

Recent Trends in M&A of Japanese Firms and Corporate Governance

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ABSTRACT

It is said that we are in the middle of a second boom of mergers and acquisitions in Japan. After the collapse of the bubble economy, many failed companies have been rescued by viable companies through mergers. At the same time, the number of owner-managers looking for successors by way of being acquired increased. Almost all of them are owners of small and medium companies. In addition, for diversification, Japanese companies have come to rely upon mergers and acquisitions (M&A) more frequently than before. The second M&A boom in Japan implies that Japanese business people have learned how to use M&A techniques for corporate restructuring as well as corporate growth, through the experiences of cross-border M&A activities in the 1980s.

New trends in cross-border M&A of Japanese companies emerged. For example, foreign direct investments by Japanese companies shifted away from Asia towards the US and Canada in the 1980's. Investment in the US and Canada increased to as much as half of all of the direct foreign investments by the Japanese, compared with the previous level of one third. Subsequently, starting around 1989, the number of acquisitions in Europe surged, presumably due to the unified markets in Europe.

The Japanese corporate governance system which became active after the collapse of the bubble economy in Japan, remarkably reduced the need to use takeovers and acquisitions as a disciplinary mechanism; this contrasts sharply with the way business is conducted in the US. Acquiring or merging with another company was an option only when the survival of an important business relationship is jeopardized by financial distress or loss in competitiveness.

The bubble economy has brought excess cash for management. Cash is the easiest asset to deploy in the interests of a select group of stakeholders. Therefore, decisions about how to allocate cash bring sharp disagreements among stakeholders about the future direction of the company. Japanese managers who are virtually free from shareholders' control have pursued Zeiteku activities (financial engineering), making use of cash in hand and low-cost funds procured in the capital market. The results turned out to be a total failure when the bubble burst. Managers in declining industries are pushing to restructure companies in the direction of product or business diversification. Implicit promise of employees' life-long employment and corporate growth are the main motives of their strategies.

The behaviour of Japanese managers suggests that freedom from capital market discipline prompted them to benefit themselves and the employees of the firm at the expense of other stakeholder interests. The remarkable success of Japanese companies in the postwar period has furnished the Japanese corporate governance system with a unique market for corporate control. Experience and knowledge obtained after the collapse of the bubble economy will create a different market for corporate control—a market which brings more challenge to incumbent management since there is a greater chance of hostile bids by outsiders.

1. TWO MERGER MOVEMENTS IN POST-WAR JAPAN

As FTC figures in Exhibit 1 indicates, the number of mergers and acquisitions in Japan has been increasing since 1948. According to the annual reports from FTC, between 1985 and 1992 there were about 12,100 mergers, i.e., 1,500 or so per year. In comparison with about 500 mergers per year for the period 1951-1970, and about 1000 mergers per year for 1970s, it is clear that mergers have occurred more frequently in recent years.

We can identify two surges in Japanese mergers. One of them is the rise in the period 1967-1978, and another in the period 1985-1994. The first merger movement corresponded mostly to an unprecedented business boom in the so-called *Izanami Keiki* period 1965-1970. The second merger movement is still going on, and it will be broken down into two parts. The first stage of the second merger movement covers the period 1985-1990, which corresponds fully to the fourth merger movement in the US and UK. The second stage of the second merger movement started in 1991 and is still going on.

To better understand the background of the first merger movement, we should know the situation that Japanese companies faced during that time. Japanese companies were urged to strengthen their international competitiveness against threats from the liberalization of foreign capital. When the Japanese government began to liberalize foreign capital entry into Japan in the 1970s, management became increasingly concerned about the thin capitalization of Japanese companies. In order to compete with foreign capital, they needed to realize the merits of large-scale operations by reducing excessive competition in the domestic market. The result was that a number of large-scale mergers occurred in the period 1967-1978. Some of them were Yawata-Fuji Steel (New Nippon Steel-merge firm), Daiichi-Nippon Kangyo Bank (Daiichi-Kangyo Bank) Nissan-Prince Motors (Nissan Motors), and Toyo Koatsu-Mitsui Chemical (Mitsui Koatsu).

In Japan, a merger is usually arranged either by the governmental agencies such as MITI, and MOF as part of some overall policy,

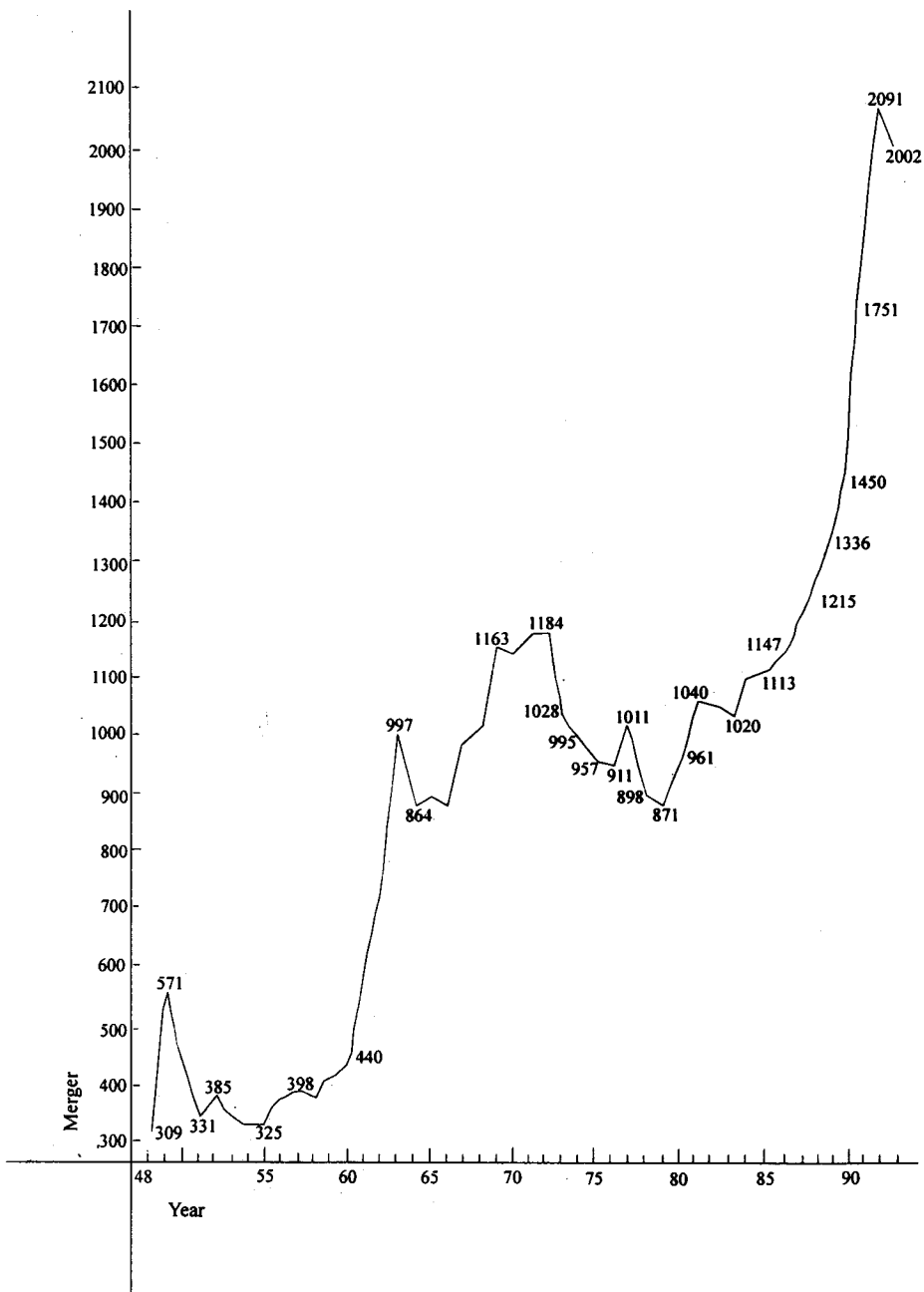
or by the main banks, or by influential business leaders. The reorganization operation in the automobile industry in the 1960s, supported by MITI, is a good case in point. The Industrial Bank of Japan played an important role by participating in the Nissan-Prince merger. The 1969 mega-merger of the two giant steel makers, Yawata and Fuji offered an instance of interaction of MITI and banks against FTC which initially rejected the merger proposal.

One of the characteristics of the first merger movement was *taito gappaei*, merger on equal footing, where shares of the old companies are exchanged for those of the newly born company on a one-to-one basis. Almost all of the major mergers were effected in the form of *taito gappaei* until the end of the first merger movement. One of the mergers on equal footing was, in 1975, that of Daiichi Bank and Nippon Kangyo Bank resulting in the present Daiichi Kangyo Bank, the largest bank in the world.

2. THE SECOND MERGER MOVEMENT

It would be more convenient for us to use Yamaichi Securities figures than to use FTC figures for the analysis of the second merger movement. Yamaichi data cover all kinds of M&A in the broader sense, that is, stock purchase of business and assets. In FTC data, cases where a parent company merges with a child or a sister merges with another sister are excluded from the terminology 'merger'; this kind of merger reportedly accounts for 30%-40% of the entire mergers in Japan. Exhibit 2 covers the period 1985-1993, that is, the first stage and the second stage of the second merger movement. As Exhibit 2 shows, the number of mergers increased steadily until 1991 when it hit a peak, and decreased gradually thereafter, whereas the number of purchases of business and assets hit a peak in 1988 and decreased gently. These trends correspond to the Western M&A trends in general. The trends in stock purchase (majority) and capital participation (minority) showed a steeper rise in the number of transactions and reached the highest point in 1990. Afterwards they dropped gently toward 1993 as did mergers and purchases of business assets.

EXHIBIT 1. Number of Mergers by FTC



Merger in Japan is very similar to a pooling of interests aimed at combining two companies in terms of management and personnel. Usually both management and personnel remain in the surviving company, but shares in the surviving company are exchanged for outstanding shares of the disappearing company. Since the purchase of business and assets is similar to a merger in a practical sense, some researchers would regard the purchase of business and assets as a form of merger and examine a trend in merger (broader sense) after adding up two kinds of figures.

Not only the number of mergers, but also the number of stock purchase and capital participation increased drastically in the first stage of the second merger movement, and levelled off towards the second stage. Japanese prefer affiliation to merger, where one would expect a merger in the West. The employees of many affiliates feel happy when they work with the employees of the parent company. They maintain their independence from the parent, but at the same time enjoy the services and benefits of the parent in general. It is also true that, in some cases, the affiliated company is a candidate for merger.

In the 1980s, Japanese firms held an abundance of free cash flow in their balance sheets, which was the fruit of their competitiveness in the world product market. After

repaying their bank loans, Japanese management invested cash in ways that were of dubious value. Much of the free cash flow in Japan was spent in *Zaiteku* (financial technology) operation on one hand, and used in corporate M&A activity abroad on the other. A rapidly appreciating Yen, trade conflicts with American or foreign competitors and the governmental policy of deregulation, all caused Japanese companies to acquire target companies and real estate abroad. As Exhibit 3 clearly indicates, the number of In-Out type of M&A increased rapidly; it was non-existent in 1982, but surpassed the number of In-In type of merger, and reached the level where it accounted for 58% of the entire M&A of Japanese companies in 1990.

Although acquisitions are not as popular as mergers among Japanese companies, most corporate consolidations are achieved similar to acquisitions and takeovers abroad. As opposed to a Western-style takeover however, the bidding activity of Japanese companies is friendly and defensive. In other words, a company is an active bidder for corporate control if and when (1) the target company has had some relationship with the Japanese bidder, and (2) that relationship is threatened in some way.

In the second stage of the second merger movement, we can observe an interesting trend which is different from the

EXHIBIT 2. Number of M&A by Type (1985-1993)

	85	86	87	88	89	90	91	92	93
Stock Purchase (majority)	111	196	197	186	276	343	246	218	166
Capital Participation (minority)	102	154	187	214	235	283	232	138	126
Merger	28	31	25	38	35	45	69	63	67
Purchase of Business or Assets	48	70	60	117	114	80	67	64	72
Total	289	451	469	555	660	751	614	483	431
(Index)	100.0	156.1	162.3	192.0	228.4	259.8	212.5	167.1	149.1

Source: Yamaichi Securities Corp.

Western counterpart. That is, M&A activities of Japanese companies did not decline as much as their Western counterparts did. In spite of the fact that Japanese companies suffered from losses caused by speculation on the stock and real estate markets, the collapse of the so-called "bubble economy" has stimulated the domestic M&A market to a greater extent. Many failed banks and companies have been rescued by viable banks and companies through mergers. Many mature companies have pursued an unrelated diversification strategy: life sciences, electronic communications, advance businesses that mature manufacturers are trying to enter. The rationale for doing so was to avoid the keen world-wide competition in their mature core businesses and, in particular, to keep their employees continuously employed. They have come to rely upon mergers and acquisitions more frequently than before, partly because they needed to develop their diversification strategy quickly. In other words, internal development of new businesses from the ground up was believed to require more time than managers believe acceptable in present circumstances, and partly because Japanese business people have learned how to use M&A techniques for corporate restructuring as well as corporate growth through the experiences of cross-border M&A activities in the 1980s.

Another interesting phenomenon is the increasing number of owner-managers of small and medium scale companies who are looking to sell their businesses. Although the traditional approach is to choose their successors among their sons and relatives, nowadays youngsters have liberal and diversified

attitudes towards their own lives so that many owner-managers are forced to sell their companies.

3. CROSS-BORDER M&A

(a) *Recent Trend in the In-Out Market*

International mergers and acquisitions involving Japanese companies were relatively small in number and size until the 1970s. However, faced with opening markets and intensified competition in the world market, the management of Japanese companies realized the necessity of cross-border alliances for its strategies in the 1980s. The pace of Japanese acquisitions in US clearly quickened in the late 1980s.

To better understand the cross-border activities involving Japanese corporations and foreign capital, we examine Exhibit 3 and Exhibit 4. As can be seen in Exhibit 3, in the 1981-1993 period, In-Out transactions, that is, the number of deals where Japanese companies acquired foreign companies, were surpassed by In-In transactions in the 1981-1993 period. On the other hand, as Exhibit 4 clearly indicates, the value of individual transaction in In-Out deals was much higher than that of In-In deals. This implies that Japanese corporations and investors tend to invest on a larger scale abroad, while they invest on a smaller scale in the domestic M&A market. In comparison with the trend in the number of In-In transactions, the number of In-Out transactions rose more quickly and reached its peak in 1990 and fell rather rapidly in the 1991-1992 period. It seems that the quick rise in number and value of In-Out deals corresponds

EXHIBIT 3. Number of M&A by In or Out (1981-1993)

	81	82	83	84	85	86	87	88	89	90	91	92	93	Total
In-Out	122	122	141	140	163	226	219	223	240	293	302	260	259	2,710
In-Out	48	28	37	44	100	204	228	315	405	440	294	186	140	2,469
Out-In	6	3	5	6	26	21	22	17	15	18	18	37	32	226
Total	176	153	183	190	289	451	469	555	660	751	614	483	430	5,405

Source: Yamaichi Securities Corp.

to the pattern in the fourth merger movement that took place in the Western countries.

It is interesting to note that in the 1987-1990 period the value of individual deals was much greater than in other years as seen in Exhibit 4. This is mainly because outright acquisition as a mode of investment by Japanese companies has surged in the UK and Western Europe beginning in 1985. Large scale acquisitions by Japanese corporations account for a large part of the enormous value of transactions in the 1987-1990 period. After the collapse of the bubble economy, that is, after the latter half of 1991, the number and value of Japanese mergers and acquisitions dropped dramatically, underscoring the nation's accelerating economic slowdown.

As we have observed so far, the Japanese, aided by a rapid yen appreciation and driven by pressure to restructure and diversify businesses have shown an increased willingness to invest abroad. Although Japan remained firmly entrenched in fifth place among all major foreign buyers of US companies in the period 1979-1988, towards the end of the decade, Japan was pushed up to either the second or third place, taking turns with Canada for the second place. According to the *Mergers & Acquisitions*, Nov/Dec, 1992 issue, the US accounted for 54.2% of all Japanese In-Out M&A activities in terms of number, 77.0% in terms of value in the 1988-1992 period. On

the other hand, European countries including the UK accounted for 28.9% in number, 16.1% in value, and the rest of the Japanese M&A investments went to Asia and other areas. In Europe, the UK was the largest target country of Japanese acquirers, that is, the investment in the UK accounted for 36.3% of all M&A investments in Europe in terms of number, and 73.9% in terms of value in the 1988-1992 period.

(b) *A Survey on Cross-Border M&A*

The 108th Commission on Administration, Japan Society for the Promotion of Science (*Nippon Gakujitsu Shinko Kyokai, Keiei Mondai Dai 108 Inukai*) conducted a survey on cross-border M&A activities of Japanese corporations in 1993. The author joined the research project as a member of the committee. The survey was conducted to obtain information about international comparisons of corporate behaviour and behavioural standards of corporations as a whole. The survey on cross-border M&A activities constitutes part of it. Questionnaire sheets were mailed to 398 major corporations excluding major financial institutions in Japan and 108 companies responded. Samples are composed of 44 machinery and metal companies (iron & steel, general machinery, electrical appliance, vehicles, and precision machinery), 18 chemical companies (mining & petroleum, chemical &

EXHIBIT 4. Value of Transaction/Case (million yen)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	Total	Average
In-In	366	933	842	1,580	2,200	2,219	2,226	2,958	2,412	15,646	1,738
In-Out	2,282	5,292	8,032	10,475	10,238	9,603	4,083	2,251	3,826	57,082	6,342
Out-In	1,536	2,843	2,060	9,973	3,643	549	9,601	3,898	1,997	36,100	4,011
Averager	1,711	3,862	5,532	8,110	9,166	7,719	3,507	2,611	2,987		
Number of disclosed transaction	73	141	196	261	336	358	281	211	160		

Source: Yamaichi Securities Corp.

rubber, and clay & pottery), 8 light industrial companies (food, textile, paper & pulp etc.) and 38 companies in service industries (construction, trade, real estate, transportation, electricity & gas, and mass-media).

The survey showed 85.1% of respondents experienced some kind of merger, acquisition and partial combination (minority) that involved foreign companies at least once, prior to 1993. Only 15% of them did not have any experience. These respondents experienced 69 acquisitions, 105 mergers, and 85 partial combinations that involved foreign companies. It seems that some respondents have not differentiated clearly mergers from acquisitions, because the number of mergers surpassed that of acquisitions a great deal, which is unlikely to be the case in overseas M&A markets.

The trend toward M&A (broader sense) varies from industry to industry. M&A activities of Japanese companies in the machinery and metal industry account for 43.5% of all sorts of M&A activities, chemicals for 20%, light industries for 9.4% and service industries for 27%.

Targets of acquiring Japanese companies are broken down with respect to several index; 41% of all targets were listed companies, 63% of all targets parent companies, and the rest subsidiaries.

The classification of target by country is as follows; US and Canada accounts for 36.6% of all targets, Taiwan for 8.4%, China for 7%, the UK for 5.6%, and all other countries for 4.2% or below. This shows that a large number of Japanese companies have made direct investments in North America. However, these figures might mislead us by giving a slightly distorted picture, because our samples are not evenly distributed in size, being mainly relatively major corporations.

About 60% of correspondents acquired foreign companies with the payment of ¥5 billion or less per deal; 25% paid prices between ¥5 billion and ¥10 billion; and 15% paid ¥10 billion or more.

One of the questions asked was: how do you start negotiations for M&A with a foreign company? About 34.5% of respondents initiated negotiations directly, 29.5% of them started negotiations through middlemen such

as investment banks and securities houses, and 25.2% of them were approached by foreign target companies directly, or through their agents; 10.8% of them did not answer this question.

The subsequent question was: what method was employed to acquire a target company? Of the 59 respondents to this particular question, 8.5% of them acquired stocks through take-over bids; 25.2% of them negotiated with target companies (which had other bidders) directly; and 66.3% of them negotiated targets which had no other bidder.

Among 53 respondents, 18.9% of them evaluated the results of their M&A very positively, 60.3% evaluated moderately, 5.7% evaluated negatively, while 13.2% did not answer.

The next question was: what is your plan in M&A over the next 5-10 years? Among 108 respondents, 7.4% of them wished to use the M&A strategy aggressively; 12% hoped to use the M&A strategy as much as other Japanese companies do; 14% showed a rather negative attitude; while 65.8% of them did not respond.

It is difficult to draw conclusions about Japanese In-Out M&A activities from the above figures, because the number of samples are biased toward large-scale corporations. In spite of that, the author derived a general impression that the historic reluctance of Japanese companies to resort to the M&A strategy for launching overseas markets is being lifted fairly swiftly.

(c) *Recent Trends in Out-In Market*

The number of Japanese companies acquired by foreign companies has been very small; about one-eleventh of the In-Out deals during the 1981-1993 period, as Exhibit 3 explains. Exhibit 4 shows that in value, Japanese firms acquired by foreign investors has been about two-thirds of the In-Out activities.

During the period 1955-1980, foreign acquisition of Japanese companies was strictly controlled by Japan's Foreign Exchange and Foreign Trade Control Law and Foreign Investment Law. With only a few exceptions, these laws virtually prohibited direct investment in Japanese firms by foreign investors. Japanese government restrictions entailed joint ventures with a principal form of foreign investment.

Even after the enactment of a new Foreign Exchange and Foreign Trade Control Law in 1980, which lifted old restrictions and bureaucratic procedures, operational issues often made the joint venture the dominant pattern of foreign investment. For the Japanese partner, the joint venture was the ideal vehicle to obtain a technology that it cannot obtain through a simple license from the foreign partner. Although direct foreign investment in the equity of Japanese companies became permissible in principle, foreign investors rarely took majority stakes of any of the well-established Japanese companies. And almost half of acquired corporations were simply buyouts of partners in Japanese joint ventures.

No one can deny that acquisition in Japan is attractive for foreign investors, because acquisition is the preferred mode of entry into a highly developed market like Japan. However, it is unfortunate that almost all of the companies in Japan are not accessible for would-be foreign buyers. As has been true for domestic mergers, non-legal barriers such as industrial group membership, mutual shareholding among Japanese companies, and the nepotism associated with M&A activities in Japan have hampered the development in In-Out acquisitions. Another constraint on acquisition in Japan is the relatively high price of Japanese corporate shares with the high P/E ratios. High share prices reflect the fact that Japanese companies usually have high hidden values which are not reflected on the balance sheet, because land and investments are carried on the balance sheet at cost. The collapse of the bubble economy which involved the fall of land prices and corporate share prices has relaxed the constraints mentioned above to some extent.

Things are steadily changing in the arena of Out-In M&A market in recent years, even though the level remains low relative to In-Out and In-In markets. But there are some M&A patterns that are not likely to be seen in the future especially in Japan. The hostile takeover bid is one of them. All of the directors of the target company must approve the sale of the shares of the company in Japan. When T. Boone Pickens having acquired more than 20% of Koito's outstanding shares,

attempted to join Koito's management (Koito-Toyota's large subsidiary), he failed in his bid by being rejected from its general assembly of shareholders in 1989. *The Japan Times* commented as follows: In short, as Pickens should have discovered by now, Japanese companies are essentially people ... people at work. And people are not for sale! Neither does share holding in a joint company entitle anyone in Japan to participate in management (*The Japan Times*, May 8, 1989).

4. CORPORATE GOVERNANCE IN JAPAN

The corporate governance issue began to be discussed intensively in Japan after the collapse of the bubble economy, while in the US, it was put on the top of the agenda in the 1980s, when institutional investors with their sophisticated knowledge, gained a greater influence over the management of the companies in which they invested, and hostile takeover conflicts made people focus on the issue of "who owns the firms". The Japanese corporate governance system, characterized by (a) stable shareholdings, (b) a set of long term reciprocal contracting among *keiretsu* member companies, (c) a main bank system, and (d) managerial incentives based upon overall corporate growth, remarkably reduced the need to use takeovers and acquisitions as a means of disciplining for managers and a means of sharing information among transacting companies.

(a) Stable Shareholders

Shareholding characterizes a basic Japanese corporate governance system. Under the system of stable shareholding, a large number of stockholders are corporate investors in Japan, and they hold other companies' stocks mutually. Japanese institutional investors accept low profits and lean dividends, unlike their Western counterparts who try to optimize current profits and dividends. When the stockholders' claim to a return on their investment (capital gain on market value of stock) is met by the company, they have little say in management matters. They are concerned with smooth and reciprocal business transactions between the particular company and them, through their mutual

equity ownership. Since these institutional stockholders are not as interested in dividends and capital gains as in maintaining their good relationship with business partners, they do not sell their stocks even if the stock prices declined in the market and favourable stock prices were offered by would-be acquirers and raiders. Stable stockholders are in general willing to subscribe to new stock offerings at the company's request. Stable shareholding is a development of long-standing mutual shareholding which has evolved from the industrial group and related company group in Japan.

When the Japanese government began to liberalize foreign capital entry into the Japanese market in the 1970s, Japanese management became increasingly worried about the thin capitalization of Japanese companies. It seemed to offer a temptation for takeover by foreign companies and investors. One of the effective solutions to foreign capital threats was to form networks of stable shareholders, who would not sell their stocks to foreign investors planning a takeover at any event. A major task for the financial manager is to locate stable shareholders. Main banks, life insurance companies, trade companies and suppliers are usually able to subscribe to new share offerings and retain their stocks even if the market value were high enough to make other shareholders sell out.

(b) *Keiretsu*

Mutual shareholding and industrial grouping (*keiretsu*) are closely related. In the early years after World War II, mutual shareholding was a core instrument in the formation of the major *keiretsu*. Later, much mutual shareholding took place. Banks and other financial institutions became the largest shareholders of their clients under the constraints of the Antimonopoly Act.

Interlocking directorates, president's meetings of the industrial group's member companies, besides stable shareholding, are all features of *keiretsu*, and serve to maintain close ties within the industrial group. For most Japanese companies, the long-term trading relationship with *keiretsu* companies constitute the major value of their overall dealings with

those companies. Within the framework of such stable long-term dealings, mutual trust relationship between managers can be created and cooperation formed.

Another feature that helps Japanese industrial groups is extensive information sharing among member companies. Usually core group members such as a main bank, a large trading firm and a major industrial company form the core of a *keiretsu*. These core companies form the hub of a large information-sharing network. Information gathered by the core of the group is eventually dispersed through a network of channels. The networks of interlocking directorates, alumni directors and various business interest associations including president's meetings are some of the examples. The information sharing systems sometimes perform valuable services. For instance, they quickly identify financial trouble spots in the group members and help resolve their problems under the guidance of the main banks or other stakeholders.

(c) *Main Bank*

Besides loans, another tie binding an industrial company to its main bank is share ownership. About 58.3% of the largest stockholders of the top 100 Japanese companies in 1986 were banks and other financial institutions. The amendment of Article 11 of the Antimonopoly Act requires banks to divest part of equity ownership in any company in excess of 5% by the end of 1987. The 5% rule aims to prevent a main bank from exercising undue control over their clients. Nevertheless, as the largest single supplier of capital to the company, a main bank is likely to intervene. Usually main banks have considerable amounts of debt at risk, and the character of the main bank's loans changes a great deal when its client is in trouble financially. That is, most main banks subordinate their debt to that of other banks leading to the main bank's clients. When a client encounters severe problems, often the main bank steps in to perform a rescue operation and reconstruct it with the cooperation of other banks, financial institutions and group member companies. Industrial group cohesion must be kept over time, and is determined by intangible factors. Member

companies are often persuaded by the main bank to act together to protect a failing member of the group.

Selective intervention by main banks is not confined to cases involving financial problems. They sometimes step in to resolve a dispute between labour and management. In short, the main bank monitors the performance and acts of its member companies like a management consultant or a controlling shareholder to prevent various problems from going out of control. One effect of this monitoring with selective intervention is to reduce the cost associated with the failure of lending.

(d) Managerial Incentives

Japanese managers are agents of the coalition of various stakeholders rather than those of shareholders or any other single group. Consensus decision-making or bottom-up decision-making, for which the Japanese style of management is well known, is explained by the responsibility assumed by management to minimize conflicts among the needs and expectations of the stakeholders. Within the context of the Japanese stakeholder coalition, management is evaluated not so much by its ability to increase the wealth of shareholders or the welfare of any other single stakeholder as by its ability to maximize revenue and survive in the long run.

If we look at mergers and acquisitions in the Japanese setting, we find that the functions of the market for corporate control as a disciplinary force do not work. Unlike the Western corporate governance, a confrontation between management and shareholders seldom occurs in Japanese corporations. Therefore, Japanese management can concentrate its efforts to coordinate the actions of various stakeholders and to resolve the conflicts of stakeholder interests, without worrying about the shareholders' disciplinary actions. The interest of the management is kept in line with the preservation of the coalition of stakeholders by a system that rewards people for achieving corporate size, stability, and growth.

While Western incentive systems are characterized by profit sharing, stock ownership and stock options, the Japanese system of

management offers virtually none of these. Instead, as far as monetary compensation is concerned, it offers only monthly pay and cash bonuses. The management reward system consists of promotion, membership of the president's meeting in the industrial group or the related company group, a post-retirement position with a company, in addition to the compensation based on the size and growth of the corporation. In Japan, the well-being of the management depends upon the company's growth and the preservation of its relationships with other firms in the same group and in the same industry.

5. TRANSFORMATION OF JAPANESE CORPORATE GOVERNANCE

The overall effect of Japanese corporate governance has been to enhance tremendous efficiencies in the execution of business transactions by making it easier to maintain long term commercial relationships with other companies. These trust-based relationships have enabled Japanese companies to function with lower asset-ownership, in spite of higher interdependence in the transactions supported by those assets. In many respects, the corporate governance system that has developed since the end of World War II is distinctly different from the system for a typical Western corporation. Japanese corporate governance relies more heavily on (a) reciprocity in equity ownership and commercial trade, (b) the use of flexible contracts based on mutual trust, (c) selective intervention by main banks to correct problems before they become serious, and (d) the managerial incentives toward sustainable growth and survival.

Significant changes have occurred in the capital and industrial structure of Japanese corporations, and they have affected the corporate governance of Japan in the last decades. An abundance of trade surplus and slower growth have contributed towards overcoming financial lack on the Japanese corporate balance sheet. Bank debt has been substantially reduced and excess free cash has been accumulated. Further, an easier access to the global capital market and an accelerated liberalization in Japanese financial

market have resulted in weakening ties with main banks and general trading companies in the group. As a result of these trends, banks and other financial shareholders are increasingly concerned with obtaining higher direct returns on their equity investment rather than with intervening selectively to maintain their reciprocal business relationships with industrial clients. In general, Japanese management enjoys great freedom and exercises much discretion. Some traditionally stable shareholders are showing signs of disloyalty to present management and unwillingness to subscribe to new stock offerings at the company's request.

A sharp yen appreciation beginning in 1985, coupled with the collapse of the bubble economy has accelerated the industrial hollowing in manufacturing and has brought numerous changes to the *keiretsu* system. Close ties between large manufacturers and suppliers and subcontractors are threatened by the manufacturing sectors' moving abroad. The Japanese style of management, which is symbolized by life-long employment, seniority-based wage and enterprise unionism is now under great pressure. At the corporate strategic level, restructuring is diversifying many large manufacturing sectors into unrelated and niche business.

As mentioned earlier, the traditional Japanese corporate governance system has been influencing merger and acquisition activities throughout the period of high economic growth in Japan. It has greatly lessened the need for an active market for corporate control. It has also set a distinct Japanese standard for the merger and acquisition transactions at home. The gradual transformation of Japanese governance that takes place today has a great deal of bearing

on Japanese merger and acquisition activities. A 1985 survey of Yamaichi securities on Japanese manufacturing corporations revealed that 83% of the respondents thought that M&A were becoming popular in Japan. 56% of them thought that M&A could help them achieve corporate objectives and 42% of them had at least tried a merger or an acquisition.

The results of the Yamaichi and the Gakushin survey explained earlier reflect the fact that the number of mergers and acquisitions by FTC statistics and Yamaichi statistics did not decrease. The Japanese are not as M&A-averse as they were before: it is no longer a taboo.

Despite all the recent developments in Japanese corporate governance and the market for corporate control in Japan, it is still very unlikely that a complete transition to Western standards will be made. The question is—how soon and how far the Japanese corporate governance system and market for corporate control will resemble that of their Western counterparts.

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