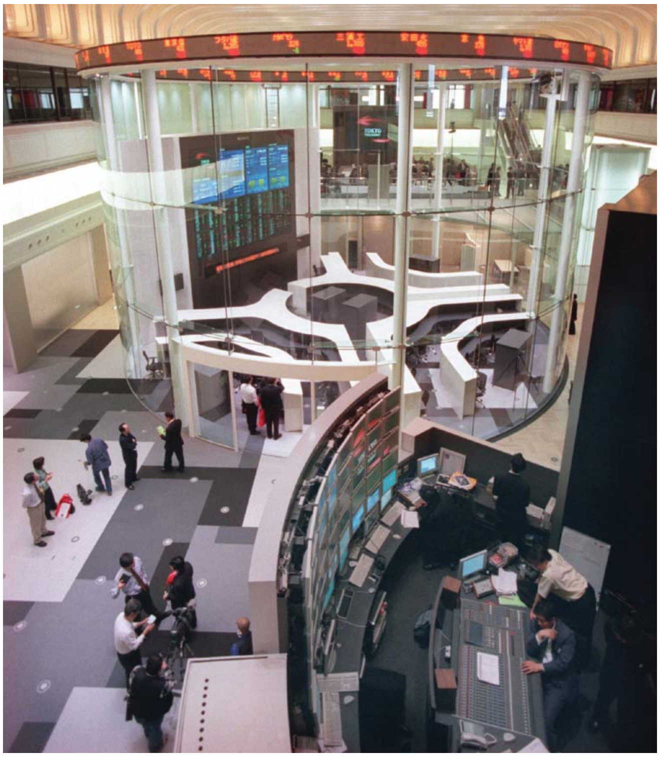
International M&As and Corporate Governance

By *Kagono Tadao*

Photo: The Mainichi Newspapers



Tokyo Stock Exchange

AGGRESSIVE investors, who buy undervalued corporate stocks, pressure management to adopt policies to boost the stock price for a short while and then sell the stocks to make a quick profit, have now emerged in Japan.

Some experts insist that this type of investment should be banned from the markets. Although such action remains a matter of debate, many experts would agree that, at the very least, effective restrictions are needed to ensure the healthy development of our industrial society.

US manufacturing industries lost much of their international competitiveness when aggressive investment practices were rampant. We have to prevent the same thing from happening in Japan.

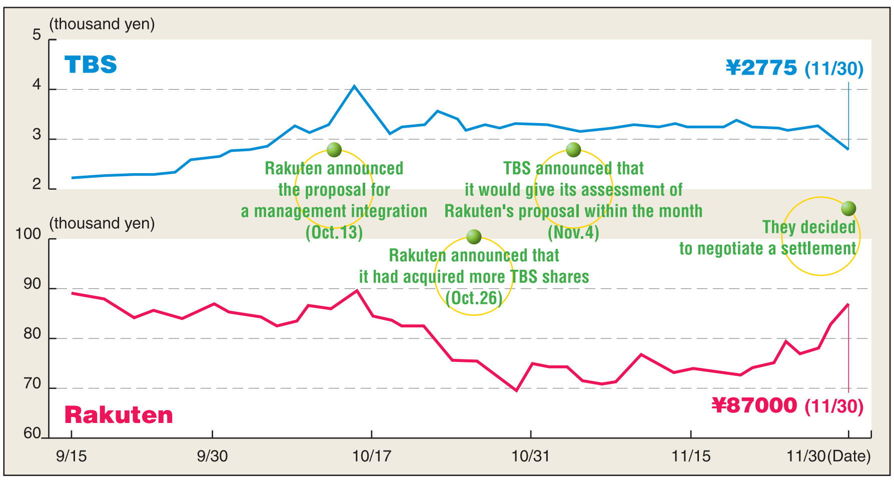
There are some essential reasons why we cannot allow aggressive investment practices to spread. First, it leads the door to a culture of easy profit. The pursuit of profit is not bad, but problems develop when that pursuit is too easy. Alfred Marshall, the codifier of economic freedom, wrote that a laissez-faire economy requires economic chivalry, which shows respect for a moderate profit, not for an easy windfall.

Japan's post-bubble experience taught us the danger of a headlong rush for easy profits which can corrupt corporate culture. The most dangerous situation for a corporation is to lose workers who work honestly and hard. Modern capitalism cannot exist unless people have a "good conscience," as the sociologist Max Weber indicated.

Aggressive investment practices have adverse effects on society as well because they trigger opportunistic investment activities. It is hardly a coincidence that, after aggressive investment practices emerged in Japan, IT ventures began buying up companies in a nefarious manner.

The second reason is that aggressive investment strategies promote ill-conceived management strategies that only look at business from a short-term perspective. This is a serious problem because other shareholders and groups suffer losses. According to economic theory, a stock price is the present value of the expected profit that a company generates over the long term. A short-term profit-oriented strategy will diminish future profits and reduce the stock price, creating losses for general shareholders. However, it will take some time before general shareholders realize that such a policy will causes losses in the long term, and before the stock price declines, aggressive investors will

Figure 1 Stock Prices of Tokyo Broadcasting System (TBS) and Rakuten



Source : *Nihon Keizai Shimbun*, Dec. 1, 2005
Note : Following the acquisition attempt, the stock prices of the buyer (Rakuten) and the target (TBS) changed as shown above.

sell their shares. The effect of poor management practices will fall on the remaining shareholders. The damage goes well beyond general shareholders – ill-conceived management strategies block corporate growth, bringing social disadvantages: employees will be thrown out of work, and local communities will suffer.

A company that focuses on long-term management may look inefficient and slow to react to investors, and it is difficult to make shareholders understand such policies. Even Toyota Motor Corporation had its market ranking downgraded once because the company refused to abandon the principle of lifetime employment.

Aggressive shareholders pretend to bring better order to management, but what they are actually doing is forcing companies that have a long-term goal to make wrong-headed decisions.

The best thing for managers is to ignore irrational instructions from aggressive shareholders and keep managing the company from a long-term perspective. It is hard, though, to explain this to general shareholders, and some will be shortsighted enough to join the aggressive camp. Current legislation gives shareholders the final say in appointing and dismissing top management, so executive officers need plenty of courage to refuse shortsighted shareholder demands. This courage could be included in Marshall's "economic chivalry."

Managers need support when standing up to aggressive investors. Improved legislation is needed. In the United States, laws now make it easy for managers to defend their companies. In France, shareholders who have held stock for a long time have more voting rights than their short-term counterparts. In Japan, we also need rules making it obligatory for shareholders to hold stock for a certain length of time before they can ask the company to sell some of its assets or make a payout such as provide a dividend, or repurchase its own stock.

Some people defend aggressive investment strategies by saying that they enforce discipline on managers who are not eager to lead their companies to the next rank. This is a very far-fetched idea as there are other more effective and less damaging ways to maintain discipline. Some excellent companies are now avoiding being listed on a stock exchanges for fear of aggressive investors. This is a great disadvantage for ordinary investors and the economy as a whole. JS

Table 1 Recent Changes in Japan's Corporate Governance

The current most important interested party (Select a maximum of 2 from the following)	2002	1999
General Customers	50.0%	37.9%
Employees	28.5%	27.3%
Individual Investors	18.6%	10.9%
Domestic Institutional Investors	14.2%	13.7%
Overseas Institutional Investors	2.1%	3.8%
Main Banks	16.6%	27.9%
Client Companies	44.1%	49.4%
Group Companies	8.5%	12.2%
Others	4.3%	3.1%
No ideas	1.2%	1.8%

The future most important interested party (Select a maximum of 2 from the following)	2002		1999
General Customers	47.6%	General Customers	35.0%
Employees	24.6%	Employees	33.9%
Individual Investors	36.2%	Shareholders	69.2%
Domestic Institutional Investors	20.9%		
Overseas Institutional Investors	5.5%		
Main Banks	6.9%	Main Banks	6.6%
Client Companies	30.2%	Client Companies	24.5%
Group Companies	7.7%	General Creditors	1.7%
Others	4.9%	Others	1.7%
No ideas	2.1%	No ideas	4.4%

The most appealing point in the management strategies (Select a maximum of 2 from the following)	2002	1999
Bills (proposals) at general shareholders' meetings	25.8%	19.6%
Dissolve cross shareholdings	4.3%	2.7%
Introduction of stock option system	2.7%	5.2%
Introduction of ROE (return on equality) and EVA (economic value added) as indices of management performance	16.9%	31.7%
Promotion of IR (investor relations) activities	80.3%	69.3%
Positive disclosure	22.0%	22.4%
Introduction of outside director and executive officer system	7.9%	6.7%
Improving functions of internal auditing system	9.3%	8.7%
Introduction of auditor-corporation that follows global standards	1.9%	2.8%
Others	2.2%	1.7%
No ideas	2.1%	4.4%

Source : Basic questionnaire for the *Report on The Developing Revolution for Corporate Governance and the Regeneration of Japanese Companies*, 2003, Ministry of Finance, Policy Research Institute
Note : The results of corporate surveys held in December, 2002 and November, 1999

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