

Japan: Time for a Sleeping Kaiju to Awaken

While Japan is famous for its innovation and high technology products, the physical infrastructure of many of its companies is way behind the curve. Many Japanese businesses need a tech upgrade to make them more efficient, a point the Japanese government has been making for several years now.



In 2018 Japan's trade ministry, METI¹, warned that companies in its corporate sector were in danger of stumbling off a 'digital cliff' due to limitations caused by the industry's ageing IT systems. METI warned that companies would have to innovate or die, else the country could fall behind other jurisdictions, potentially incurring losses estimated at \$120 billion a year, should they fail to achieve this digital transformation by 2025.

METI's 2018 report recommended that, in the decade that followed, Japanese companies should embrace digital transformation by overhauling IT systems that have long since passed their prime, while also harnessing Cloud, big data and social technology, in order for Japan to remain globally competitive.

It was a stark warning from a government not known for its use of hyperbole. Businesses stood up and listened when METI told them to, "organise existing, closed, overly-specific and outdated systems and determine which of them should be abolished."

Progress has been slow but steady, with the need for transformation further amplified by the pandemic, as the world became more accustomed to relying on more updated technology to allow workforces to work remotely.

Japan's digital transformation has become the focus of the Japanese government and is now a top priority. Once realised it will immediately make Japanese companies more rapid, agile and efficient. This in turn will release investment value, helping Japanese companies achieve their full potential.

AVI's experience in Japan

AVI has real experience and expertise in Japan. We've been investing here for nearly three decades now, with members of our 12-strong investment team based both in London and Tokyo. And as well as a strong Japanese allocation in the AVI Global Trust (AGT), we also manage the AVI Japan Opportunity Trust (AJOT), which launched in 2018.



Over the last 30 years, we've invested in our resources to help us better understand Japan, its economy and the companies that operate within it. We have people on the ground in Tokyo, people who know the market and understand how things work. Within our investment team we have three Japanese nationals, one based permanently in Japan and two in London. This gives us a rich understanding of how Japanese companies work, and how we can work with them and add value to their businesses.

As investors, we're continually looking for undervalued, quality, small and mid-cap companies listed in Japan, businesses that have a large portion of their market capitalisation held in cash, listed securities and/or other realisable assets. We look to unlock this value through proactive engagement, taking advantage of an increased focus on corporate governance. We're interested in high-quality companies that have strong prospects for profit growth or resilient earnings, companies which look to convert balance sheet assets into cash, and prioritise returns to shareholders in Japan.

Pro-active engagement with Japanese companies

At AVI, we pride ourselves on active engagement across all of our investments. We engage with the management teams of every single company we invest in, building close relationships with our portfolio companies and helping them to develop their businesses and achieve their potential. In Japan we are equally engaged with the businesses we invest in, we encourage balance sheet efficiency, and advise on ESG and sustainability issues. In fact, many Japanese companies actively seek out our help when it comes to responsible investment.

And our experience in Japan leads us to believe that the vast majority of Japanese companies will make that digital transformation required in time for 2025.

Today we see Japanese companies working together on several transformative projects, such as working together to introduce a new digital currency for exploratory projects, and retail businesses implementing new transactional systems allowing them to accept a new type of payment card. In addition, we see business pages of Japanese newspapers awash with stories of digital transformation across the country.

In time, we expect Japan's digital transformation to create new growth opportunities for investors - not just in the run-up to 2025, but in the years beyond. We see opportunities in sectors such as Human Resources, IT consulting and Hardware, where the value of their businesses will be elevated by this digital upgrade. Then there are the businesses - like DTS and NS Solutions - who will actually deliver these digital upgrades in Japan.

We've been investing in Japan for over three decades, building relationships with companies and working with management to help them grow their businesses. Japan may be considered a sleeping giant (or 'Kaiju') right now, but as the digital transformation gets underway, we see opportunities for growth across the region. Now is a great time to be interested and invested in Japan.

¹METI is Japan's Ministry of Economy, Trade and Industry