Japan in the Stage of Mastering M&As
– System of Independent Directors Proposed –

Interviewer: Doge Ichiro

JAPAN is entering an "age of high-profile M&A deals," with mergers and acquisitions involving Japanese companies reaching an all-time high in the first six months of this year. In the meantime, many analysts point out that Japanese financial authorities lag behind in establishing adequate M&A rules as exemplified by disarray over Internet service provider livedoor's attempted takeover bid of Nippon Broadcasting System. Nikko Cordial Group Chairman Kaneko Masashi, who also chairs a committee on ways to adequately use capital markets at the Japan Association of Corporate Directors, discusses the problems of Japan's M&A system.

"Cat-and-Mouse Game" Between Law & Reality

High-profile M&A dramas, including hostile takeover bids just like those seen in the United States some time ago, are now taking place in Japan.

Kaneko: Such a trend can basically be regarded as good because the appearance of corporate bidders and defenders leads to revitalization of the securities market. The main concern is that adequate rules and laws concerning M&As have yet to be established in Japan, with most of them being settled in court. Some judges are not well versed in the current corporate activities, and I wonder if it is advisable for such judges to make the final decisions. The current law does not assume that such a large number of M&As and hostile takeover bids occur. Meanwhile, corporate society is rapidly making strides, resulting in a "cat-and-mouse" game between law and reality. Rules and laws should be amended in a flexible manner to generate understanding among market participants.

The high-profile takeover bid between livedoor and Fuji Television Network for Nippon Broadcasting System invited public criticism mainly because livedoor acquired a massive amount of NBS shares at a stroke during off-hours trading.

Photo : Kyodo News

Kaneko: Off-hours trading is a system intended for use by institutional investors. It should not be used for M&As. The absence of legal provisions does not mean that market participants can do anything they want. Employing such a tactic shows a lack of corporate morality. A securities firm with a sense of ethics had told livedoor that it is "difficult" to employ off-hours trading. Corporate managers should attach importance to both laws and a sense of ethics in their activities. The securities market would otherwise be thrown into confusion.

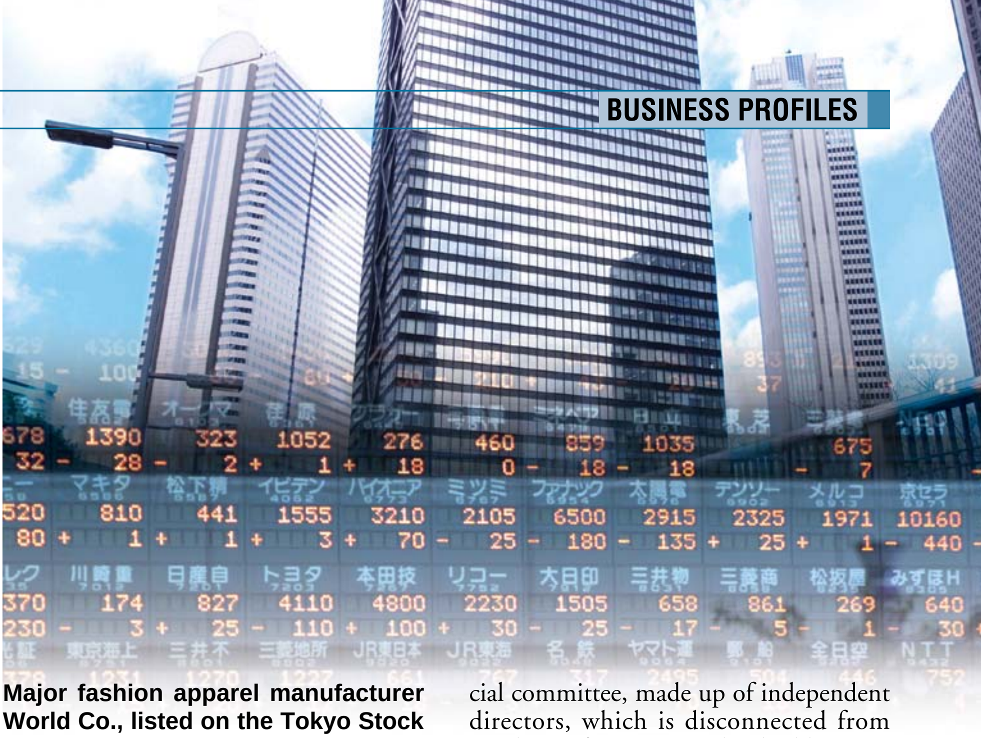
Raising Aggregate Market Value: The Best Defensive Measure

Livedoor's takeover bid has stirred Japanese businesses to take measures to fend off such attempts. Critics say, however, that some of the measures they took can be regarded as "excessive self-defense" on the part of management which could harm the interests of existing stakeholders.

Kaneko: It is wrong to consider all corporate takeover bids to be evil. Acquisitions aimed at raising corporate value should be construed as the right way. Bidders need to fully specifically explain to target company's shareholders how to boost the company's value. This is what livedoor was lacking. The target corporation should take defensive measures if it concluded that the takeover bid is meant to sell off its assets by piece against its stockholders' interests. The most effective defense measure is to raise the company's aggregate market value by redoubling business efforts.

How do you judge whether takeover bids will benefit or hurt the interests of a target company?

Kaneko: Corporate executives may reject takeover bids for fear that they could be dismissed, even if they think acceptance of such bids would benefit the interests of their shareholders. I myself might do so, although I wish I could choose to step down knowing that the shareholder value would be raised if the company was to be taken over. In order to avert such a situation, it is necessary for Japanese businesses to intro-



duce a “system of independent directors,” in which they can make judgments on takeover proposals from the viewpoint of shareholders. The Japan Association of Corporate Directors is to present the definition of such a system this fall. At least those who have an interest in the company such as former executives, corporate clients, major shareholders and those who have been dispatched from a law firm will not be able to become independent directors.

Do you think some companies will introduce such a system?

Kaneko: Corporate executives tend to reject those who are not in their interests. Therefore, the system may not take firm root in Japan unless introduction is made mandatory. The system will not effective if executives take in their friends and supporters as independent directors – a practice that cannot be regulated by rule. This is an ethical problem on the part of top management.

Tokyo Stock Exchange Should Serve as a Model for Listed Companies

Along with the growing risk of being taken over, the advisability of going public has become a matter of discussions among Japanese companies.

Kaneko: Going public brings numerous benefits to companies such as greater public awareness, easier recruitment and greater client trust. On the other hand, listed companies need to disclose management information and business results. Comparing a company to a human being, one should take off one’s coat so that everyone can confirm there are no hidden weapons. The company should not go public if it does not want to disclose such information.

Major fashion apparel manufacturer World Co., listed on the Tokyo Stock Exchange, has decided management buyout (MBO) to turn itself into a privately owned company. Signs are being observed of other companies following suit as a way to ward off hostile takeover bids.

Kaneko: I think World has taken the right decision because its financial standing is solid. A company does not have to go public if it is financially stable and sees no need to raise funds on the market. Moreover, as far as a personally owned corporation is concerned, both management and shareholders are the same in the end. Even if the company becomes insolvent after choosing to be delisted, the general public does not suffer losses. I do not think, however, the number of companies that choose this route will increase significantly in the years ahead.

The issue of Tokyo Stock Exchange (TSE) planning to list itself on the bourse is also drawing public interest. The largest Japanese stock exchange has a regulatory division to screen applications for listing in a fair manner. The Financial Services Agency, worried about the possible conflict of interests that a publicly traded bourse could face, has advised the TSE to consider splitting off its regulatory segment.

Kaneko: The TSE should increase the number of directors with a high degree of independence. It should set up a special committee, made up of independent directors, which is disconnected from regulatory functions so that highly transparent management operations can be secured. Directors’ salaries and remuneration along with the method of calculating them should be made public, if possible. If the TSE takes these measures, it will then be able to obtain market trust. The bourse should build up a corporate governance system that would serve as a model for listed companies.

It may take some time before an adequate M&A system is established in Japan. Do you think high-profile takeover dramas will continue to occur?

Kaneko: The M&A fray will continue for a while. Without such a process, however, the market cannot learn lessons. Japan has suddenly enforced deregulatory measures without full knowledge or the ethics for M&A deals. The country is now in the stage of accumulating expertise in this field. Everyone is learning about them amid the rapid progress of globalization, with new corporate moves appearing and the Company Law updated. Everyone will have better knowledge of M&As if one or more high-profile takeover cases similar to those involving livedoor occur. If the nation’s legal flaw is rectified in a year or two, an M&A rulebook will approach completion. JS

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