World's Giants Make a Landfall in Japan
– The Changing Japanese M&A Market –

By Takahashi Naoto

JAPAN'S stock market enjoyed a boom in the fall of 2005 for the first time in many years. Keeping pace with rising stock prices, Japan's corporate merger and acquisition (M&A) market was on a course of expansion. A symbolic episode is the landfall of a major foreign investment fund and a corporate rehabilitation consultant in Japan. Behind the advent of these "giants in the world" was a change in the Japanese M&A market, which traditionally had focused on the reconstruction of bad-debt corporations. Japanese corporations have now come to pursue strategic realignment to raise their own corporate values.

High Hopes Pinned on Growing Japanese M&A Market

Kohlberg Kravis Roberts & Co. (KKR) of the United States has announced that it will establish an office in Tokyo in April 2006. KKR, one of the world's largest buyout funds, made headlines in 1989 for taking over major US tobacco and food maker RJR Nabisco Inc. for $25 billion. Founded in 1976, KKR racked up profits in the United States and moved into Europe in the latter half of the 1990s. Its next target was Japan where the investment climate saw an improvement thanks to the relaxation of government controls and the active stock market.

Justin Reizes, chief operations manager in Asia, explained KKR's advance to Japan, saying the country's M&A market is still smaller than its US and European counterparts, and there is growth potential. Following in KKR's footsteps, AlixPartners, LLC, a major US turnaround consulting firm, announced it had started full-fledged business operations in Japan last fall. Founded in 1981, AlixPartners is known to have reconstructed troubled giants such as US major retailer Kmart and telecom carrier WorldCom Inc. As was the case with KKR, AlixPartners moved into Japan after its experiences in the United States and Europe. Representatives of the company were invited to Japan by political and business leaders in 2003, and visited the country's major banks and investment funds. Its long-awaited advance into Japan came after a full analysis of the needs peculiar to the country.

Photo: Kyodo News

Timothy Collins, President and CEO of Ripplewood Holdings (right) and Yashiro Masamoto, President and CEO of LTCB (All titles as of September, 1999)

Jack Smith, former CEO of General Motors Corp. and now chairman of AlixPartners' advisory board, said "special skills" are necessary to conduct "special medical treatment," referring to its purpose in Japan. Smith indicated that the Japanese M&A market has grown into a mature stage where skilled turnaround experts are required.

Critical of Vulture Funds, Placing Stress on Reconciliation

Both KKR and AlixPartners are not eager about bad-debt disposal businesses. They also prefer reconciliation with existing managers and employees to hostile takeovers.

Bad-debt disposal deals in Japan got into full swing after a series of collapses of major financial houses like Yamaichi Securities and the Long-Term Credit Bank of Japan (LTCB) in the latter half of the 1990s. The US investment fund Ripplewood Holdings was the first to launch turnaround businesses in Japan, bidding to revive the collapsed LTCB, which has since been reborn as Shinsei Bank. A number of foreign securities firms and investment funds followed in its footsteps.

While major Japanese banks were busy with bad-debts helping reconstruct debt-ridden client companies, such foreign equity firms as Goldman Sachs, Morgan Stanley, Lehman Brothers, Lone Star Group and Colony Capital were flocking to rehabilitate major companies in the so-called structurally depressed industries.

Amid a prolonged economic slump, these foreign investment banks and funds came under fire from Japanese political and business circles for being "vulture funds" that reap fabulous profits through aggressive takeovers with their rich financial resources. As a result, the effectively state-run investment fund, the Industrial Revitalization Corporation of Japan (IRCJ), began full-fledged operations. It later launched many bailout projects despite a wave of proposals from foreign funds. Major supermarket chain operator Daiei Inc., whose rescue package was called the final big project, also fell into the IRCJ's hands.

In parallel with the IRCJ's activities, Japanese investment funds were established successively. Major banks, which had almost disposed of their nonperforming loans, and corporations whose streamlining efforts got through the critical stages, began funneling excess cash into these investment funds.

Ripplewood posted a huge profit by relisting Shinsei Bank, but such a success now became history. Foreign brokerages and investment funds have found bad-debt disposal businesses in Japan are no longer attractive. After making quick money, these foreign equity firms have acquired the unfavorable nickname of vulture funds.

Foreign Money Supports TOBs for Broadcasters

KKR and AlixPartners have refrained from making hostile takeover bids (TOBs) after being criticized as vulture funds. In addition, they have also witnessed Japanese investment funds stage hostile TOBs for broadcasting companies.

In February 2005, Internet service provider livedoor launched a hostile TOB against Nippon Broadcasting System, which later became a subsidiary of Fuji Television Network. Horie Takafumi, CEO and President of livedoor, attracted national attention.

His action sent shock waves through Japan's political and business communities as the vulture funds did. Behind Horie was Lehman Brothers, which is believed to have provided him with a huge amount of funds and key advice over the M&A strategy. Lehman Brothers chose to remain in the backseat from lessons learned through bad-debt disposal. Eventually, livedoor sold its equity stake in Nippon Broadcasting System to Fuji TV and posted, together with Lehman Brothers, huge profits.

Internet shopping mall operator Rakuten Inc., led by Mikitani Hiroshi, acquired a large stake in major TV and radio broadcaster Tokyo Broadcasting System (TBS), and proposed integrating their operations under a joint holding company in October 2005. Mikitani stressed that his proposal for management integration is a friendly one, denying a recurrence of the bitter battle between livedoor and Fuji TV. Behind Mikitani though, was another foreign investment bank, Goldman Sachs. Rakuten seized a stake of more than 15% in TBS. In contrast with Rakuten's high-handed takeover attempt, Goldman Sachs sent out the message at home and abroad that it will never help in any hostile TOB. It showed the maximum cautiousness so as not to make its financial advisory contract with Rakuten adversely affect its activities in the Japanese market.

Photo: THE YOMIURI SHIMBUN

Murakami Yoshiaki surrounded by reporters

Revived Japanese Banks Compete with Foreign Capital

The cautious attitude of Goldman Sachs is motivated by the resurrection of major Japanese banks. Japan's major banks were reorganized into three megabank groups – Mitsubishi UFJ Financial Group, Mizuho Financial Group and Sumitomo Mitsui Financial Group. The reorganization was achieved through a series of bad-debt disposals and injection of public funds to strengthen their financial health. After a series of streamlining efforts, the three major banking groups have sought to pay back the public funds and have quickly shifted their attention to investment bank operations that are expected to produce high yields. They are swiftly advancing into the M&A market which had so far been monopolized by foreign capital.

The Japanese economy had been characterized by the so-called main-bank system under which main dealing banks monitor every move of their client corporations and take care of them. Although Japanese corporations have recently softened their allergy to foreign capital somewhat, ostentatious hostile takeovers are still disliked. There remains a traditional method of corporate rehabilitation in which continues corporate managers and a bank that plays the double roles of a consultant and a fund supplier work hand in hand.

The current keyphrase in the Japanese stock market is "corporate value." The so-called Murakami Fund, led by Murakami Yoshiaki, a former-bureaucrat-turned-investor, is purchasing shares in companies whose stock prices are a relative bargain. As a shareholder, he asks for an improvement in the companies' corporate value. As a result, prices of shares in companies that he purchased skyrocketed upon buy orders from investors.

AlixPartners President Michael Grindfors said his firm's activities in Japan will focus on preventive corporate revitalization so that powerful and healthy corporations will post better earnings and raise their corporate value while the economic cycle is in a favorable phase. Japan's M&A market has come out of the rehabilitation phase and stepped into the next stage where foreign capital and domestic banks are vying for healthy corporations which are seeking an improvement in their corporate value. JS

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