KEYNOTE INTERVIEW

Japanese PE is entering a 'golden age'

Favourable conditions are spurring the country's private equity industry into the next stage of development, say NSSK's Jun Tsusaka and Shohei Akiyama

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Q Why are global LPs currently so keen to deploy capital in Japan?

Jun Tsusaka: There are a number of factors driving LP interest in Japan at the moment, and that has been growing over the last six or seven years.

The first is clearly the growth of M&A activity in the market. The number of companies changing hands has been increasing over time, both in terms of volume and dollar value. Over the last 10 years, the number of M&A deals in Japan has doubled and we continue to see steady growth in the deal market.

Second, when you think about Japan, which is the third largest economy in the world, and consider the geopolitical issues around the world, experts conclude that Japan is an attractive destination for deploying capital in Asia. The legal system, accounting system, and so on are very much designed and developed along Western standards, so there is a lot of familiarity, and managers can avoid the emerging market risks inherent in other parts of Asia.

Third, in addition to the fairly attractive economic environment, there tends to be a lot of cash in the system and good availability of capital. We are in the leveraged buyout business and seek leverage for our investments – Japan is leverage friendly at low absolute costs. The Bank of Japan's policy of maintaining zero interest rates and the cooperative approach of the banking system support us in levering our investments to generate stronger returns.

Finally, Japan's private equity industry has grown over the last 30 years and in the last decade has shown consistent and steady performance, not only in terms of returns but also realisations. Very often, when dealing with emerging markets, LPs do not see a lot of cash realisations. In Japan, managers are able to exit investments on a systematic basis, as GPs have management control and can drive operational improvements, which is a proven model for delivering not only returns, but also cash, which is why LPs globally are viewing Japan as a country where they want to increase allocations.

Shohei Akiyama: There is also the fact that Japanese companies still have significant room for business improvement, including through digital transformation, and there is a lot of space for consolidation among small and medium-sized companies. Those account for around 99 percent of companies in Japan, so the potential value proposition there is attracting investors.

Furthermore, the Japanese government is actively encouraging greater transparency in corporate governance with the introduction of a new corporate governance code, helping to improve the environment for investors.

Q How is the current geopolitical landscape creating opportunities for Japanese GPs?

SA: The geopolitical issues in China and North Korea have had a relatively limited impact on the Japanese economy, and likewise Japan has limited direct economic exposure to Russia and Ukraine. Japan is in a good position relative to many major economies right now.

Japan has a large economy, worth around $5 trillion, of which about 60 percent can be attributed to domestic consumption, creating a strong opportunity for GPs to perform well here.

JT: When there is global uncertainty, investors like to flock to areas of certainty and look for investments that are uncorrelated with what is going on in the world. Japan, despite its small size geographically, has a large economy almost equivalent in size to Southeast Asia and India combined.

Many people view Japan as heavily reliant on exports because of big names like Toyota, Sony and Panasonic, but actually, net exports represent only around 16 percent of Japan's GDP. Of course, we are better off when the global economy is thriving, but we are not dependent on it.

Q What challenges do managers face when it comes to implementing successful ESG programmes at portfolio companies?

JT: Japan has come a long way in a short time in relation to ESG. Issues around the environment, social responsibility and governance are now

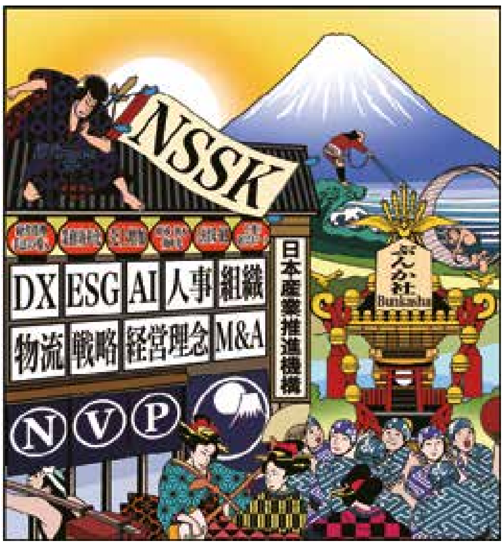
Q Can you provide an example of how NSSK is addressing ESG in its portfolio?

JT: We have taken it upon ourselves to focus on improving diversity and inclusion and narrowing the gender gap in Japan. Our data, limited as it may be, suggests a correlation between strong fund performance and greater diversity and inclusion, and we are able to point to some strong outcomes. In our Fund II portfolio companies, 40 percent of our CEOs and COOs are women or minorities, 78 percent of our total employee base of more than 5,000 people are women, and 49 percent of managerial posts are held by women.

We have made a commitment to ESG and that starts from the top. As CEO and CIO, I am also chair of the ESG committee, taking responsibility for those initiatives across the business. We have also created the role of chief philosophy officer and tasked one of our operating leaders to be a full-time ESG and compliance audit officer, monitoring our ESG initiatives not only at the holding company level but also at the portfolio level.

We have customised ESG objectives for each of our portfolio companies, including KPIs that are negotiated with the investment teams and management teams so that they are genuinely aspirational goals.

As a result, we have won two *Private Equity International* Operational Excellence Awards for our work with nursing home operator Vati and publishing business Bunkasha – these highlight how ESG is at the heart of our operational improvement strategy. In addition, we are proud to have recently been appointed Asia Regional Chair by the Secretariat of the World Bank/International Finance Corporation, to help promote ESG principles in the region.



Winning formula: NSSK enhanced ESG during its OpEx award-winning investment in Bunkasha front of mind for many corporations, both large and small.

When it comes to implementing successful ESG programmes, the difficulty has been overcoming historical business and cultural practices, and increasing understanding that making investments in ESG initiatives leads to short, medium and long-term prosperity. One key theme we are focused on in Japan is diversity and inclusion, and particularly the employment and empowerment of women, where Japan has been falling behind the rest of the world.

You see very few women in boardrooms in Japan, due to the historical social structure and norms. However, that is changing.

Now, organisations need to make sure they are creating career paths for women and building environments that women want to work in, and which provide them with opportunities to succeed and prosper. And we are beginning to see a clear correlation with gender equality and empowerment driving better outcomes.

Japan's private equity industry has had a lot of dialogue around how to be a catalyst for the implementation of positive ESG change. As control investors, we can make a difference at the board level and set criteria around ESG key performance indicators. Private equity, as an industry, has decided to proactively further those efforts and we are all sharing best practice through a concerted effort to share information among our peers on what is working and what is not.

SA: It is important to have the commitment of leadership and shareholders of companies to implement ESG policies. We do not historically have that many good examples of successful ESG implementation in Japan and so we need to encourage companies to run initiatives and improve their ESG activities. As investors, private equity firms can build up examples of success stories and share those, which will help to build momentum in this area.

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>
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>
> **JUN TSUSAKA**

Q How do you see the private equity landscape developing in Japan?

JT: We think Japan has entered a really interesting stage in its development and is now in a similar position to the US in the eighties and Europe in the late nineties, with the private equity industry truly starting to blossom as a major part of the economy. We are entering a golden age for Japanese private equity from the perspective of GPs, LPs, companies and the economy as a whole.

How do we take advantage of that? By bringing global best practice to the local market and assembling a team of investment and operational professionals with global backgrounds, knowledge and skills.

Whether you are an investor with a good understanding of global healthcare or an operating executive that understands how to develop social media strategies or global supply chains, we bring those skills together for the benefit of our companies.

Japan has a deep banking system of more than 100 regional banks, and we have strong relationships with more than three-quarters of those banks, either as LPs or as lenders. That gives us access to attractive and flexible capital, as well as local markets.

SA: We can benefit from strong institutional relationships with global LPs, in addition to good links to small and medium-sized Japanese companies, giving us a unique visibility across the market that few GPs can replicate. We also have an operational toolkit that includes turnaround specialists and senior former executives of multinational businesses, who make a real difference in bringing that global perspective to our portfolio companies. ■

Jun Tsusaka is CEO, CIO and chairman of the ESG committee at Nippon Sangyo Suishin Kiko; Shohei Akiyama is director and chief administrative officer at NSSK and was selected as one of *PEI*'s 40 under 40: Future Leaders of Private Equity for 2022