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Gains from Mergers and Acquisitions in Japan

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Abstract

In this study we focus on the dynamics of the market for corporate control in Japan. Analyzing mergers and acquisitions that take place between January 2000 and December 2014, we evaluate the short-term wealth effects of these corporate events from the perspectives of shareholders of both the acquiring and the acquired firms. We find that these events are not consequential for the shareholders of acquiring firms as they do not experience any significant wealth effects. However, these findings indicate that the acquired firms' shareholders reap significant benefits. Given the more recent data used in this study, we conclude that Japan's market for corporate control has become more competitive and now behaves in a manner similar to those of the US and other Western nations. We also analyze the longer-term wealth effects of these acquisitions by studying the pattern of abnormal returns earned by acquiring shareholders over a sixty-month period following the event. These results show no discernable pattern of long-term gains to the shareholders. The study also analyzes the longer-term effects of mergers on the acquiring firm's environmental, social and governance performance. Results indicate that mergers produce no discernable improvements in the firm's performance on any of these fronts.

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1. Introduction

Often referred to as the science of valuation, the discipline of finance has usually had its inquiries focused on the valuation consequences of mergers and acquisitions. The questions investigated, both at theoretical and the applied level, have typically centered around the nature of gains (or losses) associated with these activities and the motivations of decision makers behind such corporate events. Broadly speaking, the question of valuation can be evaluated from the perspective of stakeholders at large: shareholders, creditors, managers, employees, consumers, the society, and the environment. Within such an approach, a Pareto-optimal outcome of a merger or an acquisition would be one that would enhance the wealth position of at least one group of its stakeholders without creating an adverse effect on any of the remaining stakeholders. However, given that the current paradigm of finance maintains that the sole responsibility of the firm is to its shareholders (and that it should be only concerned about maximizing the value of their claims on the firm's assets), the literature has had an almost exclusive emphasis on analyzing the consequences of mergers and acquisitions from the perspectives of the shareholders involved.

This study is designed to evaluate the consequences of mergers and acquisitions within the Japanese markets from three different perspectives: short-term from the perspective of all shareholders involved; longer-term from the perspective of acquiring shareholders; and longer-term from a societal and environmental perspective. We analyze mergers and acquisitions that take place during the first 15 years of the 21st Century to study the nature of their wealth effects on the positions of both the acquiring and the acquired firms. In doing so, we explore the question of what set of factors explain these wealth effects. In particular, we are interested in investigating the role played by the acquiring firm's commitment to corporate social responsibility. We then look into the question of whether these corporate events create value for the acquiring firm's shareholders over the long term. Finally, we look into the question of how these events affect the longer-term performance of the acquiring firm along the environmental, social and governance dimensions.

Section 2 further motivates the paper and provides a brief overview of the extant work on the valuation consequences of mergers and acquisitions. The data and the methodology utilized are described in Section 3. Our results are presented and discussed in Section 4 and the conclusions are presented in Section 5.

2. Extant Research and Hypotheses

The bulk of the research dealing with the valuation consequences of mergers and acquisitions has taken place over the last five decades and in the aftermath of the introduction of the event-study methodology by Fama et al. (1969). Since then, the literature witnessed a flurry of research papers focused on the short term wealth effects of mergers and acquisitions. Included among these are the works of Dodd and Ruback (1977), Franks, Boyles and Hecht (1977), Bradley (1980), Asquith (1983), Eckbo (1983), Dennis and McConnell (1986), Bradley, Desai and Kim (1988), Franks and Harris (1988) Eckbo and Langohr (1989), Servaes (1991), Walker (2000), Mullherin and Boone (2000), Andrade, Mitchell and Stafford (2001), Graham, Lemmon and Wolf (2002), Bae, Kang and Kim (2002), Moeller, Schlingemann and Stulz (2005), Ang and Chen (2006), and Alexandridis, Petmezas and Travlos (2010), Erel, Liao and Weisbach (2012).

The unanimous conclusion of these studies is that shareholders of target firms experience significantly positive returns on the day of, and the day after, the announcement of these corporate restructuring events. For example, Eckbo (1983) finds significant positive cumulative abnormal returns (CARs) of 6% in the US and Eckbo and Langohr (1989) report finding CARs of 16% for acquisitions in the French markets. Evaluating trans-national mergers and acquisitions in the pacific-basin region, Desai, Dukas and Fatemi (1996) also report significant abnormal returns to the target shareholders. Focusing on the deal's tenor, Servaes (1991) finds that these abnormal returns are higher for hostile bids (32%) than they are for friendly bids (22%). And, expanding the window within which these abnormal returns are measured to two weeks, Bradley, Desai and Kim (1988) find that these shareholders earn CARs as high as 45% (for the 1990-2001 period).

On the other hand, the near unanimous finding of these studies has been that the acquiring firms realize abnormal returns that are statistically indistinguishable from zero. For example, Asquith (1983) reports that the shareholders of the acquiring firm earn only a small return (of around 0.2%) whereas Andrade, Mitchell and Stafford (2001) find that such returns are negative, albeit insignificantly so. Additionally, as reported by Dennis and McConnell (1986) these negligible returns cannot be attributed to the anticipation of the transaction, as the one-month run-up in the share price of the acquirer is found to be negligible.

Finally, and again as measured by abnormal returns around the announcement date, these findings also indicate that in the short-term mergers and acquisitions are value-enhancing activities in that they increase the combined value of the acquiring and the acquired firms. For example, Bradley, Desai and Kim (1988) report that an equally weighted portfolio of acquirers and targets earns a 7% abnormal return. Of course, given that the target shareholders gain and the acquirers do not lose, this is not a surprising outcome. While these short-

term wealth effects are found to be positive, the longer-term effects are reported to be somewhat different. Indeed, while not unanimous, most such evidence indicates that long-term abnormal returns are at best insignificant. For example, Ang and Chen (2006) report the abnormal returns for the 36 month period following the event are insignificantly negative for cash acquisitions and significantly negative for stock transactions.

Therefore, a fairly substantial body of literature has been devoted to the analysis of the effect of mergers and acquisitions on the welfare of only one group of the firm's stakeholder; the shareholders. And, the accumulated evidence indicates that the shareholders of target firms realize significant short-term gain in this process but that the acquiring firm shareholders do not experience such a gain. Longer-term, it is not clear that even this class of stakeholders ends up any better off.

More recently, a number of studies have been motivated by the question of the impact of mergers and acquisitions on other stakeholders. For example, introducing the issue of corporate social responsibility into the debate, Akta, deBodt and Cousin (2011) consider the possible impact of targets' corporate social responsibility (CSR) on acquirers' gains and find that they are a positive function of target's CSR performance. Deng, Kang and Low (2013) analyze the effect of acquirers' corporate social responsibility on their wealth effects and find that firms with high CSR scores earn higher announcement returns. They further find that high CSR firms produce better post-merger operating performance and that they also perform better when judged on the basis of the value-weighted portfolio of the acquirer and the target. Equally importantly, they find that high CSR firms generate positive long-term returns for their shareholders. However, to the best of our knowledge, the literature is void of studies with a focus on the effects of mergers and acquisitions on the welfare of other stakeholders. This study is designed as an exploratory work in that direction. More specifically, we study the post-merger pattern of changes in the firm's performance along the social, environmental and governance dimensions.

The available empirical evidence indicates that, other than the short-term wealth gains accrued to the shareholders of acquired firms, mergers and acquisitions do not create any significant longer-term shareholder benefits. We expect to find similar results in our analysis of the consequences of Japanese firms' mergers and acquisitions. However, we expand the scope of such an analysis to study the effect of these corporate restructurings on all stakeholders. Thus, we examine the firm's post-merger performance on the environmental, social and governance (ESG) fronts. A priori, it is not clear what the effect on the surviving firm's performance on the ESG front would be. Its performance would improve if the post-merger firm finds it essential to its long-

term interest to improve its relationship with these other stakeholders. The same kind of outcome can be expected if, due to increased visibility and the added scrutiny entailed, the post-merger firm would find it more difficult to externalize its costs. On the other hand, ESG performance has the potential to show signs of deterioration if, as a result of an enhanced position of power or of an improved bargaining position, the firm extracts more concessions from its other stakeholders (such as regulatory agencies, labor unions, communities) or if it finds it easier to externalize some of its costs. This improved bargaining position, and its attendant benefits, may indeed be a factor motivating the so-called “activist” investors (that seek to enhance shareholder returns) in nudging the firm to increase its scale. Therefore, when the first scenario prevails, we would expect to observe improvements in the firm’s performance on ESG factors. Under the second scenario, a deterioration of the firm’s ESG performance would be observed.

2.1 Evidence from Japanese Mergers and Acquisitions

Japanese mergers and acquisitions have also been extensively examined, including analyses by Kang et al., (2000), Schaik and Steenbeek (2004), Inoue and Kato (2006), Kakuda and Takeda (2006), Hanamura et al., (2011), Mehrotra, et al. (2011), Nogata, Uchida and Goto (2011), Yeh (2013), Higgins (2013). Specific details aside, the overall conclusion that can be drawn from these works is that the market for corporate control may behave differently in Japan than it does in the US and other Western countries.

Examining the reaction of stock prices of firms involved in domestic Japanese mergers and acquisitions between 1997 and 1993, Kang et al. (2000) find that cumulative abnormal returns for acquiring firms are significantly positive.¹ Schaik and Steenbeek (2004) analyze mergers of non-financial Japanese firms that took place between 1993 and 2003 and find that bidders realize a positive abnormal return around the announcement date. Unlike Kang et al. (2000), they do not find an association between announcement returns and the strength of bidders' relationship with banks. Therefore, given that the time period of their analysis starts when that of Kang, et al. ends, they argue that their results may indicate that Japan’s market for corporate control has experienced an evolution that renders the importance of the main bank diminished.

Inoue and Kato (2006) examine mergers and acquisitions that took place between 1990 and 2002 and find that such announcements tend to lead to increased stock prices for both targets and acquiring firms. However, their findings indicate that the market reaction for target firms is larger than it is for acquiring firms. Similar results

¹ However, they also report that acquirers experience a significantly negative wealth effect when the acquisition is motivated by rescue purposes.

are obtained by Kakuda and Takeda (2006) when they evaluate Japan's mergers and acquisitions within the two-year period of 2002- 2003 as well as by Hanamura et al. (2011) who evaluate transactions that took place between 2000 and 2007. Inoue and Kato (2006) attribute the differential wealth effects of these transactions in the Japanese markets (compared to those of the US markets) to the friendly nature of such transactions in Japan and their hostile nature in the US.

Yeh (2013) examines the market's reaction to the adoption of anti-takeover measures by 130 Japanese firms between 2005 and 2007 and finds significant negative wealth effects. However, his findings show that, in contrast to the findings for the US market, the adoption of such measures affect neither the managerial behavior nor the post-adoption performance of the firm.

Employing data from the 1998-2007 period, Nogata, Uchida and Goto (2011) compare stock price reactions of regulated non-financial firms involved in mergers and acquisitions and with those of banks and unregulated firms. They find that while unregulated firms and banks experience a significantly positive share price response the regulated group does not. They also find that unregulated firms with stricter governance structures experience a more favorable response.

Mehrotra, et al. (2011) focus on 91 mergers of Japanese firms during the 1998-2003 period and find that mergers in Japan, unlike those in the US, tend to be countercyclical. They also find that in a significant portion of these mergers a main bank is the common link between the target and the bidder and that, when that is the case, these mergers do not create wealth for the shareholders. Further, they report that both the acquiring and the target firm experience positive pre-announcement returns but that these gains are reversed during the post announcement-period. Additionally, Ushijima and Schaefer (2014) investigate trades between Japanese firms of their wholly- or partially-owned subsidiaries for the 1996-2010 period and find that subsidiary sales generate positive abnormal returns for their buyers but negligible returns for their sellers. However, the seller realizes significantly negative returns when the subsidiary subject to sale is in its core business.

Finally, and without being exhaustive, Higgins (2013) analyzes the wealth gains accruing to acquirers involved in mergers during the 1990-2004 period and finds that they do not gain from their acquisitions. He also finds that, when compared with firms with weak bank ties, acquirers with stronger bank ties experience a larger wealth loss. However, these findings stand in contrast with the rest of the literature, including those of Kang et

al., (2000), Schaik and Steenbeek (2004), Inoue and Kato (2006), Kakuda and Takeda (2006), Hanamura et al., (2011), and Nogata, Uchida and Goto (2011) with regard to the wealth effect experienced by the acquiring firms.

3. Data, Methodology, and Sample Characteristics

The primary sources of data utilized in this study are Thomson One Banker for details of mergers and acquisitions, Thomson Reuters Asset4 for environmental, social and governance (ESG) data, and Datastream for company data and returns analysis. To select our sample, we search Thomson One Banker for announcements of all mergers and acquisitions involving a Japanese firm either as the bidder or as a target starting in January 2000 and ending December 2014. Using the announcement date from Thomson One Banker as the event date, we utilize Eventus to calculate abnormal returns and the cumulative abnormal returns. We use the value-weighted index as the proxy for market return but also perform robustness checks utilizing the equally-weighted index.

Our initial sample is chosen to provide us with a basic understanding of the volume of M&A transactions involving a Japanese firm. Figure 1 provides a visual presentation of the volume of this M&A activity. According to these statistics, with 2,049 deals, the year 2007 witnessed the largest number of M&A activities involving a Japanese firm as one the parties. However, the global financial crisis led to a slowdown in these transactions with the volume dropping to 1,480 deals in 2010. Since then, the M&A activity has regained its momentum and reached 1,717 deals in 2014. Figure 1 also shows the numbers of terminated (or withdrawn) deals for each of 15 years covered. The largest number of terminations (60) occurred during the depth of the financial crisis in 2008. The year 2011 witnessed the fewest number of terminated deals, both in absolute numbers and as a fraction of announced deals.

Working with this population of deals, we next impose the dual requirements that (1) both the acquiring and the acquired firm be publicly traded, and that (2) the total value of the announced deal be greater than (or equal to) \$100 million. The resulting sample size is a total of 958 transactions. Table 1 reports the distribution of these deals over the 15-year period covered. According to these results, the Japanese market for corporate control had its banner year in 2005 when 95 transactions each worth more than \$100 million were announced. The largest number of withdrawn deals took place in 2006 with six cancelled transactions. Table 1 also reports the mean and median value of the transactions for each of the 15 years covered. While the annual median

values of these deals are fairly stable (and fall within a fairly narrow range of \$228 to \$400 million), their mean values are larger and more spread-out (and fall in the \$449-\$1,406 million range).

Beyond these 958 deals, each worth \$100 million or more, in which both parties are publicly traded, the 2000-2014 period also witnessed 430 deals in which the target was a non-publicly traded firm. Table 2 provides the summary statistics for these deals. According to these results, with 50 acquisitions each year, 2012 and 2013 have been the two most active years for publicly traded Japanese firms to acquire privately held firms. As would be expected, compared to acquisitions of publicly traded firms, these transactions are smaller in size regardless of whether size is by mean or median transaction value. Further, similar to the results reported in Table 1, the annual median values of these transactions are more stable (ranging between \$153m and \$260m) than are their mean values (ranging between \$243m and \$535m). However, because of the relative absence of very large-value outliers, mean and median values of these transactions are much closer to each other.

To arrive at our final sample of deals, we next impose the set of additional requirements that (1) the acquirer holds less than 50% of the target shares before the announcement and that it secures majority control as a result of the deal, that (2) the deal is completed (not cancelled or withdrawn at a later date) and that (3) the acquirer's ESG ratings be available in Asset4's database. ASSET4 reports ESG ratings for more than 4600 firms worldwide. Utilizing more than 750 individual data points and more than 250 key performance indicators (KPIs) it classifies these data into 'categories' within the each of the four major 'pillars' of corporate governance, economic, environmental and social. The corporate governance pillar consists of five categories: board functions, board structure, compensation policy, shareholders policy, and vision-and-strategy. The second pillar, economic, has three categories of performance, client loyalty and shareholder loyalty. The environmental pillar is comprised of the three categories of emission reduction, product innovation, and resource reduction. The last pillar, social, is made up of seven categories: community, diversity, employment quality, health-and-safety, human rights, product responsibility, and training-and-development. Utilizing the data underlying these categories, ASSET4 develops performance indicator scores that are then normalized and adjusted (for skewness and the differential between the mean and the median) and fitted to a bell curve to derive ratings between 0 and 100 for each company. The resulting percentage is therefore a relative measure of performance, z-scored and normalized to distinguish values and position the score between 0 and 100%.² Each firm is ranked against

² More specifically, each firm's performance is calculated first as the average value of its indicators. These averages are then used to calculate the average and the standard deviation of all company averages. The standard deviations are then used to center everything around zero.

the four pillars designed to assess its performance on ‘Corporate Governance,’ ‘Economic,’ ‘Environmental’ and ‘Social’ dimensions as well as its overall ESG performance.

The first pillar (corporate governance) provides for an assessment of a firm’s systems and processes and is designed to indicate how well its board members and executives act in the interests of its long term shareholders. Accordingly, it can be used as a proxy to captures a company’s capacity to direct and control its rights and responsibilities to generate long term shareholder value through the creation of incentives and the appropriate sets of checks and balances. According to Asset4, the economic pillar is designed to measure the firm’s capacity to generate sustainable growth and a high return on investment as well as efficient use of all its resources. It can, therefore, be used as a proxy for a firm’s overall financial health and its ability to generate long term shareholder value through implementation of best management practices.

The environmental pillar is designed to assess a firm’s impact on living and non-living natural systems, including the air, land, water, and the complete ecosystems. It can, therefore, be used as an indicator of how well the firm uses best management practices to avoid environmental risks and how responsible it is in its use of the natural system to generate long term shareholder value. The social pillar is designed to assess the firm’s capacity to generate trust and loyalty with its workforce, customers and the society at large. As such, it can be used as a proxy for the firm’s reputation, the strength of its support foundation, and the health of its license to operate. Finally, the equal-weighted scores are equally weighted assessments of company performance on the four pillars.³ Therefore, the equal-weighted score can be used as a summary proxy for the firm’s performance in all four areas; economic, environmental, social and corporate governance.

Imposing the above three additional constraints, our final sample consists of 243 transactions. Table 3 reports the summary statistics for this sample. Approximately six-tenth of these transactions are all-share deals, three-tenth all-cash, and with the remainder are hybrids. Conglomerate-type mergers make up about 23% of these transactions, and about 60% are horizontal. Further, according to these results, at \$1.07 billion, the mean transaction value for our sample is about three-times its median value and about ten times the book value of assets acquired. The average premium paid for the control of these target firms is 20.4% (the premium paid is measured as the offer price compared to the target’s share price four weeks before the announcement of the deal). These targets appear to be highly-levered as the average debt to equity ratio (total debt divided by book

³ It should be noted again that these ratings are also z-scored and normalized to position the score between zero and 100%.

value of equity) of targets is 1.66. Measured by the average equally-weighted ESG ranking, the typical acquirer has a z-score of 48 and, as such, it can be argued that it has an ESG profile not much different than the average firm surveyed by ASSET4. The same can be said about the economic ranking of these acquirers where the average score is 51. With an average of 56, the social ranking of these firms is slightly above the mid-point for all firms in the universe of ASSET4. Their environmental ranking is higher yet, averaging 65, indicating much better performance than their global peers. However, with an average score of 14, the corporate governance ranking of these firms is significantly below the mid-point of their peers elsewhere. Combined, these rankings paint a picture of these Japanese acquirers as a group of socially and environmentally responsible firms that have relatively weak corporate governance structures but manage to produce par-level economic and overall performance.

The summary statistics in Table 3 also show the annual breakdown of these mergers. With a total of 28, the largest number of transactions included from any given year comes from the 2006 mergers. However, the largest total dollar value of transactions included in our sample are those that represent the deals consummated in 2007. The year 2002 contains the fewest number of deals (seven transactions) but 2010 represents the smallest total dollar transaction value. Similar to the results reported in Table 1 for our initial sample of 958 deals, the final sample's annual median values are smaller and fairly stable (within the \$146 to \$575 million range) but the mean values are larger and more spread-out (in the \$209-\$2,453 million range). Interestingly, the premium incorporated into the offer price (relative to target's share price four weeks before) exhibits a considerable degree of variation between a low of 1.06 percent in 2001 to a high of 54 percent in 2010. Targets' debt-to-equity ratios also register wide variations between a low of 0.45 times in 2014 and a high of 3.78 times in 2002. There are also inter-year variations in ESG rankings of the acquirers. However, similar to the overall averages, these annual averages are indicative of a profile of high social and environmental performance, poor corporate governance, but average economic and overall performance.

4. Empirical Results

Starting with the intermediate sample of 958 M&A announcements of Japanese firms acquiring publicly traded Japanese firms, we evaluate the wealth effect of these events by computing the abnormal returns realized by the shareholders of the acquiring firms. Panel A of Table 4 shows these results, indicating that shareholders of

acquiring firms earn significantly positive abnormal returns at the announcement of these transactions.⁴ Indeed, positive abnormal returns in the magnitude of 0.44% are realized on the day of announcement followed by 1.13% the following day.⁵ Additionally, as shown in Panel B, shareholders of target firms fare better and realize abnormal returns in excess of 3% on both the announcement date and the following day. Therefore, it appears that M&A activity in the Japanese markets produces significant gains for the shareholders of both the acquiring and the target firm. These results are in line with the findings of Kang et al., (2000), Schaik and Steenbeek (2004), Inoue and Kato (2006), Kakuda and Takeda (2006), Hanamura et al., (2011), and Nogata, Uchida and Goto (2011). However, it appears that the magnitude of the gains for mergers of the first decade-and-a-half of the 21st century, when compared to those reported in these earlier studies, is somewhat different: smaller gains for the shareholders of acquiring firms and larger ones for target shareholders. This may signal that Japan's market for corporate control may be losing some of its unique attributes and that its dynamics may be converging with those of the US markets.

Analyzing the wealth effects of the withdrawal of M&A offers or the termination of proposed deals, we find that both the (would-have-been) acquiring firm shareholders and target shareholders experience a reversal of their earlier gains. As reported in Panel C of Table 4, shareholders of acquiring firms experience a small but statistically significant negative abnormal return on the day of offer withdrawal/termination. Further, as results reported in Panel D indicate, target shareholders realize significantly negative abnormal returns on the day after the announcement of withdrawal or termination.

We next analyze the wealth effects of announcements of acquisitions of non-listed Japanese firms by publicly traded acquirers (i.e., those included in table 2). Results are reported in Panel E of Table 4. According to these results, acquisitions of unlisted firms lead to significant gains for the shareholders of acquiring firms. In terms of their magnitude, these gains appear to be similar in to those experienced by the shareholders of acquiring firms when the target is a publicly traded firm. As such, these results are different than those reported by Faccio, McConnell and Stolin (2006) who find that, when compared to the abnormal returns experienced by its shareholders when the firm acquires a publicly traded firm, the acquirers of non-listed firms earn significantly higher abnormal returns. Here, again, it can be argued that the evolution of Japanese market for corporate

⁴ The requirement of complete availability of returns data reduces our number of usable events from to 708 acquisitions involving traded target firms and 28 non-traded targets.

⁵ Once the event window is widened to 11 days, starting with five days prior to and ending five days after the announcement, we observe that shareholders of acquiring firms experience negative abnormal returns at t+3 and t+4. However, the 11-day cumulative abnormal returns is still significant at 1.46%.

control is responsible for the differences in results. A higher degree of competition among acquirers for assets complementary to theirs in place has the expected effect of reducing the windfall to successful bidders, regardless of whether the bidder is publicly traded or otherwise.

4.1 Detailed Analysis

The major focus of our attention now shifts to an analysis of the short-term and longer-term wealth effects of mergers and acquisitions as well as their social, environmental and governance effects. To this end we concentrate on the 243 transactions of Table 4.⁶ The short-term wealth effects are summarized in Tables 5 and 6, with the former reporting the abnormal returns realized by the acquiring shareholders and the latter those by the shareholders of target firms. According to these results, shareholders of acquiring firms experience significantly positive abnormal returns on the day of and the day following the deal's announcement. This holds true regardless of whether we analyze the returns for all acquiring firms (Panel A) or only those for the non-financial acquirers (Panel B). As such, the cumulative abnormal returns over the three-day window of $t-1$ to $t+1$ are significantly positive, again irrespective of whether financial firm are included or not. However, in both the total sample and the non-financial subsample, a reversal of fortunes takes place two days after the announcement with these shareholders experiencing significantly negative returns. The magnitude of the reversal is such that it erases the gains realized over the three-day window of $t-1$ to $t+1$. Consequently, when analyzed over the five-day window of $t-5$ to $t+5$, the cumulative abnormal returns are indistinguishable from zero. Therefore, it can be concluded that mergers in Japan are not consequential events for the shareholders of acquiring firms as they experience no significant wealth effects, positive or negative. These result, therefore, stand in contrast with the conclusions of some earlier works (e.g., Kang et al., 2000, Schaik and Steenbeek, 2004, Inoue and Kato, 2006, Kakuda and Takeda, 2006, Hanamura et al., 2011, and Nogata, Uchida and Goto, 2011) that the shareholders of Japanese acquirers experience significant abnormal returns. Given the more recent data used in this study, it can be concluded that the comparative advantage of bidding firms has started to disappear as Japan's markets for corporate control has evolved to become more competitive. In this respect, today's Japan's market for corporate control behaves in a manner identical to the US and other Western markets.

⁶ Note, however, that the requirement of complete availability of all data items reduces the actual number of transactions to a total of 165.

Insofar as the shareholders of target firms are concerned, results reported in Table 6 clearly establish that they earn significantly positive abnormal returns. This holds true regardless of whether we focus on the returns realized by the sample of all acquired firms (Panel A) or the subsample of non-financial firms (Panel B). According to these results, significantly positive abnormal returns are earned on both the day of and the day after the deal's announcement. The three-day (t-1, t+1) cumulative abnormal returns to target shareholders register at 8.09% for all acquired firms and 9.07% for the non-financial subsample, both highly significant. The magnitude of these abnormal cumulative returns is even larger, 12.0% for all acquired firms and 13.95% for non-financials, when we widen the event window to the 11-day period of t-5 to t+5. We note, however, that the ratios of positive-to-negative abnormal returns suggest that a reversal of fortunes may be taking place starting on the second day after the event. Although this indication of a reversal is supported by the Patel Z-statistics, the average abnormal returns for all three days retain their positive signs. Therefore, it can be concluded that in contrast to the experience of acquiring shareholders, acquired firms' shareholders reap significant benefits from these restructuring events.

4.2 Determinants of Abnormal Returns

We next set out to investigate which firm or deal-specific variables may explain variations observed in the magnitude of abnormal returns experienced by the shareholders of acquiring firms. To this end, we are particularly interested in studying the possible role played by the acquiring firm's commitment to ESG factors. Our null hypothesis is that firms with a higher degree of commitment to ESG factors are positioned to appeal to a broader set of stakeholders and can, therefore, secure a more favorable set of merger terms. If so, we would expect ESG factors to positively influence the magnitude of abnormal returns experienced by their shareholders. We utilize the acquiring firm's equally-weighted ESG score, as compiled and reported by Asset4, as a proxy for the firm's commitment to ESG factors.

Additionally, given that the existing literature has identified a number of company and deal-specific factors as determinants of abnormal returns, we include the following set of factors as well: the acquiring firm's size (proxied by the natural log of the firm's total assets), the acquiring firm's debt ratio (proxied by the ratio of book value of total debt divided by the sum of market value of equity and book value of debt), acquiring firm's Tobin's q (proxied by the ratio of the firm's excess market value, i.e. market value one week prior to the deal's announcement, net of its book value divided by its book value), target's debt ratio (proxied by the ratio of book value of total debt divided by the sum of market value of equity and book value of debt), target's size (proxied by

the natural log of its total assets), and the merger's relative size (proxied by target's size divided by acquirer's size). We also include three dummy variables: the first one is designed to assume a value of 1 if the acquisition is an all-cash deal, the second to signify if the merger is an all-share deal and the third to indicate if the merger is a conglomerate-type acquisition. Finally, we also include year and industry fixed effects.

Results, as reported in Table 7 indicate that although the coefficient estimate of the ESG score has the expected sign it is not statistically significant. Both the acquiring firm's size and the target's size exert negative influences on the acquiring firm's abnormal returns. However, neither one of the estimated coefficients is statistically significant. The same holds true for target's degree of financial leverage and the dummy variable for all-cash deals. The estimated coefficients for all remaining variables are positive. However, the estimated slope is statistically significant only for the deal's relative size, which indicates that the larger the target relative to the acquiring firm, the larger the payoffs to the shareholders of the acquiring firm. With an R-square of 78%, the model has a highly significant explanatory model. However, most of the variation is attributed to calendar year and industry effects.

4.3 Longer-Term Shareholders Benefits

Turning our attention to the question of longer-term wealth effect of mergers and acquisitions, we analyze the pattern of abnormal returns over the 60-month period following completion of the deal. Figure 2 provides a visual presentation of the monthly abnormal returns earned by the shareholders of acquiring firms for the five-year period that follows the merger. These results indicate that, insofar as these abnormal returns capture the longer-term wealth experience of the surviving firm's shareholders, in terms of their statistical significance, these mergers are inconsequential events. However, given a continuous pattern of decreases in the CAR, a different conclusion may be warranted when these events are evaluated in terms of their economic significance. As Figure 2 shows, during the five-year period following the merger, monthly abnormal returns fluctuate considerably. However, no significant wealth creation or wealth destruction is evident. Cumulative abnormal returns drift consistently in the negative territory approaching six percent by the end of the five-year window. Therefore, it can be concluded that Japanese mergers and acquisitions do not produce significant long-term benefits for the surviving firm's shareholders.

4.4 Longer-Term Effects on Other Stakeholders

Finally, we turn our attention to the question of how these restructuring events affect the positions of other stakeholders. Ideally, we would want to measure and quantify the impact of such activities on the wealth and welfare of these stakeholders such as the firm's employees, its suppliers and customers, the broader communities that the firm resides within and benefits from, the natural eco-system that it relies upon. However, the absence of data on such impacts precludes direct analyses of the effects.⁷ In the meantime, analyses of the firm's ESG scores can provide for indirect evaluations of the effect of mergers and acquisitions on the positions of other stakeholders.

Therefore, to assess the impact of mergers and acquisitions on the positions of other stakeholders, we evaluate the surviving firm's performance on economic, environmental, social, and governance factors during the five-year period that follows the restructuring event. To this end, we form an event-based portfolio for which $t=0$ is the year in which the merger takes place. We then evaluate the pattern of changes in the firm's performance starting at $t=0$ through $t=5$. To account for changes that are industry-wide and unrelated to the event, we use industry-adjusted scores by subtracting the average score for all firms operating in the same industry from the firm's raw score. Results are reported in Figures 3 through 7. Specifically, Figure 3 charts the pattern of changes in the surviving firms' industry-adjusted economic performance for each of the five post-merger years. Figures 4, 5 and 6 portray the sequence of changes in the firms' performance on the environmental, social, and governance fronts and Figure 7 maps out the same for these firms' overall performance as measured by the equally-weighted composite of the four factors.

According to these results, the typical acquiring firm's economic performance (Figure 3) shows signs of improvement during the first three years that follow the merger. However, performance deteriorates during the fourth and fifth year in a manner that washes away the gains of the first three years. A similar pattern is observed with regard to the firm's environmental performance (Figure 4), with improvements during the first two years and an erosion of those gains during the subsequent three years. The firm's performance on the social front (Figure 5) is somewhat different in that a slight improvement is observed only during the first of the post-merger years. However, a deteriorating pattern of performance starts in the second year and continues into the fifth year with the fifth-year performance noticeably inferior to its performance at the time of the merger. With regard to governance (Figure 6), these firms' performance remains largely unchanged over the course of the five years that follow the merger with no changes for the first two years, a slight improvement during the third year

⁷ We can envision that future availability of detailed data may make such an inquiry more encompassing.

and a reversal of that gain during years four and five. Finally, on an overall basis (Figure 7), these firms show an improvement during the first year, exhibit flat performance for the next two years and inferior performance in years four and five. This negative performance washes away all initial advantage and leaves them worse off when compared to their performance at the time of merger.

Comparing the mean performance of these acquiring firms at the time of the merger to their performance five years later, t-statistics indicate that these firms' performance show no significant change on any of the four pillars of performance (economic, $t = -0.038$, environmental, $t = 1.46$, social, $t = -0.69$, or governance $t = 0.89$). The same is true with regard to the overall equally-weighted average of the four performance pillars ($t = -0.38$). Accordingly, it can be concluded that these mergers fail to produce any significant improvements in the surviving firm's performance on any fronts, economic, environmental, social or governance. Combined with our earlier results that these events fail to produce long-term value shareholder value, we can infer that executives involved are the only beneficiaries of these transactions.

5. Conclusions

This paper focuses on the dynamics of the market for corporate control in Japan. To that end, we analyze mergers and acquisitions that take place within the Japanese market between January 2000 and December 2014. We first evaluate the short-term wealth effects of these corporate events from the perspectives of shareholders of both the acquiring and the acquired firms. We find that the shareholders of Japanese acquiring firms do not experience any significant wealth effects. On the other hand, our findings indicate that the acquired firms' shareholders earn significant positive abnormal returns. These results stand in contrast to some of the earlier results reported for the Japanese markets. Given the more recent data used in this study, we conclude that Japan's market for corporate control has become more competitive and now behaves in a manner similar to those of the US and other Western nations.

We also analyze the longer-term wealth effects of these acquisitions by studying the pattern of abnormal returns earned by acquiring shareholders over a sixty-month period following the event. Our results indicate that the shareholders of the surviving firm experience no significant abnormal long-term benefits during the five years that follow the merger. The paper's most significant contribution to the literature is a pioneering analysis of the longer-term effects of mergers on the firm's environmental, social and governance performance. Results indicate that Japanese mergers produce no discernable improvements in the firm's performance on any

of these fronts over the five-year period that follows the merger. An argument that can be forwarded is that in the process of combining its operations with another firm, the acquiring firm increase its size and its power base. It, therefore, improves its bargaining position vis-a-vis other stakeholders such as regulatory agencies, labor unions or communities. Accordingly, it positions itself to extract more favorable terms from the other stakeholders. Under such conditions, mergers do not necessarily result in improvements in environmental, social and governance performance of the post-acquisition surviving firm. Indeed, this improved bargaining position, and its attendant benefits, may be a motivating factor for the so-called “activist” investors i.e., those seeking to enhance shareholder returns. Their tactic may amount to one of nudging the firm to increase its scale and extract rents otherwise inaccessible. The best-expected outcome under such a scenario would be no improvements in the firm’s performance on ESG factors. This is precisely what our findings point to.

Table 1. The frequency of mergers and acquisitions by Japanese acquirers of publicly traded targets with deal values of \$100 million or more, and the means and medians of transaction values for the years 2000 thru 2014.

Year	Numbers of Deals Announced	Numbers of Deals Terminated	Mean Transaction Value (millions of dollars)	Median Transaction value (millions of dollars)
2000	50	1	\$1,378	\$343
2001	46	1	\$683	\$343
2002	64	0	\$513	\$261
2003	84	1	\$498	\$273
2004	50	2	\$1,406	\$256
2005	95	4	\$1,353	\$400
2006	83	6	\$829	\$321
2007	76	4	\$449	\$267
2008	75	3	\$794	\$299
2009	68	3	\$781	\$233
2010	48	1	\$888	\$249
2011	56	0	\$831	\$227
2012	64	1	\$919	\$288
2013	52	2	\$688	\$228
2014	47	1	\$778	\$262

Table 2. The frequency of mergers and acquisitions by Japanese acquirers of unlisted targets with deal values of \$100 million or more, and the means and medians of transaction values for the years 2000 thru 2014.

Year	Numbers of Deals Announced	Mean Transaction Value (millions of dollars)	Median Transaction value (millions of dollars)
2000	27	445	241
2001	9	535	276
2002	11	321	217
2003	21	352	190
2004	19	543	236
2005	33	444	229
2006	27	243	160
2007	38	433	191
2008	31	268	189
2009	26	378	260
2010	25	242	155
2011	37	330	201
2012	50	349	153
2013	50	243	213
2014	26	461	211

Table 3. Summary statistics for mergers and acquisitions, between January 2000 and December 2014, made by Japanese acquirers of Japanese publicly-traded targets with deal values of \$100 million or more where the acquirer holds less than 50% of the target shares before the announcement and secures majority control as a result of the deal.

Year	Number of Transactions	Number of All Cash Deals	Number of All Shares Deals	Number of Conglomerate Deals	Number of Horizontal deals	Mean Transaction Value	Median Transaction Value	Average Target Book Value	Offer Premium Relative to Share Price Four weeks Earlier	Target's Leverage Ratio	Equal-Weighted ESG Ranking	Corporate Governance Ranking	Economic Ranking	Environmental Ranking	Social ranking
2000	22	0	20	4	18	2107	575	30429	8.33%	1.06	54	17	49	75	65
2001	15	1	10	3	9	910	497	25684	1.36%	3.07	49	16	65	55	61
2002	7	0	4	1	4	314	234	1460	2.26%	3.78	45	20	46	59	49
2003	14	4	8	0	11	403	178	2428	14.81%	2.11	51	12	55	68	61
2004	14	3	8	7	5	1015	184	6059	15.69%	0.66	38	13	40	53	48
2005	27	8	14	8	12	2453	550	32252	15.80%	1.90	36	10	38	52	46
2006	28	14	13	9	13	580	349	2366	14.49%	1.99	50	13	53	69	58
2007	18	9	9	4	9	576	186	2886	15.11%	1.63	53	17	58	64	59
2008	15	6	9	6	9	1037	270	6546	21.36%	3.21	38	11	41	57	51
2009	17	7	10	4	11	1439	371	20189	27.43%	1.33	59	18	60	78	64
2010	9	6	3	3	5	237	160	932	54.07%	1.01	58	9	70	79	64
2011	15	7	8	3	9	1579	208	4395	30.05%	0.92	43	10	51	67	53
2012	19	6	13	1	16	547	269	2594	53.03%	1.26	42	17	46	57	50
2013	11	4	7	0	8	209	146	2852	16.52%	0.58	68	12	76	91	70
2014	12	4	7	2	7	464	262	4730	15.75%	0.45	56	15	56	76	59
All	243	79	143	55	146	1066	290	11675	20.40%	1.66	49	14	54	67	57

Table 4. Abnormal returns associated with the announcements of Japanese mergers and acquisitions to the acquiring and target firm shareholders and the abnormal returns experienced by shareholders at the announcement of withdrawal or termination of such deals during the 2000-2014 period. Panels A-D report the results for acquisitions involving listed targets. Panel E reports the results for acquisitions of unlisted firms. Day zero is the date on which a public announcement is made. All abnormal returns the equally weighted index and market adjusted returns.

	Day	N	Mean Abnormal Return (%)	Positive: Negative	Patel Z	Generalized Sign Z
A. Announcement-Date Returns to Acquiring Firms; Listed Targets	-1	708	0.07	365:356	1.12	1.39
	0	708	0.44	404:317	5.65***	4.3***
	+1	708	1.13	407:314	16.12***	4.52***
B. Announcement-Date Returns to Target Firms; Listed Targets	-1	708	0.38	349:359	4.41***	1.12
	0	708	3.01	435:273	36.79***	7.59***
	+1	708	3.08	432:276	46.26***	7.37***
C. Withdrawal-Date Returns to Acquiring Firms; Listed Targets	-1	28	-0.04	17:13	0.48	0.62
	0	28	-0.01	17:13	-3.55***	0.62
	+1	28	-0.05	14:16	0.55	-0.48
D. Withdrawal-Date Returns to Target Firms; Listed Targets	-1	28	-0.01	14:14	0.22	-0.14
	0	28	-0.34	12:16	-1.63	-0.9
	+1	28	-2.88	9:19	-5.99***	-2.03*
E. Announcement-Date Returns to Acquiring Firms; Unlisted Targets	-1	424	0.23	210:214	3.69***	1.24
	0	424	0.67	212:212	5.57***	1.43
	+1	424	0.50	212:212	5.32***	1.43

The symbols *, **, and *** denote statistical significance at 0.05, 0.01, and 0.001 levels using a generic one-tail test.

Table 5. Abnormal returns to the shareholders of acquiring firms associated with the announcements of mergers and acquisitions during the 2000-2014 period. Day zero is the date on which a public announcement is made. All abnormal returns are calculated using the equally weighted index and market adjusted returns.

A. All Acquiring Firms (N=165)

Day	Mean Abnormal Return (%)	Positive: Negative	Patel Z	Generalized Sign Z
-5	0.10	77:88	-0.116	-0.565
-4	0.15	82:83	2.193	0.353
-3	0.11	83:82	0.081	-0.106
-2	-0.23	75:90	-0.980	-0.871
-1	-0.03	77:88	-0.152	-0.565
0	0.61	94:71	3.588***	1.731*
+1	0.97	88:77	5.423***	0.812
+2	-0.53	64:101	-2.952**	-2.707**
+3	-0.16	71:94	-0.432	-1.330
+4	-0.60	66:99	-4.062***	-2.905*
+5	-0.06	81:84	1.218	-0.259
Cumulative (-1,+1)	1.55	95:60	5.114***	2.649**
Cumulative (-5,+5)	0.33	84:81	1.148	0.812

B. Non-Financial Acquiring Firms (N=141)

Day	Mean Abnormal Return (%)	Positive: Negative	Patel Z	Generalized Sign Z
-5	0.02	62:79	-0.258	-0.844
-4	-0.01	66:75	1.249	-0.186
-3	0.10	64:77	-0.144	-0.679
-2	-0.17	65:76	-0.462	-0.515
-1	-0.12	67:81	-0.670	-0.679
0	0.64	75:66	3.712***	1.295
+1	1.08	77:64	5.703***	0.637
+2	-0.68	65:76	-3.544***	-2.818***
+3	-0.08	69:72	0.003	-1.008
+4	-0.54	62:79	-3.722***	-1.502
+5	-0.06	71:70	1.341	-0.021
Cumulative (-1,+1)	1.60	81:60	5.049***	2.282*
Cumulative (-5,+5)	0.190	78:63	0.968	0.966

The symbols *, **, and *** denote statistical significance at 0.05, 0.01, and 0.001 levels using a generic one-tail test.

Table 6. Abnormal returns to the shareholders of target firms associated with the announcements of mergers and acquisitions during the 2000-2014 period. Day zero is the date on which a public announcement is made. All abnormal returns are calculated using the equally weighted index and market adjusted returns.

A. All Target Firms (N=165)

Day	Mean Abnormal Return (%)	Positive: Negative	Patel Z	Generalized Sign Z
-5	-0.04	80:85	0.388	-0.022
-4	0.19	83:82	2.030	0.445
-3	0.13	86:79	1.341	0.912
-2	0.15	77:88	2.236	-0.490
-1	0.28	84:81	0.829	0.601
0	3.12	105:60	23.799***	3.872***
+1	5.10	111:54	44.908***	4.806***
+2	2.15	75:90	15.97***	-0.801
+3	0.82	76:89	7.568***	-0.645
+4	0.40	73:92	4.825***	1.113
+5	-0.28	72:93	-0.594	-1.268
Cumulative (-1,+1)	8.09	127:38	38.379***	7.620***
Cumulative (-5,+5)	12.02	125:40	31.146***	6.208***

B. Non-Financial Target Firms (N=141)

Day	Mean Abnormal Return (%)	Positive: Negative	Patel Z	Generalized Sign Z
-5	0.08	69:72	0.996	0.072
-4	-0.02	69:72	0.839	0.072
-3	0.15	74:67	1.326	0.915
-2	0.10	62:79	2.366	-1.107
-1	0.13	67:74	0.270	-0.265
0	3.57	95:46	25.848***	4.453***
+1	5.57	94:47	47.553***	4.285***
+2	2.49	62:79	17.388***	-1.107
+3	1.01	65:76	8.202***	-0.602
+4	0.54	63:78	5.148***	-0.939
+5	-0.25	62:79	-0.465	-1.107
Cumulative (-1,+1)	9.07	110:31	41.009***	7.222***
Cumulative (-5,+5)	13.95	109:32	31.837***	7.418***

The symbols *, **, and *** denote statistical significance at 0.05, 0.01, and 0.001 levels using a generic one-tail test.

Table 7. Regression of acquiring firm cumulative abnormal returns on explanatory variables. The abnormal returns are those accruing to the shareholders of acquiring firms over the three-day window of t-1 to t+1. The explanatory variables consist of the acquiring firm's ESG score, proxied by the firm's equal-weighted ESG score as reported by Asset4, the acquiring firm's size, proxied by the natural log of the firm's total assets, the acquiring firm's debt ratio, proxied by the ratio of book value of total debt divided by the sum of market value of equity and book value of debt, acquiring firm's Tobin's q, proxied by the ratio of the firm's excess market value (market value one week prior to the deal's announcement), net of its book value divided by its book value, target's debt ratio, proxied by the ratio of book value of total debt divided by the sum of market value of equity and book value of debt, target's size, proxied by the natural log of its total assets, the relative size of the acquisition, proxied by target's size divided by acquirer's size, a dummy variable assuming a value of 1 if the acquisition is an all-cash deal, a dummy variable signifying if it is an all-share deal and a dummy variable indicating if the merger is a conglomerate-type acquisition. Year and industry fixed effects are also included.

Variable	Parameter Estimate	Standard Error	t-Statistic
Constant	0.11331	0.09934	1.14
Acquirer's ESG score	0.00009	0.00019	0.46
Acquirer's size	-0.00694	0.00609	-1.14
Acquirer's debt ratio	3.24289	3.60644	0.9
Acquirer's Tobin's q	0.00004	0.00004	1.15
Target's debt ratio	-0.02946	0.02446	-1.2
Target's size	-0.00520	0.00583	-0.89
Relative size of the acquisition	0.07284	0.03248	2.24
All-cash deal dummy	-0.01878	0.01861	-1.01
All-share deal dummy	0.00388	0.01667	0.23
Diversifying merger dummy	0.00028	0.01217	0.02
Industry fixed effects	Yes		
Year fixed effects	Yes		

Figure 1. The frequency of Mergers and Acquisitions involving a publicly-held Japanese firm either as an acquirer or a target between 2000 and 2014

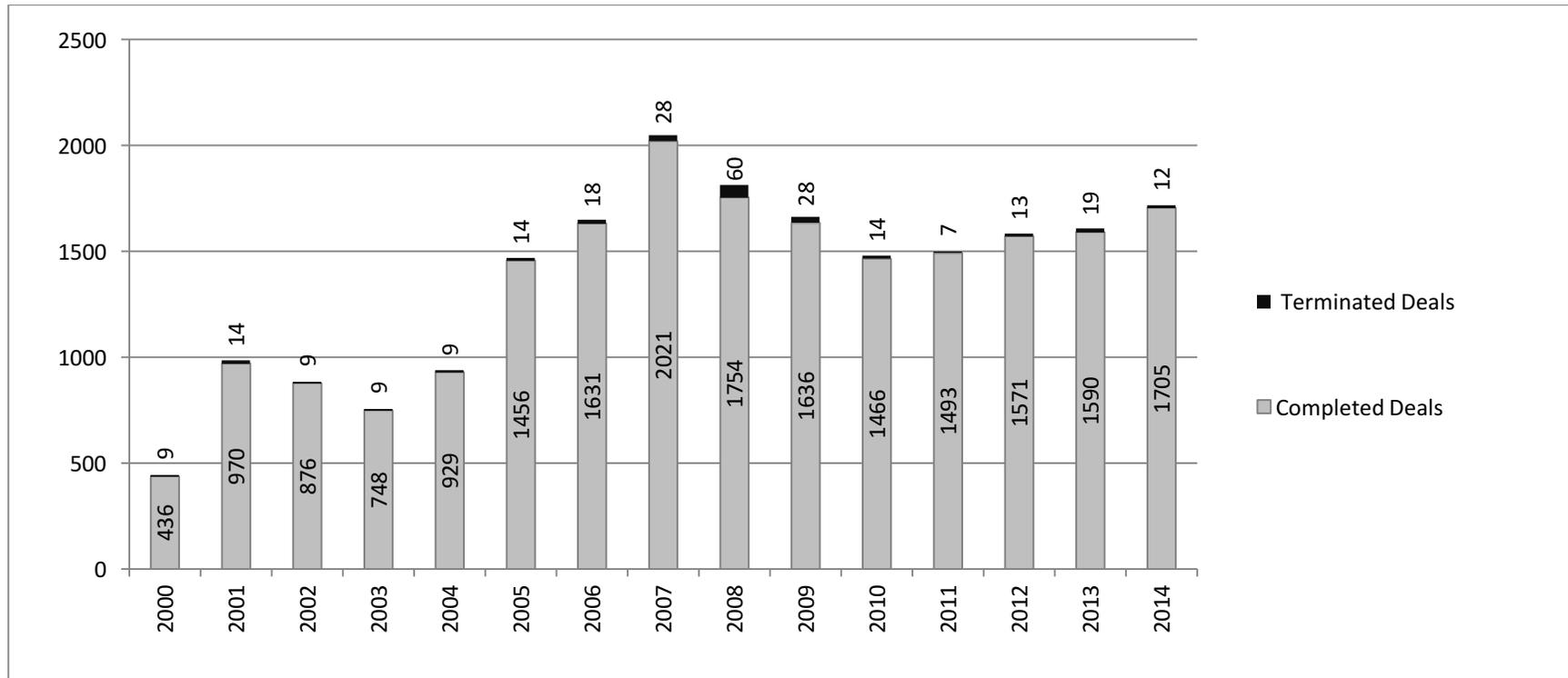


Figure 2. Average abnormal returns and cumulative abnormal returns experienced by the shareholders of acquiring firms over the 60-month period following the merger. Results correspond to returns on an event-based portfolio consisting of the shares of all acquiring firms in which $t=0$ is defined as the merger date. Abnormal returns are calculated using the equally weighted index and market adjusted returns. The horizontal axis records the number of months after the merger and the vertical axis records the returns.

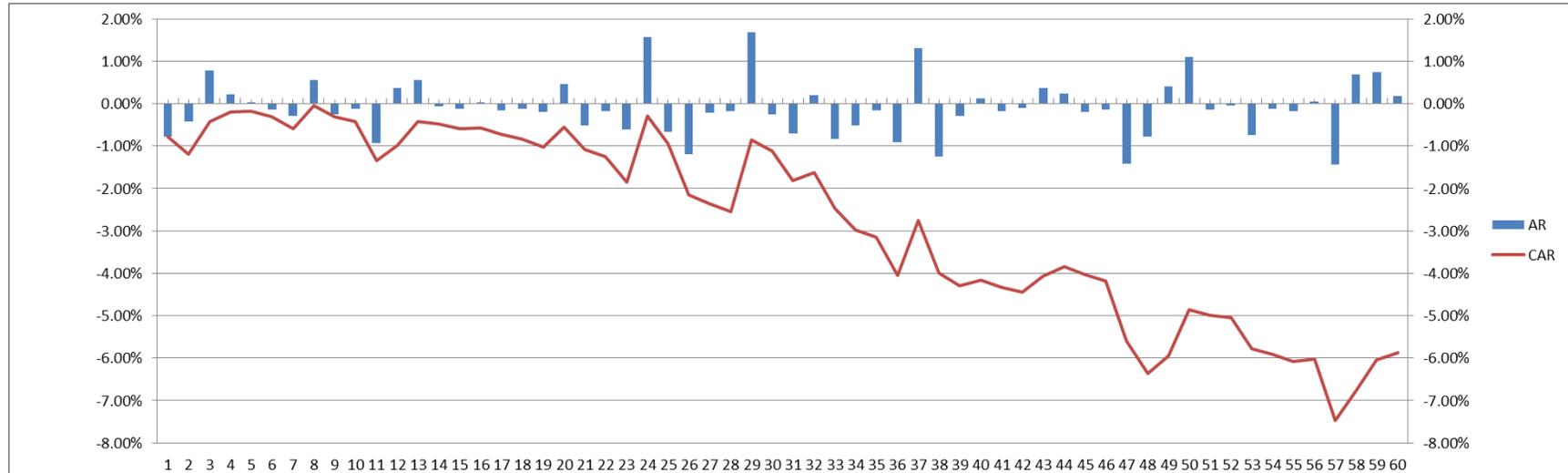


Figure 3. Economic performance of Japanese acquiring firms during the five-year period that follows the merger. Performance is measured by adjusting each firm's Asset4 score by the industry average that excludes the firm.

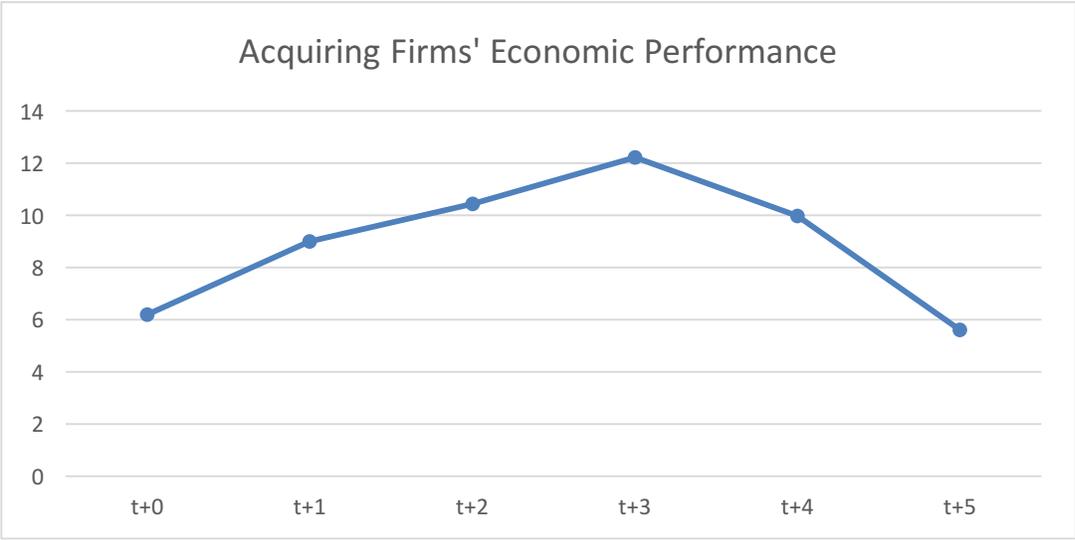


Figure 4. Environmental performance of Japanese acquiring firms during the five-year period that follows the merger. Performance is measured by adjusting each firm's Asset4 score by the industry average that excludes the firm.

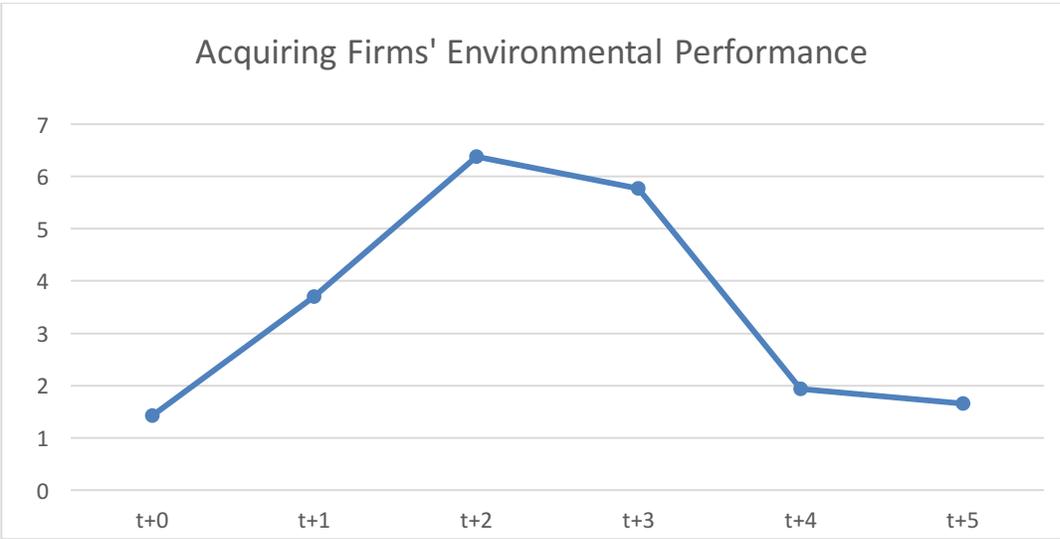


Figure 5. Social performance of Japanese acquiring firms during the five-year period that follows the merger. Performance is measured by adjusting each firm's Asset4 score by the industry average that excludes the firm.

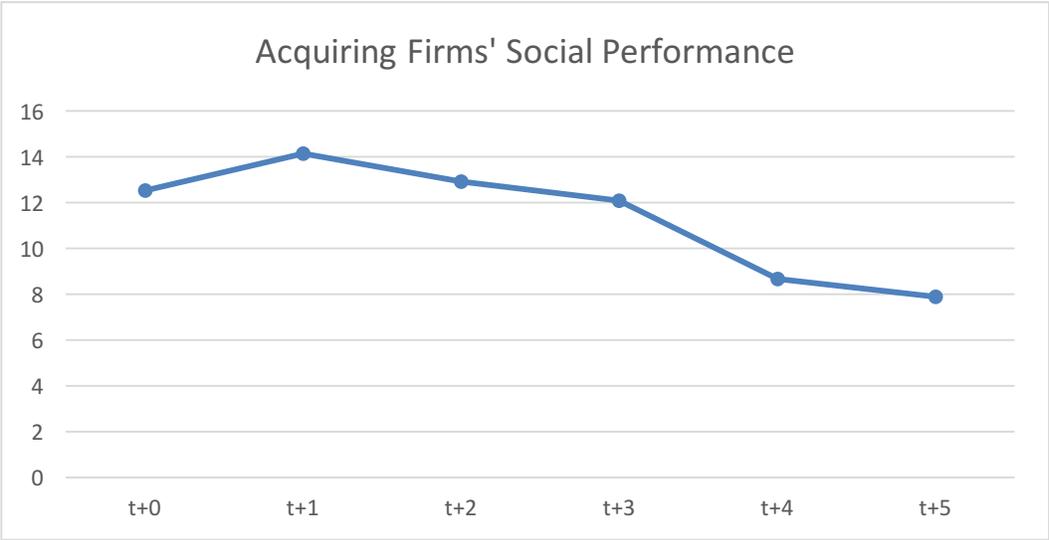


Figure 6. Governance performance of Japanese acquiring firms during the five-year period that follows the merger. Performance is measured by adjusting each firm's Asset4 score by the industry average that excludes the firm.

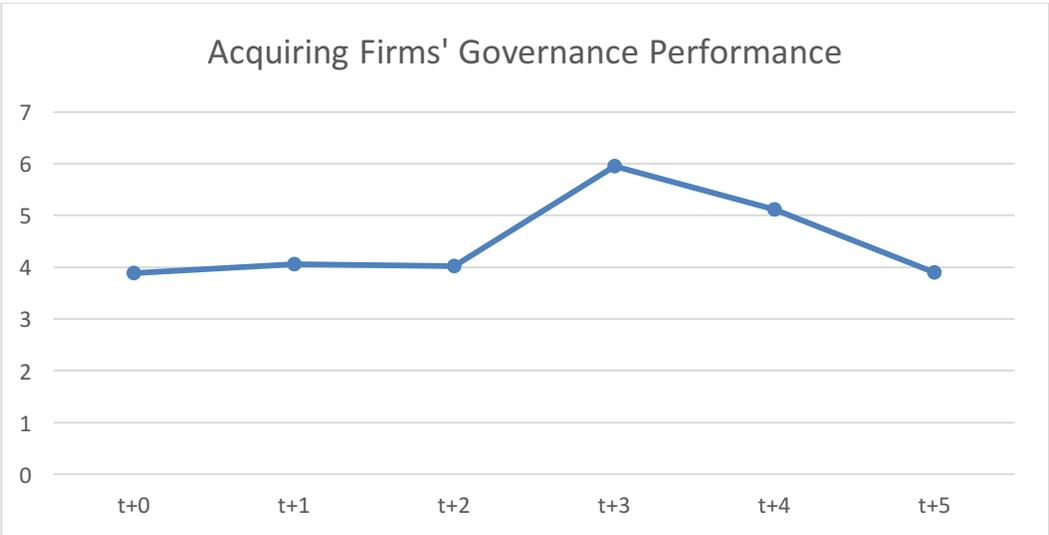
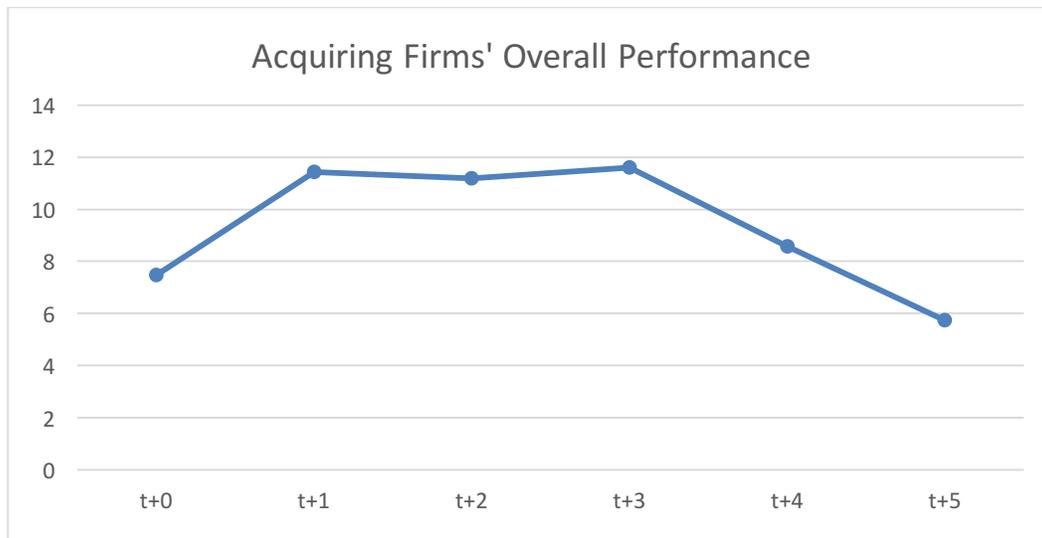


Figure 7. Overall performance of Japanese acquiring firms during the five-year period that follows the merger. Performance is measured by adjusting each firm's Asset4 score by the industry average that excludes the firm.



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