum while Australian and Japanese management came to a landing on who would drive post acquisition strategy for the Australian business.

Well-developed governance principles clearly delineating authority

Clearly defined authority limits documented at an early stage of the acquisition were commonly raised as a factor of success.

Lion chairman Sir Rod Eddington observed having foundation governance principles jointly developed at the outset gave Australian management the right degree of autonomy to use local industry knowledge for the benefit of the global business.

Authority limits were typically high level written principles stating the matters over which Australian management could exercise authority without separate approval from Japanese management and matters for which separate approval from Japan was required.

Although respondents reported ongoing negotiation between Australian and Japanese management over the scope of these limits, all respondents who had these arrangements in place agreed early stage implementation established a clear framework for decision-making that placed the business on a steady footing.

A balance of independent oversight and operational risk management

A flexible balance between adequate transparency for the Japanese shareholder and operational risk management for Australian management was repeatedly identified as a critical success factor.

Unsurprisingly, what constitutes balance differed significantly from sector to sector. In businesses operating in highly regulated industries like finance, a majority of external directors was key to achieving this balance.

In another highly regulated business, board composition featured an Australian managing director and shareholder representative non-executive directors. Over time this was supplemented by a separate advisory board of independent business people with recent industry-specific expertise and understanding of Australian regulatory requirements.

Shareholder representatives with high EQ (emotional intelligence), a strong understanding of the Australian business and a meaningful executive function

Japanese shareholder representatives were seen not only as critical to the Japanese investor but as adding significant value to the Australian business. This was maximised where the shareholder representative had:

- a clear understanding of the drivers of the Australian business.
- early experience with or an appreciation for the culture of the Australian business (whether based on comprehensive pre-arrival briefings or exceptional person-to-person skills).
- a meaningful executive function within the Australian business. This aided in aligning interests with Australian employees and in maximising the value of reporting back to Japanese headquarters.

- an ability to draw on an existing network of relationships across the Japanese business to make new connections at many levels between the Australian and Japanese parts of the business.

WHAT MORE CAN BE DONE?

Many respondents observed that synergies envisaged when first embarking on the acquisition had not been fully realised in the way initially anticipated. Often in these cases, the Australian business continued to operate as an integrated but essentially separate part of the global business.

This suggests opportunities remain to maximise the value of Australian investments. Responses touched on three main areas where additional value stands to be realised:

More rigorous testing of the original rationale for the investment

In one example, the initial business case for the acquisition was predicated on an ability to leverage the Japanese investor's existing broad relationships to cross-sell products of the Australian business to the investor's existing Australian customers and others globally. This assumption was not rigorously tested with Australian management at an early stage. As a result, the investor did not factor in the impact of a different client-service provider relationship in the Australian market. The ultimate outcome was a limited ability to introduce the product to markets that had been earmarked for expansion in the initial business case.

The need for an innovation champion to introduce knowhow in the Japanese market

Unless there is a champion within senior Japanese management, it can be difficult for operations in Japan to make effective use of Australian expertise.

Several Australian operations interviewed were highly profitable and had been acquired as a natural hedge to a Japanese market constrained by demographic, economic or digital disruption factors. However, some respondents reported resistance or a lack of interest in introducing knowhow or efficiencies acquired through the Australian business into other parts of the business.

Conversely, Toll Group Managing Director Brian Kruger said senior executives of Toll's Japanese parent company had a strong awareness of the parent company's strengths and platform gaps. This awareness gave those senior executives a keen interest in making the most of learnings from the newly-acquired Australian subsidiary.

A fresh approach to movement of people

The practice of exposing Japanese employees to Australian operations is well established and has been an important factor in the development of those critical relationships of trust.

Some respondents, like Japan Post/Toll, were taking steps by seconding high potential young people from Japan into the Australian business with the vision that ideas seeded in Australia would in the future be taken to other parts of the network, as well as Japan and across Australia.

Although the practice of exposing Japanese employees to Australian operations is well established, the survey confirmed programs for the reverse — transferring Australian employees to Japan or other parts of the business, even for short periods — remain extremely limited. Even in 2016, a perception exists that the cultural context and different language environment of the Japanese parent business poses barriers to ideas flowing from Australia to Japan.

Nevertheless, many respondents could identify individuals from the Australian business who had excelled within, or collaborated closely with, Japanese head office. These individuals tended to have high emotional intelligence and openness to change.

Feedback from leaders in both Australia and Japan suggested a fresh approach is needed to systematically better identify and equip talented future leaders in the Australian business with knowledge of the parent company and personal networks, if the value of Australian talent is to be maximised across the business.

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APPLYING THE LESSONS LEARNT

In an increasingly competitive global business environment, it is important for Japanese businesses to draw on lessons learnt in Australia by:

- applying the M&A integration experience gained to larger and more strategically ambitious acquisitions in other parts of the world.
- drawing on expertise of Australian management in making regional and global decisions.
- implementing Australian knowhow where it presents a solution in other parts of the business.
- encouraging innovation through moving people's ideas across geographic, linguistic and cultural borders within the business.

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