Daiwa SB Investments

PM'S PERSPECTIVES

VALUE + ALPHA GROUP

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Why do companies go public?

What is the rationale behind a company going public? They used to go public in order to raise funds for capital investments. Manufacturers wanted to build new factories and retailers wanted to expand their network of outlets. But most companies allocate an amount within profits made by their core businesses for capital investments these days with less funding needs for capital investments.

According to **Teikoku Databank's** survey in 2019 on intentions for an IPO[1], the top answer was to build recognition and trust while the secondary answer was to secure good workers. This means companies now do not go public for fund-raising but to improve awareness in the job market or enhance brand recognition among potential customers.

These reasons might be applicable to small and mid-sized companies, but why would a major and well-known company choose to be public? They often say that being listed is important to facilitate recruitment activities, but we don't think unlisted companies such as **Suntory Holdings** and **Takenaka** are struggling to hire great talent, while listed companies are not actively recruiting excellent people from outside by dangling stock options. It seems most large companies keep themselves on the public markets by force of habit without considering the meaning or advantage of being public.

There are two reasons to go public. One is fund raising and the other is equity governance. Excellent managers will talk about this dream, raising money in the public market, investing that money in equipment and raising the corporate value. This is an ideal scenario of listed companies.

In fact, there are large companies overseas that do take advantage of being public. The stock price of some companies may climb due to the excellence of its investment plan in the days after an announcement. Or some companies may invite better managers with an external perspective to help expand its business. These stories are common in other countries. When it comes to capital policy, we only talk about dividend and share buybacks in Japan. But if an increasing amount of large companies try to increase their profits through fund-raising activities, the Japanese equity market would become much more active.

We note that, in the past, equity finance has had an image problem in Japan and we think that there are three main ill-considered actions which may help to explain that image, which have been likened to rotten apples. The first is aggressive capital-raising activities without consideration for capital costs or capital needs. The second is activities to increase capital increase for the purpose of merging overvalued overseas companies. The third is IPO transactions in which owners, such as investment funds and large companies, extract funds from investment destinations and force their debts and goodwill on new investors. This behaviour erodes the confidence in capital market, which is public property. So we think that equity investors should do their best to seek out and remove these rotten apples and attempt to ingrain sound equity financing activities in Japan.

Reference

*1 Survey on intention for IPO in 2019 by Teikoku Databank
https://www.tdb.co.jp/report/watching/press/pdf/p190409.pdf

Daiwa SB Investments

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Mr Kamiishi joined Daiwa SB Investments in 2009 and covered US & European equities as a strategist from 2010 to 2013. He moved to Hong Kong in 2013 as an analyst for the auto & industrials sector in Asia Pacific ex-Japan equity. In 2015, he returned to Japan and covered the IT & services sector as a Japan equity analyst. In 2016, he became a portfolio manager in the Value + Alpha group.

Mr Kamiishi obtained a BA degree in Economics from Keio University (2009) in Japan.

Note: Daiwa SB Investments Ltd. (DSBI) merged with Sumitomo Mitsui Asset Management Company, Limited (SMAM) on 1 April 2019.

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Disclosures

On 1 April 2019, Sumitomo Mitsui Asset Management and Daiwa SB Investments merged to form **Sumitomo Mitsui DS Asset Management.**