The Development of Corporate Governance for Mergers and Acquisitions in Japan

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Abstract

The purpose of this paper is to study for how corporate governance in Japanese firms has developed more effective for M&A. Mandatory disclosure related to corporate governance have rapidly improved and established. However, the sensational case of Olympus for accounting fraud makes us to remember that Japanese firms have the weakness of corporate governance and audit as well as various disgraceful affairs in the past. Actually, overseas investors have thought that financial statements of Japanese firms without reliability since several frauds since 1990, which resulted in the problem of *Legend Clause*. Recently, several global M&A of Japanese companies are presented lively in foreign countries, but such M&A are abused by concealment of loss for many years of Olympus. The growing discussions about higher corporate governance made global markets to develop with the transparency of their accounting information. Thus, it is necessary for Japanese firms to enrich the financial information for corporate governance. We need to consider several of historical cases in Japan such as Sotoh and Yushiro that indicate the change of their positive disclosure to effective corporate governance after TOB attack.

Keywords: Corporate Governance, M&A, Takeover Bid, TOB, Disclosure

I Introduction

Recently, most global firms including Japanese firms understand the threat of M&A that they might be faced on that in near future. According to the survey*1 in 2011, the 93.3% of Japanese listing companies answer for the positive opinion forward M&A, because of the strength of Yen and the shortage of electricity. Actually, in 2011, there are 609 cases which Japanese companies purchased overseas companies and the ratio gets higher to 78% than last year. The total price of purchase is 68.4 billion dollars*2.

*1 This survey announced in September 7, 2011 by Nihon M&A Center Inc. is for M&A of the listed company in Japan.

*2 Nikkei Shimbun, December 29, 2011.

Investors in Japanese firms are sensitive to the manager's response to the effectiveness of corporate governance, particularly in their accountability. The increase of M&As by takeover bid "hostile TOB," makes most managers to face a critical problem on management. Mandatory disclosure for corporate governance has rapidly developed. The First Subcommittee of the Financial System Council, an important third-party advisory council to the Financial Services Agency (FSA) stated in the Report, December 16, 2002, that we need more information to strengthen corporate governance. This report was one of the reforms to improve security market through the cases of window dressing by U.S. firms in 2003.

Furthermore, based on the report, FSA announced*3 *Measures for Ensuring Confidence in the Disclosure System* on November 16, 2004; (1) Introduction of the following requirements regarding internal control over financial reporting: an assessment by management of the effectiveness of internal control over financial reporting, and auditing by CPA or audit firm of the above assessment by management, (2) Introduction of an administrative civil money penalty system against breaches of the continuous disclosure requirements, (3) Enhancement of disclosure of governance-related information and (4) Enhancement of disclosure about a parent company by a public subsidiary, in cases where the parent company is not under the continuous and disclosure requirements. FSA revised the regulations*4 for securities report from March 2005 in order to (a) enhance disclosure related to corporate governance and to (b) put into effect disclosure of parent company information in subsidiary companies' financial reports in cases in which the parent company is not under the continuous disclosure requirement. This paper mainly deals with the above (3) and (a).

However, the case of Olympus for accounting fraud gave us a sensational example in the world which the function of corporate governance and audit in Japanese company are not always effective. Several global M&A by Japanese companies are presented lively in foreign countries, but such M&A are abused by concealment of loss for many years of Olympus. Hatta et al (2011) explains that it has historically been considered to be a serious problem that Japanese companies have sometimes the weakness of governance and audit and various disgraceful affairs. Actually, overseas investors have thought that financial statements of Japanese firms without reliability since several

*3 'Further Measures for Ensuring Confidence in the Disclosure System,' *Press Release*, December 24, 2004, FSA (http://www.fsa.go.jp/news/newse.html).

*4 'Work Schedule for the Implementation of the Program for Further Financial Reform,' *Press Release*, March 29, 2005, FSA (http://www.fsa.go.jp/news/newse/e20050329.pdf).

frauds since 1990, which resulted in the problem of *Legend Clause*. The growing discussions about higher corporate governance made global markets to develop with the transparency of their accounting information.

The survey*5 on Listed Companies' Corporate Governance by Tokyo Stock Exchange, Inc. (TSE) was announced on November 30, 2000 and returned by 1310 of 1994 companies, more than 97% firms answered that they were interested in corporate governance. And it pointed out the actual conduct of their management, more than 88% of the companies, which was almost the same level compared with last time, answered they were paying attention to recent discussions on corporate governance to some extent. The 2003 survey shows that 75.3% of the companies answered the extensive disclosure and accountability for investors to enhance corporate governance (TSE 2003).

Now, we have to study for good experiences in the past for Japanese firms to conscious the significance of disclosure, which makes corporate governance more effective. Therefore, this paper consider that the three Japanese firms which have been faced on hostile TOB: Sotoh Co., LTD. (Sotoh), Yushiro Chemical Industry Co., Ltd. (Yushiro) and Nippon Broadcasting Network, Incorporated (Nippon Broadcasting) have achieved higher corporate governance by improving their financial information.

II Nature of Corporate Governance

What is the Corporate Governance?

Definitions of corporate governance are so various that it cannot be standardized globally.

Organization for Economic Co-operation and Development (OECD) states the OECD principles of Corporate Governance*6 which have been developed as the international benchmark since the endorsement in 1999 and the revision in 2004 by OECD ministers. OECD (2004, p. 4) explains about the reason of the revision, as the principles are a living instrument offering non-binding standards and good practices as well as guidance on implementation, which can be adapted to the specific circumstances of individual countries and regions. That revised principles show that there is no single model of good corporate governance (OECD 2004, p. 13). Yanaga (2004, p. 75) also points out the variety

*5 Refer to the TSE website (http://www.tse.or.jp/english/news/2001/200102/010221_a.html).

*6 You can download the document by various languages such as French, German, Japanese, etc. on the following website (http://www.oecd.org/document/49/0,2340,en_2649_34813_31530865_1_1_1_1,00.html).

of the definition of corporate governance. For example, of other previous researches, Wakasugi (2001, p. 194) regards it as the system to supervise managers for stockholders. Osano (2001, p. 1) mentions that the purpose is to make them well disciplined to secure shareholder's income. It is called as "kigyo-touchi" in Japanese that means 'to govern a company'.

The relationship between corporate governance and Disclosure

Because the measure to evaluate the corporate value is stock price in general, the effectiveness of corporate governance needs positive disclosure. Disclosure is classified into two types: mandatory systems and voluntary systems. The former depends on some regulations like accounting standards, audit standards, and corporate law etc, while the latter is a part of public relations. Corporate governance has 'direct' relationship with the mandatory disclosure as a means of announcement of corporate earnings to related party. 'Direct' relationship is a kind of *correlation* that one affects the other. In short, effective corporate governance is influenced by whether the mandatory disclosure system is enough and appropriate for users.

Ⅲ Hostile TOB in Japan

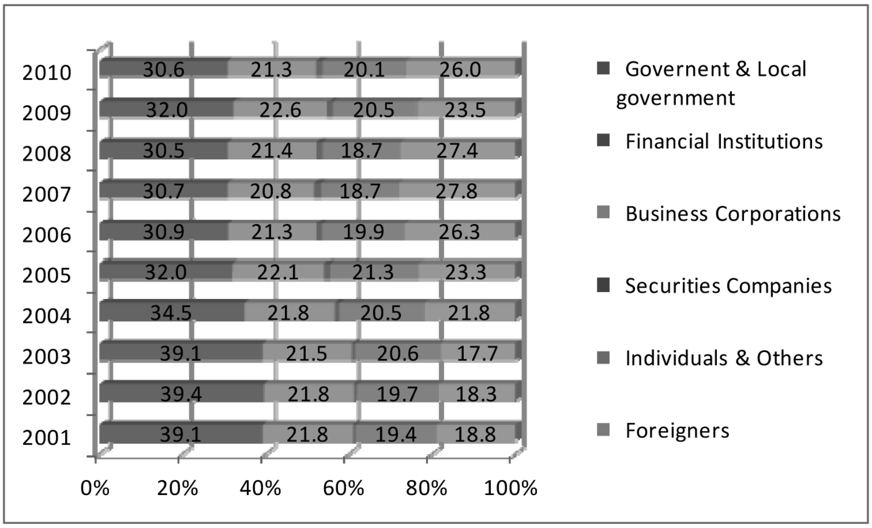
Background and Impact of Hostile TOB

Japanese managers are in whirlpool that is requested the effectiveness of corporate governance. Over recent years, they feel such a *threat* that they have never experienced by some hostile TOB. *Threat* is an anxiety that their firms might be faced on the TOB in the near future. However, some cases for hostile TOB have already been shown before 10 years. Then, why are they concerned in recent years? According to the report by Economic and Social Research Institute (ESRI) *[7], ESRI (2004) showed the

*7 The Economic and Social Research Institute (ESRI) was founded in January 2001 as part of the Cabinet Office with the expansion of the functions and scale of the Economic Planning Agency's Economic Research Institute under the reorganization of Japan's central government ministries and agencies. Known as the "forum for knowledge" for the Cabinet, the Cabinet Office is in charge of key administrative issues (Prefer to http://www.esri.go.jp/en/esri/menu-e.html). ESRI have studied M&A issues and improve the investment system by M&A in the Study Group for M&A established on December 11, 2003. Go into the website (http://www.esri.go.jp/jp/mer/kenkyukai/031211-01.html). The Cabinet Office was not only established to strengthen the functioning of the Cabinet, but also created with Prime Minister as its head for the sake of key issues in the reform by central govfollowing points as the background: (1) non-transparency of accounting and governance systems and (2) overvalued stock price, and (3) unattractive business or companies for investment. First, it points that accounting and corporate governance systems in Japan have been more transparent than those in the beginning of 1990. Indeed, after several window dressing or frauds by Japanese Firms, various accounting standards have already prepared or revised and the settled organization have transferred public sector, BADC into private sector, Accounting Standard Board, Japan (ASBJ). Corporate Law have been revised some articles concerned about corporate governance, involving the number of auditors and the establishment of company with committees.

The second point, overvalued stock price brings about cross-shareholdings, that is one of traditional management style in Japan, but the style has got old-fashioned. Many companies have unwound their shareholders yet after the collapse of Bubble economy, because they could not stand up to the write-off many *cross-shareholder stocks* with the fair-value accounting for securities. Third, business and company that have damaged by the long recession are undervalued. Table 1 illustrates the more attractiveness of Japanese firms for overseas investors by shareownership of foreigners.

Table1 Shareownership in listing companies in Japan



Source: Tokyo Stock Exchange Inc. 2011. *Fact Book 2011*, p.84.

ernment ministries and agencies intended to create a new system of governance for the 21st century. See to the web (http://www.cao.go.jp/about-cao/pmf2004/3-4.pdf).

The ratio of foreigners in Mar. 2004 has been 21.8%, about two times as high as in Mar. 1996. Iemori (1998) verifies that the correlation between this ratio and the assessment of governance system is positive, that is, the better the market assessment of governance system is, the higher the shareownership of foreigners is. Anyway, the three points would be some factors to increase hostile TOB in these days.

Defense Measures: Legal and Corporate Governance System

The Defense Measures against hostile attacks are divided into two factors by inside and outside points where the responsibility lies: (1) Improvement of effective corporate governance and (2) Preparation of regulations. Improvement of effective corporate governance depends on individual responsibility of each firm and manager, that can be defined as the inside factor. Managers are usually charged to go up corporate value and manage for shareholders. The improvement means the sustainable growth of earnings as well as the stability of high stock prices. And then, several regulations for hostile TOB are on board. Ministry of Economy, Trade, and Industry (METI) has organized a study group for corporate value for the purpose to prepare the countering methods for hostile TOB on September 16, 2004 and summarized the main points on March 2005*[8]. It is also scheduled to complete those drafts in cooperation with the Ministry of Justice on May 2005. As mentioned above, the study group for M&A, ESRI has already suggested that in Japan, both the defense measures laws for business and taxation have to be prepared in that proposal that has already reported on September 16, 2004. These inside and outside activities surrounded hostile TOB would become more and more active, especially after they know a new case of hostile TOB.

Ⅳ Case Studies

Summary of three hostile TOB

This paper has surveyed some previous researches of corporate governance and the background of discussing the hostile TOB that threatens for firms and managers and makes governance system ineffective, including the reasons why it has been focused in recent Japan. It can be mainly explained by various reports or researches by scholars or government and the concerned ministries. In next section of this paper, I would examine the change of their disclosure for effective corporate governance through case studies of

*8 Refer to the METI website for this information of the study group (http://www.meti.go.jp/committee/index.html).

three companies, Sotoh, Yushiro and Nippon Broadcasting. It also considers the reason why they had to face the hostile TOB.

Cases of Sotoh and Yushiro

Sotoh is one of the chemical companies for staining of woolen textile. Those activities for hostile TOB over Sotoh have started on the great investment by SPJ, a U.S. investment firms, in October 2002. Sotoh's executives have announced the MBO plan in collaborations with a venture capital, NIF Ventures after a week when SPJ had first accepted the TOB, December 19, 2003. Because they could not get ahead of the second TOB price showed by the fund, they has declared to increase the dividend for two years running, the annual year, Mar. 2004 to Mar. 2006, concurrently the withdrawal of MBO. The plan (Table 2) settled the dividend per share into 200 yen in Mar. 2004 and promised the total would be 500 yen in next two years, which defended against the hostile TOB.

Yushiro, a chemical firm that in the field of metalworking oils and fluids, is recognized

Table 2 Sotoh's Cash Dividends before and after the TOB

(Yen)

	Interim Dividends Per Share	Annual Dividends Per Share
Interim results, September 2003	6.50	–
Interim results, September 2004	75.00	–
Fiscal results, May 2004	–	**200.00**

Source: Sotoh's information in Separate Interium Statements of the fiscal year ending March 31, 2005.
Note: 75.00 yen per share including 68.50 yen per stock as special dividends.

Table 3 Yushiro's Amanded Dividends (Expected) after the TOB

Original Plan	May-04	May-05	May-06	May-07
Net Income (Million Yen)	700	800	900	1,000
Cash Dividends (Million Yen)	2,960	740 ~ 770	840 ~ 870	940 ~ 970
Cash Dividends per Share (Yen)	200	50 ~ 55	55 ~ 60	60 ~ 65
Amanded Plan	May-04(results)	May-05	May-06	May-07
Net Income (Million Yen)	830	900	950	1,000
Cash Dividends (Million Yen)	2,960	840 ~ 870	880 ~ 920	940 ~ 970
Cash Dividends per Share (Yen)	200	50 ~ 60	57 ~ 62	60 ~ 65

Source: The 14 th Yushiro's management plan revised in December 3, 2004 (http://www.yushiro.co.jp/ir/pdf/14ji%20keikaku%20syuusei.pdf).
Note: The amanded amounts are underlined (ex. 2,960).

and well-respected in building maintenance products and textile auxiliaries*[9]. The Company announced that it would pay 200 yen per stock as the annual dividends in May 2004 and the payout ratio would be 100% for next three years since May 2005 (Table 3), as soon as SPJ had accepted TOB into the company in December 2003 like the case of Sotoh. After the TOB, Yushiro's executives have changed the management strategies to make a positive use of the holding fund without pooling.

These two Companies have been accepted TOB by SPJ at the same time. As one of factors, I could consider that SPJ felt their market value before TOB was good bargain in comparison with those book values, and you can see them by Table 4. For example, both of market values based on the stock price in the fiscal year ending Mar. 31, 2003, are almost half of the book values, 44.3% and 53.9%, respectively shown by rate of book value.

Table 4 Sotoh's and Yushiro's Value in 2003

	Sotoh			Yushiro		
	Million Yen	Rate of Book Value	Stock Price on the day	Million Yen	Rate of Book Value	Stock Price on the day
Market Value (Mar. 31)	10,673	44.3	Mar. 24	10,432	53.9	Mar. 31
Market Value (the day of TOB)	17,107	71.1	Dec. 24	15,512	80.2	Dec. 12
Book Value (Mar. 31)	24,075	–	Mar. 31	19,353	–	Mar. 31

Source: Sotoh's and Yushiro's preliminary release of financial results in the fiscal year ending March 31, 2003.
Note: Based on the mean of share numbers in March 31, 2003 and stock prices on each specified day.

Case of Nippon Broadcasting

Fuji Television Network, Inc. and Nippon Broadcasting System, Inc. today signed a basic agreement that will result in Nippon Broadcasting becoming a wholly owned subsidiary of Fuji Television.

This is the first sentence in the notification*[10] announced by the Broadcasting Company on April 18, 2005. Nippon Broadcasting is a broadcasting company, mainly as the means by radio. The entrance by Internet Portal Livedoor Co., LTD. (Livedoor) started the TOB battle between the media firm and Fuji TV for shares of Nippon Broadcasting. In February 4 and 7, 2005, Livedoor acquired the exceed 5% of Nippon

*9 Refer to the Yushiro website (http://www.yushiro.co.jp/english/products/index.html).

*10 This notification is disclosed on the website (http://www.jolf.co.jp/company/IR1242/index.html) in May 1, 2005.

Broadcasting's stocks by TOB, and the numbers of stocks are 1,756,760, 5.36% as of Feb. 7. Then, purchase price was 5,950 yen per share, while the stock price went up to 1,990 yen after the news *[11]. Table 5 illustrates a series of the TOB activities.

Table 5 Activities for Nippon Broadcasting-TOB in 2005

Date	Contents
Jan. 17	Fuji TV announced TOB of Nippon Broadcasting shares.
Feb. 8	Livedoor announced TOB of Nippon Broadcasting shares and acquired 35% of all the shares.
Feb. 10	Fuji TV decreased the target shares from exceed 50% to 25%.
Feb. 23	Nippon Broadcasting decided to issue the great numbers of warrant bonds
Feb. 24	Livedoor Fuji claimed the enjoinment of the issue to the court.
March. 8	Fuji TV stated to success TOB, acquiring the 36.47% of Nippon Broadcasting shares.
March. 11	The Tokyo Court admitted Livedoor's plea.
March 15	Fuji TV decided to increase payout for shareholders of Nippon Broadcasting.
March 16	Livedoor purchased exceed 50% (based on voting right) of Nippon Broadcasitng. The Tokyo Court dismissed an objection by Nippon Broadcasitng.
March 22	Fuji TV decided to increase payout for shareholders of Nippon Broadcasting that is enough 50 billions.
March 23	Livedoor purchased exceed 50% (based on voting right) of Nippon Broadcasitng. The Tokyo High Court dismissed again the objection by Nippon Broadcasitng.
March 24	Nippon Broadcasting announced to lent the 13.88 % shares for Soft Investment Co.
April 18	Nippon Broadcasting and Fuji TV signed a basic agreement that will result in Nippon Broadcasting becoming a wholly owned subsidiary of Fuji Television. Livedoor and Fuji TV signed an agreement that Livedoor sell all the shares of Nippon Broadcasting for Fuji TV.
May 10	Livedoor and Fuji TV launched executive-talks for the details of business aliancess.

Source: Nihon Keizai Shimbun, March 26, 2005; Japan Times, May 11, 2005.

The 70-day-long disturbance ended in the agreement of the two firms that the TV Company will not only purchase all the shares of Nippon Broadcasting that Livedoor took during its hostile TOB but also acquire a stake in the Web portal operator itself. They are also going to talk on a tie-up. Ultimately, Livedoor could get about 150 billion yen from 100 billion yen of the principal investment. Morewhile, Fuji has been faced on the two kinds of risk that invests in the Net and gives the negative effect for its shareholders. Fuji TV and Nippon Broadcasting showed the following considerations to their stockholder:

(1) The interests of minority shareholders of Nippon Broadcasting System

(2) The rapid execution of an exchange of stock between Fuji Television and Nippon

* 11 Nihon Keizai Shimbun, February 8, 2005.

Broadcasting System in order to capture synergies quickly across the businesses of the two companies. To prevent dilution of the value of shares held by current Fuji Television shareholders, Fuji Television will restrict the issuance of new shares.

Refer to Nippon Broadcasting's News Release, "Notification of Basic Agreement Making Nippon Broadcasting Systems a wholly Owned Subsidiary," April 18, 2005.

The wholly owned action will be done on September 1, 2005 through the stock exchange under the Industrial Revitalization Law.

Disclosure Development for Effective Corporate Governance

Table 6 Sotoh's Disclosure Information in 2004

(1) *Enhancement of Capital Efficiency*	
Management Policy	
Targeting managemet measure:	Sotoh Group makes effort for the *enhancement of capital efficiency,* profitability and corporate value, targeting 5% exceed return on equity as a management measure.
Operating Result and Financial Position	
Perspective for the next year:	Sotoh Group think that it is basically important for the high quality of management on condition that looks at such a difficult situation and discriminate against cheaper imports. We will improve operations activities positively, developing attractive processing techiniques as well as a exert ourselves to cut total costs, improve the competitivness of business, and furthermore reform over *enhancement of capital efficiency* and over management.
(2) *Methods of Dividend Yield*	
Management Policy	
Basic policy of dividend yield:	We consider that our retained earnings are at the level that can be fit for more aggressive competitiveness and larger investments of equipment and development for cost-down or market needs. Thus, we decided to pay dividend from the retained earnings within the limit that may not prevent the activities of core business. Thus, we think that cash dividends will be done without interfering with our core business, and *methods of dividend yield* are going to be the total of 500 yen per share not later than Mar. 31, 2006, of which is 200 yen per share in the current year.

Source: Sotoh's preliminary release of financial results of the fiscal year ending May 20, 2004.

This paper studies the disclosure for effective corporate governance in the preliminary release of financial results in the three cases of Sotoh, Yushiro and Nippon Broadcasting. It is examined how they changed the disclosure information for corporate governance in those documents, comparing the release ended in the fiscal year before and after each TOB. Those results are shown as the following Table 6-7.

In the Sotoh's release after the announcement of TOB, more information for 'enhancement of capital efficiency' and 'methods of dividend yield' has newly been added. That shows the executives transferred holding earnings into paying positive dividends as their management policy. In the mean time, Yushiro fulfilled more information about *positive correspondence of investor relations* (IR) and *values*, the concerned word with corporate governance. Especially, the values in this document are mentioned in 9 parts such as corporate value, shareholder value, and stock value. Such information expresses the manager's policy to strengthen operations for shareholders. Then, Yushiro announced the 14th three-year-plan which has five important policies. One of the policies is 'strengthening of corporate governance,' composed with two measures including *value*: The enforcement of profit distribution policy to increase *shareholder value* (100% payout) and the timely disclosure (positive activities for investor relations).

Table 7 Yushiro's Value Information

Value (Corporate, Shareholder, Stock)	
Management Policy	
Corporate governance:	…In the future, we will enforce the positive dividends and correspond of investor relations (IR) for the higher *corporate value* and secure the transparency of our financial statements
Basic policy of dividend yield:	Our company considers that the stockholder's equity has been already reaced the apropriate level on the future investment for medium or long term business, resulting in our efforts to hold earnings to enhance the stable dividend and corporate system. We are confident of much *stock value* than the equity, though in stock market, the *value* is now reflected on our stock price.
Management plan for medium or long term:	The enforcement of profit distribution policy to increase *shareholder value* (100% payout) The timely disclosure (Positive activities for investor relations)

Source: Yushiro's preliminary release as of May 17, 2004.

How about Nippon Broadcasting? There are no words about corporate governance in the preliminary results as of May 26, 2004, though TSE requested the qualitative information about corporate governance since 2001. However, in the interim release as of November 24, 2004 immediately before the series of TOB problems, the ten-word of *corporate governance* were described. Nippon Broadcasting emphasized on the measure of effective corporate governance as followed:

The state of enforcement in this recent year for enhancement of our corporate governance

We make effort to study for the enhancement of our corporate governance. To make the strengthening of corporate governance and the improvement of corporate value be effective, our company appointed three outside directors as new members to the board in the annual meeting, June 2004.

Refer to the Nippon Broadcasting's interim preliminary release as of Nov. 24, 2004.

However, I could not examine the change of the information concerned about corporate governance in the 2005 release ended March 31, if it is announced in May every year, because I consider that it is effective to understand how TOB affects opinions and views of the offered companies and managers for corporate governance, and it would be done soon.

V Conclusion

This paper considered again by indicating three cases that the disclosure information is deeply related to effective corporate governance. Exclusively, the preliminary release of financial results as a mandatory system is the first announcement for investors after the closing day at the end of the fiscal year. Therefore, it is natural that the information disclosed on the release is valuable for them. However, the definition of corporate governance is not collective, but various, as OECD (2004) and Yanaga (2004) stated, for example, of several previous researches, corporate governance is regarded as a system to supervise managers for stockholders (Wakasugi 2001) and to make them well disciplined to secure shareholder's income (Osano 2001). It is also generally called in Japan as "kigyo-touchi" that means 'to govern a company'.

Considering these definitions, I can consider that the effectiveness of corporate governance depends on whether firms or executives could recognize their management should turn to stockholders who make decisions to invest their shares by the financial information including the preliminary release. In other words, the preliminary release is positioned as one of the means for effective corporate governance.

In this study, it is shown that Sotoh's and Yushiro have changed their policies to disclose for corporate governance after TOB. Actually, they have prepared more information related to corporate governance as well as announced to increase the dividends for several years. Sotoh added information about 'enhancement of capital efficiency' and 'methods of dividend yield' to show their management policy that pay positive dividends for current and potential shareholders. Yushiro discloses more information about *positive correspondence of investor relations* (IR) and *values* concerned about corporate governance. As shown by the values in 9 parts, the policy is shown to strengthen operations for shareholders. On the other hand, Nippon Broadcasting changed the opinions for disclosure. The company's information about corporate governance in the interim release as of Nov. 2004 was announced, though there was no information as of Mar. 2004.

This paper does not study the Broadcasting Company's release at the year ended after TOB yet, because it has not been made public yet, however it would be done soon. Three cases give a chance for Japanese firms to recognize the significance of reliability in financial statements toward effective corporate governance to prepare M&A attacks.

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