

Market Reforms Face Crucial Test – Livedoor Scandal Leaves Many Challenges –

Photo: Kyodo News



Hiramatsu Kozo, President of Livedoor apologizes at a press conference after the TSE decided to delist Livedoor stock

INTERNET and financial services provider Livedoor Co. Ltd., which once stood out prominently in Japan's capital market, was forced out of the market effective from April 14 as the Tokyo Stock Exchange (TSE) delisted Livedoor stock because of suspected accounting fraud. Former President Horie Takafumi launched Website-design venture business six years ago. It grew swiftly with a number of mergers and acquisitions as well as stock splits, and the group's market value topped ¥1 trillion at one point. Horie made a series of headlines for attempting to branch out into the professional baseball business, mounting a takeover bid for radio broadcaster Nippon Broadcasting System, and running for the September 2005 House of Representatives election. These bold moves have inspired the owners of Japan's venture firms.

Investigations by the Tokyo District Public Prosecutors Office showed that Livedoor had been supported by stock

price manipulation involving the release of false information and accounting fraud intended to window-dress its financial statements. Just as the United States promoted market reforms following the accounting scandals of energy giant Enron Corp. and telecom carrier WorldCom Inc., there have emerged moves in Japan to learn lessons from the Livedoor scandal and to restructure the base of the capital market.

The government launched studies to tighten punishment against accounting fraud and other criminal activities on the securities market. The United States strengthened penalties in 2002 following the WorldCom and Enron scandals, sharply raising the maximum term of imprisonment to 20 years from five years. In Japan, the maximum prison term for falsifying financial statements is currently five years. Since the ruling and opposition camps argued that it is unreasonable for Japan to be softer on crime than the United States in the borderless capital market, the Securities and Exchange Law has been revised to impose a maximum penalty of 10-year imprisonment – the most severe punishment for financial crime in Japan.

After Livedoor was accused of using investment partnerships to conceal the flows of funds, the government decided to make clear the criteria for firms to include such partnerships in their consolidated accounting reports, and also moved to introduce a registration system for investment partnerships to help investors understand the actual conditions. Investors deepened their distrust of the market following the Livedoor scandal, resulting in a series of plunges in stock prices on the Nasdaq and Mothers markets for start-up firms.

Investors lost their trust in those markets' monitoring functions because of the failure to uncover Livedoor's questionable management practices. Studies have been also launched to tighten requirements for stock listing.

The question is whether retightening regulations will strip Japan's securities market of its vitality. The government has up to now continued to relax controls on the securities market to attract investment money from abroad. This has led to a wave of buying of Japanese stocks by foreign investors and eventually to a recovery of Japanese stock prices. Before tightening controls on investment partnerships and markets for start-ups, a careful checkup must be done to look into where the problems lie in Japan's market functions, and reforms must be consistent with the market rules of the United States and Europe. Following the Livedoor scandal, there is growing criticism in Japan of the market economy which some believe has increased social disparities. If these arguments reverse the flow toward an open market in Japan, they could have an adverse effect on the global capital market. Japan's ability to design ideas for restructuring its market economy is being tested.

COMING UP

"The White Paper on International Economy and Trade 2006" will be the theme of the next issue of Japan Spotlight. Our writers will analyze the recent trends in trade from a global perspectives including Japanese service industry expanding into other Asian countries. We will also have the first in a series of "GALLERY" articles on Japan's traditional performing arts. Our writers not only discuss from historical point of view, but also show us how the performances fit in the contemporary society. The theme of the next issue will be Kabuki.