Impact of Takeover Defenses in Japan

By Noriyuki YANAGAWA

Changing Japanese Corporate Governance

Japan's environment surrounding corporate governance has shown a sea change in the wake of various institutional reforms over the recent years. In the past, "main bank" relations used to be viewed as the key to corporate governance. Recently, however, the role of corporate governance played through the capital market such as through mergers and acquisitions has grown more important.

But no sufficient analysis has been done on how unsolicited takeover bids and defensive measures against such hostile moves are working in Japan. Foreigners' understanding of the relevant Japanese situation appears far from sufficient since the Japanese legal system is different from overseas ones. This report summarizes the impact of anti-takeover measures adopted in Japan, building on a discussion paper, "Information-Revealing Effects of Anti-takeover Amendments: A Case of Japan in 2005," authored in August 2007 by this writer and two others, Sumio Hirose of Shinshu University and Tomotaka Fujita of the University of Tokyo.

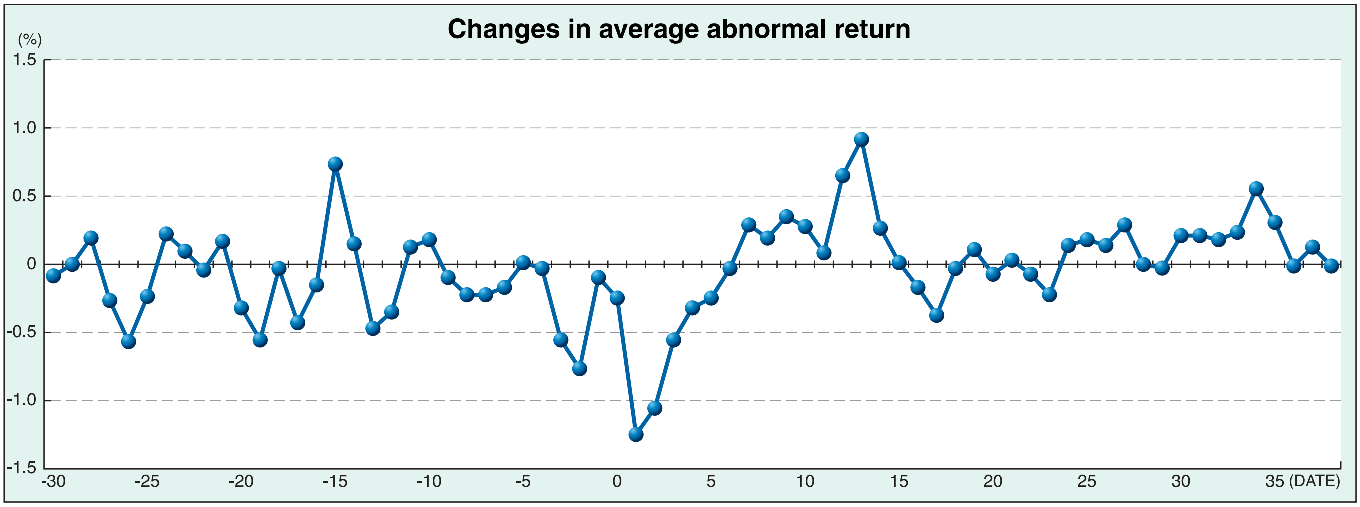
Realities of Takeover Defenses

The paper analyzed corporate managers' motives for and the effects of takeover defense measures, focusing on 2005 when Japanese firms introduced such measures in earnest for the first time. In the year, interest grew fast in takeover defenses in Japan on Internet service provider Livedoor Co.'s attempt to acquire Nippon Broadcasting System Inc. in March. But the number of firms that actually adopted such measures in the year was unexpectedly limited. According to a 2005 white paper on general meetings of shareholders by the Commercial Law Center, companies that introduced takeover defenses accounted for 118 firms, or 6.1% of 1,938 companies responding to a questionnaire survey. Thirty-six firms, 1.9% of the total, had plans to adopt such measures. The "takeover defenses" cited in the questionnaire covered a wide range of measures, including expansion in the number of authorized equity shares through revisions to company articles of association.

Stock Market Reactions

How did the stock market react to the adoption of takeover defense measures? To find out, we conducted an event study on stock prices for 99 companies that introduced some takeover defenses in 2005. The findings of the study are shown in *Chart*. As indicated by the chart, the average "abnormal return," or the average excess over an expected rate of return, for each company significantly dropped both on the day of its announcement of anti-takeover measures and the next day. The decline means that the market viewed the takeover defenses as negative. The drop was more conspicuous for companies that introduced explicit takeover defenses such as a poison pill and expansion of authorized equity shares accompanied by a change in the size of the board of directors.

***Chart* Changes in average abnormal return for 99 firms adopting takeover defense measures**



Note : Date 0 is the date when the board of directors made a decision to introduce takeover defense measures.
Source : Hitotsubashi University's Graduate School of International Corporate Strategy (http://www.ics.hit-u.ac.jp/school/studentprofile.html)

Changes in Business Performances

Why did the market view the introduction of takeover defenses as negative? In an attempt to find answers to this question, we conducted an event study on the business performances of companies that adopted takeover defenses in 2005. The analysis of financial data at the end of fiscal 2005 found deterioration of these companies' earnings performances after the adoption. Particularly, deterioration was more significant for companies that adopted tougher measures, including poison pills and expansion of authorized equity shares accompanied by a change in the number of board members. No significant deterioration was seen for those that increased authorized equity shares without changing board size.

Assessment of Findings

How can we interpret these findings? Indeed, companies that introduced takeover defenses in 2005 saw significant deterioration of their business performances in fiscal 2005 that ended in March 2006. But it is difficult to assume that the deterioration right after the takeover defense adoption resulted directly from the move. The findings do not appear to reflect the possibility of takeover defenses leading to managers' moral hazard entrenchment, as is usually anticipated. This is because it is hard to conclude that management moral hazard entrenchment emerged soon after the adoption of takeover defenses and affected business performances. Rather, a reversed cause-effect relationship can be assumed. The market interpreted the takeover defense introduction as indicating that managers, detecting their companies' risk factors leading to stock price falls in the near future, saw a high possibility of facing the risk of unsolicited takeover bids and chose to promptly adopt anti-takeover measures. Such an interpretation is presumed to have affected stock prices of the companies that introduced takeover defenses.

Developments in Fiscal 2006

How about developments in fiscal 2006? An event study on business performances indicated by financial data confirmed that performance deterioration was not statistically significant. The finding indicates that not many companies introduced takeover defenses in 2006 to prepare for near-future performance deterioration. Various factors can be assumed as being behind this. A major factor may be that stock prices declined in fiscal 2005 for companies that introduced takeover defenses in calendar 2005, as noted above. Stock price drops upon takeover defense adoption mean that the stock market interpreted the action as demonstrating managers' expectations of performance deterioration. Therefore, companies that witnessed the fact – stock price falls following employment of anti-takeover measures – apparently concluded that they could not adopt any strategy of introducing takeover defenses before the market noticed prospects of performance deterioration.

The conclusion was reflected in the stock market. An event study on 60 companies that introduced takeover defenses in 2006, which was similar to the study on those in 2005, found that the average abnormal return, though on the minus side, posted no statistically significant deviation from zero. The finding means that their introduction of takeover defenses had no impact on their stock prices in 2006. This is consistent with the above finding on business performances. As the market apparently learned that adoption of takeover defenses was not necessarily any sign of performance deterioration, the 60 companies' anti-takeover moves in 2006 fell short of triggering sharp declines in their stock prices.

Photo: Kyodo News

Hisashi Hieda(right), chairman of Fuji Television Network, and Akinobu Kamebuchi, then president of Nippon Broadcasting System (NBS), hold a press conference in Tokyo on Feb. 23, 2005 to announce the acquisition of NBS shares in an attempt to ward off hostile takeover bids for the radio station.

Japanese Companies' Behavior Changes

The above findings indicate that Japanese companies' adoption of takeover defenses has not been as widespread as generally conceived and that such a move does not necessarily have immediate adverse effects on business performances or stock prices of relevant companies. When introducing takeover defenses, Japanese companies take account of the market's possible reaction. This means that market pressures have given incentives to managers. In this sense, our experimental study demonstrates that the role of market-based corporate governance has grown greater at Japanese companies. JS

Noriyuki Yanagawa is associate professor at the University of Tokyo Graduate School of Economics, specializing in contract theory, law and economics. He was previously an associate professor at Keio University.