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## Do M&A Improve Corporate Financial Performance in Japan?

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# Do M&A Improve Corporate Financial Performance in Japan?


## Summary

1. During the "lost decade" following the collapse of the bubble economy, Japanese firms have been actively restructuring to overcome the so-called "three excesses" (in employment, investment, and debt) and to revitalize their businesses. At the same time, business objectives have shifted from the traditional focus on expanding market share to a greater focus on shareholder value and the need to raise profitability. In this context, mergers and acquisitions (M&A) have received greater attention as a meant to achieve an optimal allocation of resources and improve corporate profitability.

2. Although Japan's M&A market remains small when compared to that of the United States and Europe, there has been a marked expansion since the latter half of the 1990s, and the number of M&A transactions posted a new record high in 2005. M&A between Japanese firms are becoming increasingly commonplace as a means for business restructuring. Yet, despite the substantial increase in M&A activity, there are few studies to date that have quantitatively examined the effect of M&A on firms' profitability. Against this background, this paper aims to provide an examination of recent developments in Japan's M&A market both from a macro and a micro perspective. Specifically, using corporate financial data of listed firms, this study conducts an empirical analysis of whether M&A help to improve the performance of acquiring firms, as measured by profitability, productivity, etc. The results indicate what conditions are necessary for M&A transactions to be successful.

3. Changes in the overall economic environment that have contributed to the increase in M&A activity include: (a) the decrease in the return on assets (ROA); (b) reform in the legal framework for M&A, including the revision of the tax system; and (c) the unwinding of cross-shareholdings. ROA have been on a downward trend for industry overall (and for individual industries) since the late 1990s, increasing incentives for firms suffering from low profitability to restructure their business portfolios. Changes in the legal framework include the revision of the Anti-Monopoly Law in 1997, the introduction of stock swaps and stock transfers, and the corporate divestiture system – all of which helped to facilitate M&A transactions. These legal reforms played an important role in providing firms with incentives to conduct M&A.

4. The most important reasons why firms have been conducting M&A include: (a) the exploitation of synergy effects through rationalization and economies of scale; (b) opportunities to increase corporate value (through business rehabilitation, buyouts, etc.), such as in the case of M&A involving investment funds; and (c) defensive strategies. A review of major individual cases in recent years shows that the balance of these objectives has changed over time. From the latter half of the 1990s to around 2001, M&A were largely driven by industry consolidation aimed at the exploitation of synergy effects as well as by the advance into overseas markets. In addition, a number of foreign-owned financial institutions expanded into the Japanese market by acquiring failed Japanese firms. From 2002, M&A focusing on corporate rehabilitation led by the government, banks, and private investment funds, became prevalent following the initiation of the financial reconstruction program. In this context, it is worth noting that the objective of investment funds, whose presence in the M&A market in Japan has increased in recent years, is not the traditional takeover of a firm. Rather, investment funds dispatch management resources and after a certain period, once the acquired firm has been put on an even keel, sell it again. Since around 2003, investment funds have also been involved in the purchase of non-core businesses (for example through management buyouts) from mature firms that were in the process of restructuring in order to concentrate on core capabilities. In 2004, the objective of M&A activity began to switch from rehabilitation to growth, and since

2005, proactive M&A aiming at the exploitation of synergy effects as part of mid- to long-term growth strategies have become more prominent. In this context, M&A activity focused on the acquisition of firms (or business units) that would help to strengthen the existing business of acquiring firms rather than on the acquisition of firms (or business units) in entirely unrelated areas. At the same time, defensive strategies to fend off hostile takeover attempts following the struggle surround UFJ Trust Bank also started to take root.

5. If M&A are increasingly proactive as part of firms' growth strategies, then the relationship between M&A and capital investment and firms' choice between them becomes a question of considerable interest. In order to examine this issue, this study relies on data constructed from the Development Bank of Japan's *Survey on Planned Capital Spending* in November 2005, matching firms' responses to a question in the survey on whether they were planning to acquire assets or business divisions from another firm with information on their fixed capital investment growth rate in that year (FY2005) and the following year (FY2006). The findings suggest that with regard to M&A based on medium- to long-term growth strategies, among firms that responded that they were planning to conduct M&A, those that also maintained a "proactive" stance and were planning to increase fixed capital investment both in FY2005 and FY2006 accounted for the largest share, while those that replied they would decrease investment accounted for only 9 percent.This indicates that for firms embarked on an expansionary course, M&A and fixed capital investment complement each other.

6. Although there are number of studies that have examined whether M&A improve the performance of acquiring firms, they encountered problems with regard to the robustness of their empirical results. Moreover, there have been few investigations into the conditions that make for successful M&A. Taking these shortcomings of previous studies into account, this study focuses on mergers, acquisitions, and business transfers in order to empirically examine the effect of M&A on the profitability (ROA, operating profit-to-sales ratio), labor productivity and the ratio of general expenses to sales of acquiring firms(including the seller side in the case of business transfers) by distinguishing whether the acquired firm belongs to the same corporate group[1] or is a non-group firm and whether it is listed or unlisted. [2] The results can be summarized as follows:

a. As for mergers and acquisitions, the results indicate that the improvement in the financial performance of the acquiring firm was statistically significant and largest when the acquired firm belonged to the same corporate group and was listed on the stock exchange, and this result was robust. This indicates that in cases where an M&A target is acquired by the parent firm (the largest shareholder), the power balance between the two is unambiguous and decisions following the acquisition are speedily transmitted to the acquired firms; moreover, the acquiring firm is able to accumulate information on the target firm (going beyond financial statements) before the acquisition through the dispatch of board members and therefore is in a situation where it can discern profitable and unprofitable business divisions and decide whether to go ahead. In addition, the management of listed target firms are likely to show a greater profit-orientation as a result of the discipline exerted by the stock market. The results of the empirical analysis thus suggest that clarity with regard to the power balance, the extent of information accumulation, and whether target firms are subject to market discipline prior to the acquisition all play an important role in the extent to which the performance of the acquiring company improves.

   Moreover, when comparing the estimation results for cases where the target firm is

[1] An acquired company's being a "same corporate group" indicates that it is a subsidiary, or affiliate, of the acquiring company.

[2] Samples were grouped into four specific categories: (1) listed companies which were subsidiaries (affiliates), (2) listed companies which were not subsidiaries (affiliates), (3) companies which were subsidiaries (affiliates) but unlisted, and (4) companies which were neither subsidiaries (affiliates) nor listed.

an unlisted group firm and cases when the target firm is a listed non-group firm, the improvement in the acquiring firm's ROA is significantly larger in case of the former. This suggests that clarity in the power balance and the accumulation of information vis-à-vis the target company is relatively more important than the target company being listed on the stock exchange in determining the success of an M&A transaction for the acquiring firm. Moreover, the accumulation of information also plays an important role in shaping the relationship between the acquiring and the acquired firms. That is to say, the positive effect on the acquiring firm's finances will be greater if before going ahead with the acquisition, it slowly accumulates information on the acquired firm and then gradually increases it investment following the initial capital participation. As for the role of market discipline, although doubts have been expressed whether the disciplining function of the Japanese stock market is sufficient given the practice of long-term shareholding, the number of firms that have a diversified shareholder structure is increasing and hence the importance of being listed on the stock market is likely to grow as a criterion for acquiring firms in their choice of M&A targets. However, even if market discipline functioned sufficiently, if there are healthy firms that choose not to list because of the costs involved or for strategic reasons, a gradualist approach may still help to raise the effect on the financial performance of acquiring firms when acquiring such unlisted firms.

b. Business transfers consist of the transfer of assets involving not an entire company but a business unit and as such are expected to contribute to the efficient allocation of resources between firms and help to improve profitability. Looking at the empirical results, although no significant effects on ROA were found, buyers of assets in non-group business transfers and sellers in the case of both intra-group and non-group business transfers were found to register improvements in operating profit-to-sales ratios and labor productivity. Given that M&A activity in recent years has concentrated on the strengthening of core business areas, acquisitions of businesses related to core activities and the sale of non-core businesses were shown to lead to an improvement in profitability both for sellers and buyers.

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# I Introduction

Although M&A activity has been expanding in United States and Europe, M&A have received greater attention as a means for business restructuring and strengthening core business in Japan and the number of M&A transactions posted a new record high in 2005. Yet, despite the substantial increase in M&A activity, there are few studies to date that have quantitatively examined the effect of M&A on firms' profitability. This paper starts with a description of Japan's market for M&A in both macro- and microeconomic perspectives. Then, using corporate financial data of listed firms ,we analyze to determine whether M&A help to improves the performance of acquiring firms as measured by profitability ,productivity, etc and indicate what conditions are necessary for M&A transactions to be successful.

The paper is organized as follows. Section II describes Japan's M&A market in macroeconomic perspectives, the background to its recent expansion, and, from a microeconomic perspective, the reasons for selecting M&A. We indicate objectives to M&A in Japan and some characteristics by organizing recent transactions. As proactive M&A have become more prominent since 2005 in Section II , Section III explores the relationship of M&A with capital investment, which is one of the most important factors for a company to achieve its mid- to long-term growth strategy. Section IV focuses on mergers, acquisitions and business transfers among firms in order to empirically examine the effect of M&A on the profitability (ROA and operating profit-to-sale ratio), labor productivity, and ratio of general expenses to sales of acquiring firms, including the seller side in the case of business transfers. By distinguishing whether the acquired firm belong to the same group or not and whether it is listed or not, we indicate those conditions which enhance the improvement in the financial performance of acquiring firm by M&A.

# II Trends in Japan's M&A Market

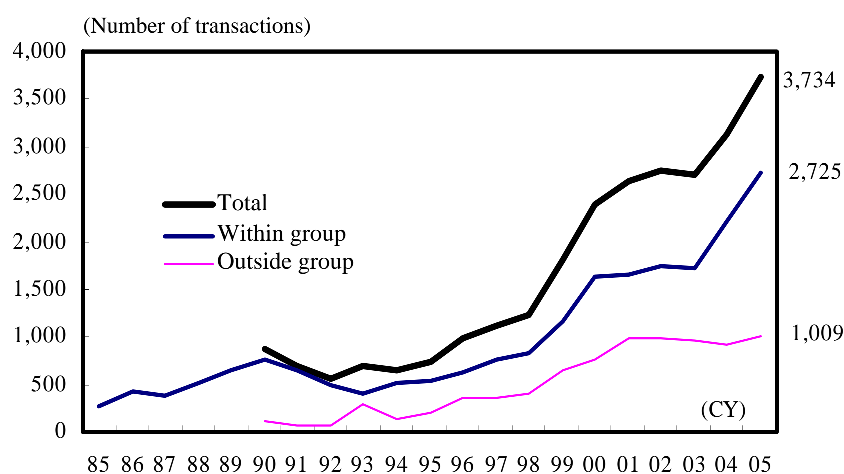
## 1. The Growth in Japan's M&A Market

Figure 2-1 indicates trends in the number of M&A transactions carried out in Japan. The figure shows clear increases in Japan's M&A[3] market during two periods: 1) from the latter half of the 1980s through the bubble period, and 2) from the latter half of the 1990s to the present day. Growth was particularly notable during the second of these periods: In 2005, the number of M&A deals, both within and outside of a corporate group, was greater than at any other time in history.[4]

During the latter half of the 1980s, most M&A transactions involved Japanese firms targeting a foreign firm as a partner ("in-out" deals). From the latter half of the 1990s, however, "in-in" deals, meaning M&A between Japanese firms, developed a growing presence in the market. By 2005, M&A targeting Japanese firms, including "out-in" deals, accounted for more than 80 percent of the total, implying that the depth of the Japanese market was increasing (Figure 2-2).

Of M&As conducted outside of the corporate group, over 80 percent took the form of acquisition, business transfer, or capital participation; mergers accounted for only a small proportion (Figure 2-3). Among those taking place within the corporate group, mergers accounted for the largest share, with business transfers showing growth as well (Figure 2-4). The growth in business transfers is thought to reflect a risk aversion strategy on the part of firms which, while pursuing selection and concentration on the business level, are also seeking to improve investment efficiency and have no wish to assume excessive risk in regard to the partner company.

**Figure 2-1. The M&A Market in Japan**

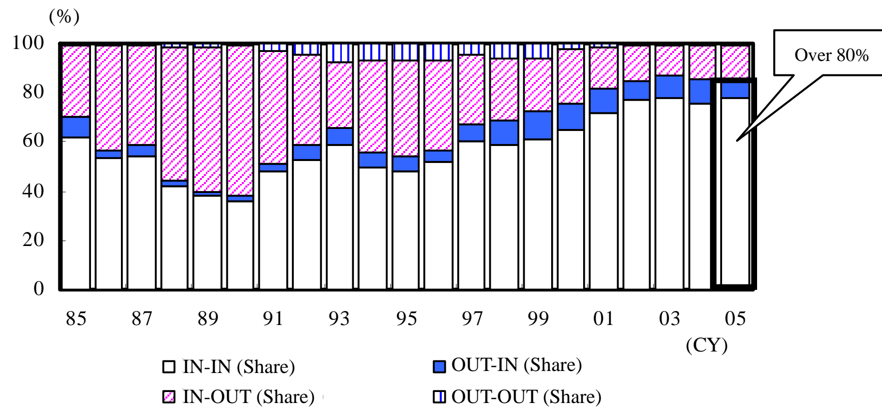



*Source*: Recof MARR.

[3] In this paper, "M&A" is as defined in the Recof periodical *MARR,* and refers to mergers, acquisitions, business transfers, capital participation, and investment expansion.

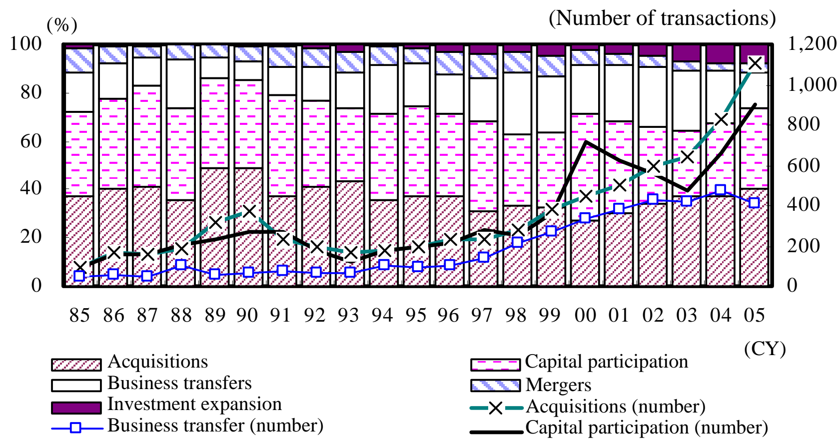
[4] According to *MARR*, M&A shows a virtually identical trend in terms of monetary value. The total in 2004 reached 12 trillion yen, and the same level was maintained the following year. It should be noted, however, that the total value of transactions in *MARR* reflects reported cases only, and for that reason coverage will differ from that based on the number of cases.

## Figure 2-2. M&A Outside of the Corporate Group, by Market



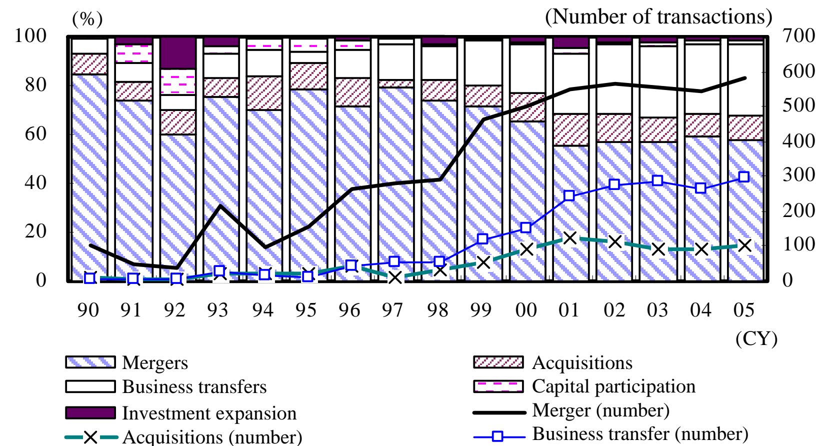

*Source*: Recof MARR.

## Figure 2-3. M&A Outside of the Corporate Group, by Form




*Source*: Recof MARR.

## Figure 2-4. M&A Within the Corporate Group, by Form

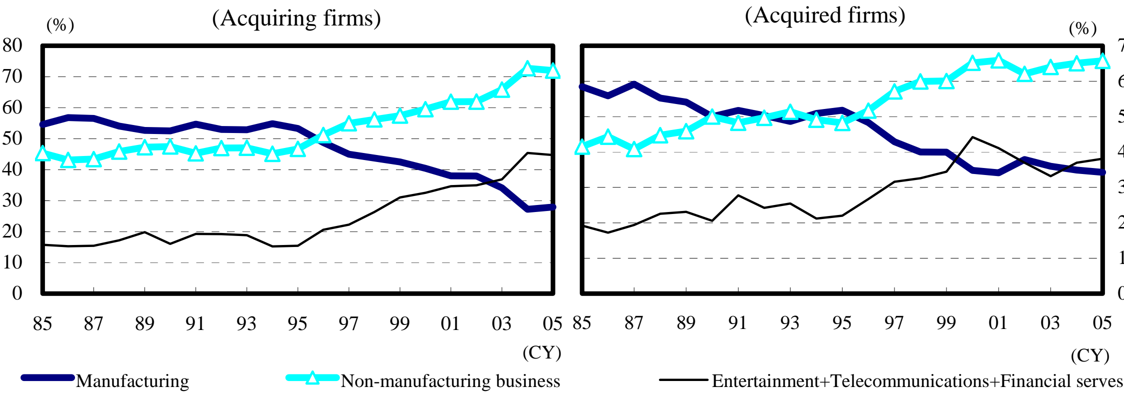



*Source*: Recof MARR.

Figure 2-5 shows trends in M&A by industry, for both acquiring and acquired firms. During the latter half of the 1980s, firms in chemicals, machinery, and other manufacturing industries accounted for the largest share. This picture changed in the next decade: By the latter half of the 1990s, the non-manufacturing sector, particularly the entertainment, telecommunications, and financial services industries, was a growing presence, accounting for some 70 percent of all M&A in 2005.

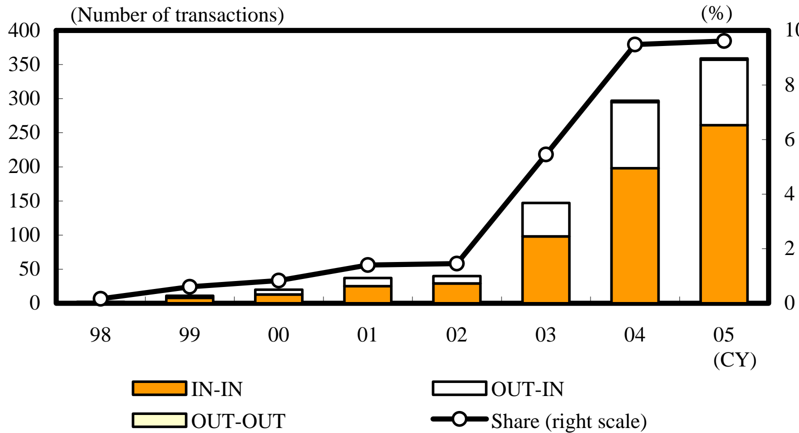
Partners in an M&A are not limited to other business corporations. One player of increasing importance in recent years is the investment firm(or fund). Figure 2-6 shows the number of M&A transactions involving investment firms, and their share in the total number of M&A deals (including those within and outside of the corporate group). In 1998, there were only two M&A transactions involving investment firms. By 2005, however, this number had swelled to 359, with the share in the total number of M&A deals rising to nearly 10 percent.

**Figure 2-5. Trends in the Share of M&A Transactions, by Industry**




*Source*: Recof MARR.

**Figure 2-6. Trends in the Number of M&A Transactions with Japanese Companies, by Investment Firms**




*Source*: Recof MARR.

## 2. Changes in the Macroeconomic Environment Since the Second Half of the 1990s

The previous subsection described the rapid expansion of Japan's M&A market since the latter half of the 1990s. Several changes in the macroeconomy are thought to have contributed to that growth.

The first of these was the deteriorating tendency of corporate profits. Figure 2-7 shows the average five-year ROA for all industries[5], and the frequency of M&A (the number of M&A transactions/number of firms), since 1985. ROA, having remained at the 7-percent level for the latter half of the 1980s, dropped to about 4 percent in the latter half of the 1990s. The same tendency was evident in individual industries,[6] indicating a progressive decline in capital profitability throughout the economy. The frequency of M&A, meanwhile, showed a moderate increase industry-wide during the same period, followed by an actual surge starting in 2000. The decline in capital earnings was the result of a concurrence of factors, including the excess investment during the bubble periods and recession after the collapse of the bubble. We can infer that the macroeconomic conditions in this period gave firms the incentive to boost efficiency by reorganizing their entire portfolios, including through M&A.

Progress in institutional reforms was a second important change. Without assured convenience for their transactions, firms hoping to restructure cannot easily conduct M&A, regardless of how strong the incentive. The first legal revision that affected M&A since the latter half of the 1990s was the amendment of the Anti-Monopoly Law in June 1997, which removed the ban on the establishment of pure holding companies. Changes have since taken place at a rapid pace,[7] with systems being introduced to govern simple mergers (1997), share-for-share exchange and share transfer (1999), and corporate divestiture (2001). Each of these revisions has increased convenience for parties to an M&A. Under the new system for share-for-share exchange, a firm can easily convert another firm into a 100-percent subsidiary through an exchange of shares with that company, without the buyer firms having to prepare slush funds. The new, more convenient corporate divestiture system is similar to the systems for share-for-share exchange and share transfer, in that firms can use shares for payment. The introduction of these systems made it possible for firms to reschedule, under certain conditions (terms of eligibility[8]), taxes ordinarily occurring on capital gains.[9]

The unwinding of cross-shareholdings also helped to improve the environment for M&A. Figure 2-8 shows the ratio of cross-shareholdings to the aggregate market value and share price.

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[5] ROA is defined as (operating profit and loss + nonoperating income)/total assets.

[6] For M&A frequency and ROA in individual industries, see Appendix 1.

[7] The revisions made to the Corporation Law in May 2006 enhance the convenience of transactions by providing for, among other things, increased payment flexibility (applied since 2007) and speedier reorganization. Previously, assets delivered to the shareholders of another company during a merger, corporate divestiture, or stock transfer were restricted in principle to the shares of the surviving company (Articles 409, 374 and 353 of the former Commercial code). The revisions made it possible to use other forms of payment, such as cash, corporate bonds, and bonds with a right to subscribe for new shares (Articles 749, 758 and 768). Under the former law – and in principle under the current Corporation Law (Article 135) – a subsidiary was not permitted to acquire shares in its parent company. But the current Corporation Law permits this act in exceptional cases during mergers and some other transactions (Article 800), effectively legalizing three-way mergers by foreign companies (see Appendix 2). There was the perspective that one effect of this revision will be to increase the number of mergers and acquisitions by foreign firms through their Japanese subsidiaries. Under the existing tax system, however, shareholders in a company targeted for an M&A must pay a capital gains tax when the share other than surviving firm was paid for shareholders of the target firm. The capital gains tax applies because the assets delivered to the target company in a three-way merger are shares not in the surviving firm but in the parent firm. If companies are not permitted to reschedule this tax, they will have less incentive to use the system. Speedier reorganization indicates softening conditions that a shareholders' meeting isn't required in case of considering corporate reorganization. By revising, a new, informal system of corporate reorganization and amends the simplified reorganization system are introduced.

[8] It indicates the case where the surviving firm pays for shareholders of the counterpart firm in any form other than shares of the surviving firm.

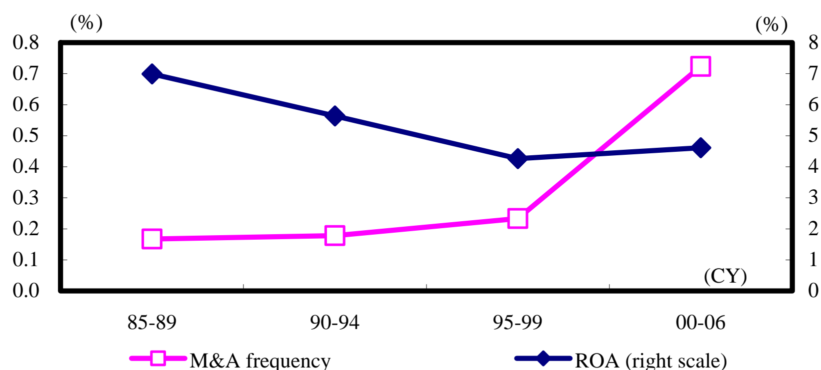
[9] A study by Suzuki, Yasui, Ochi and Okuda pointed to the introduction of a consolidated taxation system as a measure that encouraged business reorganization in their paper (2003).

Since the latter half of the 1990s, business firms and banks have moved increasingly quickly to rid themselves of cross-shares: in 2003, the crossholding ratio of 7 percent was less than half what it was during the peak years. Behind this trend was the influence of the recession, downturn of share prices and BIS regulations. With fewer cross-shareholdings, more shares came onto the market, and there was a greater variety of target firms for acquiring firms. The trend thus spurred the growth of M&A.

## 3. M&A Objectives and Characteristics of Some Recent Transactions

With changes in the macroeconomic environment acting as a spur to M&A transactions, it becomes important to identify the incentives that are causing firms to turn to M&A. This task has been attempted in some surveys, including those

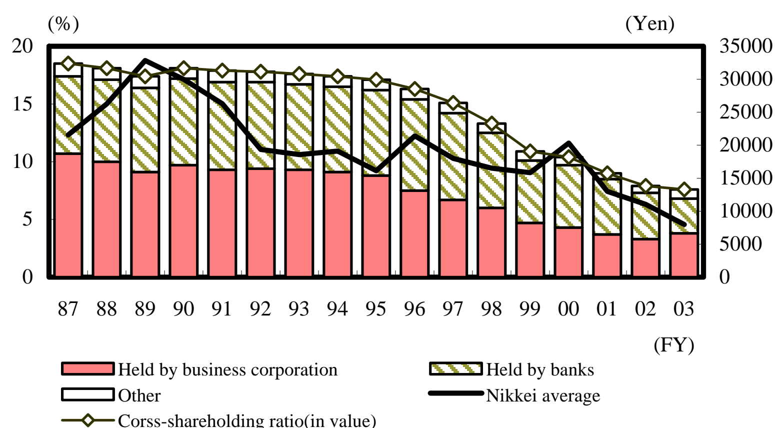
**Figure 2-7. M&A Frequency and ROA on an Industry-wide Basis**




*Notes*: 1. Figures for ROA are five-year averages (or a six-year average for the most recent period).
2. "M&A frequency" is defined as the number of M&A transactions / number of firms during each period. The number of M&A transactions constituting the numerator is the aggregate value for five years (or for six years for the most recent period). The number of corporations constituting the denominator is the number of firms covered by the Statistical Survey on Establishment and Enterprise Census carried out during each period (86, 91, 96, and 01; simple surveys excluded).

*Sources*: Recof MARR and the Ministry of Internal Affairs and Communications, *Establishment and Enterprise Census*.

**Figure 2-8. Cross-shareholding Ratio (by Shareholder) and Stock Prices**




*Notes*: 1. "Cross-held shares" are shares which are recognized as held by two firms reciprocally.
2. "Cross-holding ratio" is the ratio of cross-held shares to the total number of shares covered by the survey.
3. Cross-holding ratios are shown on a value basis.

*Source*: NLI Research Institute, *The Fiscal 2003 Survey of Cross-Shareholding*.

by Trautwein (1990), the Development Bank of Japan (2003), and the Cabinet Office (2004). In this section, we examine characteristics of recent M&A deals, particularly large-scale transactions, and explore the attractions of M&A with reference to earlier studies.[10]

Three main objectives present themselves. The first is the desire of firms to not merely transfer income, but to obtain the benefits of synergy as well. Deals between two business corporations, or between two financial institutions, come to mind in this category. But with rationalization taking on increasing importance, the category includes other objectives such as the desire to expand – sales networks, production volume, and so on – and to utilize the economies of scale to diversify income. A second objective is the desire to "regenerate" – to actualize the firm's value through its shareholders. For the most part, investment firms are the buyers in this pattern and play the central role in the transaction. By such means as dispatching board members, they try to strengthen the firm's governance and raise its value. A third type of M&A is that undertaken as a defensive strategy. The methods used here include the management buyout, cross-shareholding, and the white knight (a countermeasure against hostile takeover bids). In choosing to take defensive strategies, management has one of two purposes: to maximize the firm's value based on a mid- to long-term growth strategy without laying it open to the threat of M&A, or simply to protect the top executives while ignoring the interests of shareholders.[11] The objective for the acquired firm, meanwhile, is the opportunity to boost profitability by withdrawing from unprofitable sectors. We now explore some major representative examples of recent years.

Figure 2-9 is a list of M&A transactions undertaken from 1999 through 2001.[12] It is notable for the preponderance of deals involving industrial restructuring in the financial services and telecommunications sectors. In the financial services sector, these indicated an attempt by banks to survive, through restructuring, the financial crisis brought on by the failure of the Long-Term Credit Bank of Japan and the Nippon Credit Bank. The Dai-ichi Kangyo Bank, Industrial Bank of Japan, and Fuji Bank joined together to form Mizuho Holdings,[13] while the Bank of Tokyo-Mitsubishi, Mitsubishi Trust & Banking Corporation, and Nippon Trust Bank formed the Mitsubishi Tokyo Financial Group.[14] Both of these transactions involved the establishment of a joint holding company, suggesting that behind the firms' intentions was a desire to boost efficiency by consolidating overlapping divisions while retaining the special features of each. In the telecommunications sector, notable cases included, in addition to the fight-for-survival merger of DDI, KDD and IDO, efforts by NTT DoCoMo and other mobile telecommunication providers to expand overseas. Here there were numerous instances of capital participation in 1) the mobile phone provider division of AT&T Wireless, and 2) KPN Mobile, a European mobile telecommunications network operator and provider. (The capital relationship between the two firms has since been dissolved.[15]) Included as well are transactions in which foreign financial institutions bought up firms which had gone bankrupt, or were in danger of bankruptcy, in the hope of gaining a foothold in the Japanese market (Prudential acquired Kyoei Life Insurance; American International Group took over Chiyoda Mutual Life). This suggests that by undertaking M&A at

[10] The specific projects described herein are as disclosed in Recof *M&A Data Book for Japanese Companies* (those undertaken from 1999 to 2002) or Recof *MARR* (those undertaken from 2002 through the first half of 2006). Included in our list are, in addition to large-scale projects of 100 billion yen or more, projects for which the value has not been disclosed but which we believe to have a significant impact on society.

[11] Watanabe (2001) states that this factor – the "entrenchment" theory – and the "monopoly of interest" theory (the idea that firms try to obtain the interest of customers who, because of the expansion of corporate scale, may possess a reasonable amount of information but do not have the time to adequately scrutinize it) were behind the M&A activity occurring in the financial sector around 2001.

[12] Firms are listed in order of the factors that characterize each year, with consideration also given to the monetary value involved.

[13] The firm is now named Mizuho Financial Strategy. The shares which it held in Mizuho Bank and Mizuho Corporate Bank were acquired by the Mizuho Financial Group.

[14] As of the time of this paper, the firm has merged with UFJ Holdings to form the Mitsubishi UFJ Financial Group.

[15] According to NTT's financial report for the period ending March 31, 2005 (for AT&T) and KPN's financial report for the period ending March 31, 2006 (for KPN).

an early stage, foreign firms played a role in making the allocation of assets more efficient in the Japanese economy that was slack in that respect. Clearly, there were a good number of large-scale M&A projects in the financial services and telecommunications industries during this period. Some firms in the midst of industrial restructuring chose M&A for the efficiency and other synergistic effects it promised, while others used it as a means of uncovering foreign business opportunities. Foreign financial institutions, meanwhile, were eager to acquire bankrupt firms in order to expand their business in Japan.

### Figure 2-9. Major M&A Transactions from 99 through 01

(1) 99CY

| Incentive | Market | Acquiring firm | | Acquired firm | | Form | Time | Value(in 100 billion yen) | Detail |
|---|---|---|---|---|---|---|---|---|---|
| Growth strategy | IN-OUT | JT (Japan Tobacco Inc.) | Food & Beverages | RJ Reynolds International | Food & Beverages | Acquisition | 1999/3/10 | 9424 | JT acquired RJ Reynolds., a non-US tobacco subsidiary of RJR Nabisco, to expand JT's foreign business (JT is world's 3rd largest tobacco company). |
| | | Kyocera | Electric Machiney | Qualcomm | Electric Machiney | Business transfer | 1999/12/24 | 1020 | Kyocera aimed to strengthen its mobile phone business in North America. |
| | OUT-IN | AXA | Life and non-life insurance | Nippon Dantai Life insurance | Life and non-life insurance | Acquisition | 1999/11/29 | 2000 | First joint holding company of insurance to be established in Japan. Axa acquired almost all shares in Nippon Dantai, making it effectively an Axa subsidiary. |
| | | General Motors (GM) | Transportation machinery | Fuji Heavy Industries Ltd | Transportation machinery | Capital participation | 1999/12/8 | 1400 | With GM as largest shareholder, the two firms complemented their production and sales resources one another. |
| Industrial restructuring | IN-IN | Sanwa Bank | Bank | Toyo Trust and Banking | Bank | Investment expansion | 1999/2/11 | 1000 | Sanwa became top shareholder by accepting a third-party allotment of new shares. |
| | | Sumitomo Bank | Bank | Sakura Bank | Bank | Merger | 1999/10/15 | – | Merger carried out in April 2001 to form Mitsui Sumitomo Bank. |
| | | Dai-Ichi Kangyo Bank | Bank | Industrial Bank of Japan, Fuji Bank | Bank | Merger | 1999/8/20 | – | Firms established joint holding company (Mizuho Holdings founded in September 2000). |
| | IN-IN | DDI | Tele-com.&broadcasting | KDD,Nippon Idou Tsushin (IDO) | Tele-com.&Broadcasting | Merger | 99/12 | – | New firm, KDDI, emerges as telecommunications giant second only to NTT. |
| | OUT-IN | British Telecom (BT), AT&T | Tele-com.&Broadcasting | Japan Telecom | Tele-com.&Broadcasting | Capital participation | 99/4 | 2200 | Comprehensive business alliance; part of the two acquiring firms' advance strategy into Japan. |
| | IN-IN | Takasaki Paper Mfg. | Pulp & Paper | Sanko Paper Mfg | Pulp & Paper | Merger | 99/2 | –- | Merger of Takasaki Paper (Mitsui & Co., Ltd. group) and Sanko Paper (Itochu Corporation group). New company was effectively joined the Oji Paper group. |
| Relief and growth strategy | OUT-IN | GE Capital (GEC) | Other financial service | Japan Lease,Japan Lease Auto | Service | Business transfer | 99/1 | 8700 | GE took over leasing business from Japan Leasing (Long Term Credit Bank of Japan group), also acquiring all shares of Japan Lease Auto. Move represents GE's advance strategy into the Japanese leasing industry. |
| Rehabilitation | OUT-IN | Renault | Transportation machinery | Nissan Motor,Nissan Diesel Motor | Transportation machinery | Capital participation | 99/3 | 6430 | Renault entered into a remedial capital participation relationship with Nissan Motors and Nissan Diesel, both in the process of reconstruction. |
| Rehabilitaion through investment firm or other source | OUT-IN | Ripplewood Holdings | Other financial service | Long-Term Credit Bank of Japan | Bank | Acquisition | 99/9 | 1210 | Acquisition of LTCB (temporarily nationalized) by Ripplewood, a US investment firm. Firm aims at relisting in future. |

*Note:* Information on time and value is as reported in Recof MARR. Dates show time of public disclosure, not time when deal was finalized.

*Source*: Recof MARR.

## Figure 2-9. Major M&A Transactions from 99 through 01 (continued)

(2) 00CY

| Incentive | Market | Acquiring firm | | Acquired firm | | Form | Time | Value(in 100 billion yen) | Detail |
|---|---|---|---|---|---|---|---|---|---|
| Growth strategy | IN-OUT | NTT DoCoMo | Tele-com.&Broadcasting | AT&T wireless | Tele-com.&Broadcasting | Capital participa-tion | 00/11 | 11000 | Capital participation in mobile phone division as part of overseas deployment. Foothold in US mobile phone market. |
| | | NTT Commu-nications | Tele-com.&Broadcasting | Berio | Tele-com.&Broadcasting | Acquisition | 00/8 | 6000 | TOB. Entered US market with acquisition of Berio, an internet service provider. |
| | | NTT DoCoMo | Tele-com.&Broadcasting | KPN Mobile | Tele-com.&Broadcasting | Capital participa-tion | 00/5 | 4073 | Part of overseas deployment(Netherlands). Partner is stock company retaining mobile phone companies primarily in Europe. |
| | | NTT DoCoMo | Tele-com.&Broadcasting | Hutchison 3G UK Holdings | Tele-com.&Broadcasting | Capital participa-tion | 00/7 | 1944 | Part of overseas deployment (UK). |
| | IN-IN | Mitsubishi Corp. | General trading company | Lawson | Supermar-kets&convenience stores | Capital participa-tion | 00/1 | 1700 | Mitsubishi Acquired share of Lawson from its parent company (Daiei). Strategy aims at revitalizing e-commerce using Mitsubishi's resources in distribu-tion, marketing and other areas. |
| | OUT-IN | Pacific Century CyberWorks | Tele-com.&Broadcasting | Hikari Tsushin | Tele-com.&Broadcasting | Capital participa-tion | 00/2 | 1100 | Move designed to strengthen alliance through devel-opment of internet business in Asia. |
| | IN-OUT | Hikari Tsushin: President Shigeta | Tele-com.&Broadcasting | Pacific Century CyberWorks | Tele-com.&Broadcasting | Capital participa-tion | 00/2 | 1100 | Mobile phone sales and other business, designed to strengthen alliance through development of Asian internet business. |
| Industrial restructuring | IN-IN | Tokai Bank,Asahi Bank | Bank | Sanwa Bank | Bank | Merger | 00/3 | – | UFJ Bank was established by this merger in January 2001; Asahi Bank later withdrew. |
| | | Bank of To-kyo-Mitsubishi | Bank | Mitsubishi Trust and Bank-ing,Nippon Trust Bank | Bank | Merger | 00/4 | – | Joint holding company formed. Integral parent company, "Mitsubishi Tokyo Financial Group," established in April 2001 through share transfer. |
| | OUT-IN | Vodafone | Tele-com.&Broadcasting | Japan Telecom | Tele-com.&Broadcasting | Capital participa-tion | 00/12 | 2492 | Vodafone follows BT and other firms in investing in Nippon Telecom. Management shifts from JR to foreign capital. |
| Relief and growth strategy | OUT-IN | Prudential | Life and non-life insurance | Kyoei Life Insurance | Life and non-life insurance | Acquisition | 00/5 | 4140 | Prudential acquires Kyoei, which has applied for the Law Concerning Exceptions to Reorganization and Bankruptcy Procedure for Financial Institutions(the "Special Corporate Reorganization Law") |
| Rehabilitation | OUT-IN | Daimler-Chrysler | Transportation machinery | Mitsubishi Motors | Transportation machinery | Capital participa-tion | 00/3 | 2024 | DaimlerChrysler accepts third-party allotment of new shares, effectively assuming management authority. |
| Finance sector(for rehabilitaion of borrower firm) | IN-IN | Tokai Bank,Sanwa Bank,Sumitom o Bank,Fuji Bank | Bank | Daiei | Supermar-kets&convenience stores | Investment expansion | 00/11 | 1200 | Banks increase ratio of investment in Daiei, providing financial assistance for its reconstruction. |
| Finance sector (rehabilitation) | | Ai-ful,Sumitomo Trust & Banking | Other financial service | Life | Other financial service | Acquisition | 00/10 | 1020 | Aiful and Sumitomo acquire Life, a leading consumer credit company, making it a subsidiary. |
| | | Softbank, Oryx, Tokio Marine and Fire Insurance | Other sales and wholesale | Nippon Credit Bank | Bank | Acquisition | 00/2 | 1000 | Buyers acquire Nippon Credit Bank (temporarily nationalized), rename it "Aozora Bank." |

*Source*: Recof MARR.

## Figure 2-9. Major M&A Transactions from 99 through 01 (continued)

(3) 01CY

| Incentive | Market | Acquiring firm | | Acquired firm | | Form | Time | Value(in 100 billion yen) | Detail |
|---|---|---|---|---|---|---|---|---|---|
| Industrial restructuring | OUT-IN | Vodafone group | Tele-com.&broadcasting | Japan Tele-com,J-Phone | Tele-com.&broadcasting | Investment expansion | 01/5 | 6523 | Increase in investment ratio. |
| | IN-IN | Kawasaki Steel Corporation | Steel | NKK | Steel | Merger | 01/4 | - | Established holding company "JFE Holdings" through share-for-share exchange. |
| Growth strategy | IN-IN | ORIX Trust and Banking Corpora-tion(oryx) | Bank | Asahi Mutual Life Insurance | Life and non-life insurance | Business transfer | 01/9 | 1400 | Asahi scaled down its housing loan division to concentrate resources on core business ("select and concentrate"). |
| | IN-OUT | Nomura Securities: UK subsidiary | Securities | Le Meridien | Real estate&hotel | Acquisition | 01/5 | 3250 | Buyer acquired luxury hotel chain Le Meridien, merges it with a British hotel chain, Principal, acquired previously. |
| | | Furukawa Elec-tric,CommSco pe | Non-Ferrous Metals | Lucent Technolo-gies | Electric Machiney | Business transfer | 01/7 | 2800 | Buyers desired to strengthen their optical Textiles business. |
| | | Nomura Securities: UK subsidiary | Securities | Bass | Food & Beverages | Business transfer | 01/2 | 1060 | Buyer emerged as the UK's largest pub owner. Commission revenue was principal objective. |
| | OUT-IN | F.Hoffmann-La Roche | Pharmaceuticals | Chugai Pharma-ceutical | Pharmaceuticals | Acquisition | 01/12 | 1550 | Expansion of scale. |
| Relief and growth strategy | OUT-IN | American International Group (AIG) | Life and non-life insurance | Chiyoda Mutual Life | Life and non-life insurance | Business transfer | 01/2 | 3200 | Derived Chiyoda's business following its bankruptcy. |
| | | Manulife Century Life Insurance | Life and non-life insurance | Daihyaku Mutual Life | Life and non-life insurance | Business transfer | 01/1 | 1470 | Derived Daihyaku's insurance contracts following its bankruptcy. |
| Finance sector(securing funds for rehabilitation of borrower) | OUT-IN | BNP Paribas | Bank | UFJ Holdings:US subsidiary(United California bank) | Bank | Acquisition | 01/12 | 3100 | Sale undertaken in order to secure funds for disposition of bad debts of UFJ Group. |

*Source*: Recof MARR.

Figure 2-10 gives some representative transactions during 2002. It was in this year that the government put the financial revitalization program in motion to clean up bad debts. Banks seeking to restore their borrowers often engaged in debt equity swaps (DES), in which they increased their investment in client firms. Some examples were UFJ Bank (now Bank of Tokyo-Mitsubishi UFJ), which joined other financial institutions in assisting Daiei, and Mizuho Corporate Bank, which extended support to Orient Corporation and Isuzu Motors. Among investment firms, Ripplewood Holdings' acquisition of the Long-Term Credit Bank of Japan (temporarily nationalized) was one of the biggest deals of 1999. In 2002 as well, one of the most important M&A transactions involved an investment firm when Lone Star, a US fund, purchased First Credit, a non-bank belonging to the former LTCB group. In an integrated attempt at corporate reconstruction, funds provide their target firms not only with money, but also with management resources. They differ most conspicuously from main banks or holding companies in that they sell their share and crystallize their profits after a predetermined investment period.

**Figure 2-10. Major M&A Transactions from 02 throuth 03**

(1) 02CY

| Incentive | Market | Acquiring firm | | Acquired firm | | Form | Time | Value(in 100 billion yen) | Detail |
|---|---|---|---|---|---|---|---|---|---|
| Finance sector(for rehabilitaion of borrower firm) | IN-IN | UFJ Bank, Sumitomo Mitsui Banking Corporation, Mizuho Corporate Bank | Bank | Daiei | Supermar-kets&convenience stores | Investment expansion | 02/7 | 2300 | In process of reconstruction. Investment expansion by means of DES (dead equity swap). |
| | | Mizuho Corporate Bank(Mizuho Holdings) | Bank | Orient Corpora-tion | Other financial service | Investment expansion | 02/5 | 2000 | Acquired firm is non-bank in process of reconstruction. Investment expansion by means of DES (dead equity swap). |
| | | Daiwa Bank, Chuo Mitsui Trust and Bank-ing,Mizuho Corporate Bank | Bank | Haseko Corpora-tion | Construction | Investment expansion | 02/8 | 1500 | Investment expansion by means of DES (dead equity swap). |
| | | Mizuho Corporate Bank(Mizuho Financial Group) ,others | Bank | Isuzu Moters | Transportation machinery | Investment expansion | 02/10 | 1000 | Investment expansion by means of DES (dead equity swap). Aims at reconstruction aided by board members seconded from Mizuho and GM. |
| Finance sector(securing funds for rehabilitation of borrower) | OUT-IN | Merrill Lynch | Securities | UFJ Bank(UFJ Hold-ings :split-off company) | Bank | Capital participa-tion | 02/12 | 1000 | Buyer increase capital through a third-party allotment of new shares to UFJ Strategic Partners, a split-off attempting to dispose of UFJ Bank's bad debt. Merrill Lynch takes active role in rehabilitated business. |
| Rehabilitaion through investment firm or other source | OUT-IN | Lehman Brothers,UFJ Bank, ,others | Other financial service | Nissho Iwai,Nichimen(Jo int holding firm) | General trading company | Capital participa-tion | 02/12 | 2000 | Capital participation in Nichimen and Nissho Iwai-Nichimen Holdings(currently Sojitz). Board members were seconded to aid in rehabilitation. |
| | | Lone Star | Other financial service | First Credit | Other financial service | Acquisition | 02/11 | 1000 | Acquiring firm is US investment fund. Acquired firm is a bankrupt non-bank affiliated with former Long-Term Credit Bank of Japan. Board members were seconded with aim of going public. |
| Rehabilitation | OUT-IN | Daimler-Chrysler, Mitsubishi Heavy Industries, Mitsubishi Corpora-tion,Bank of Tokyo-Mitsubishi, others | Transportation machinery | Mitsubishi Mo-tors(Mitsubishi Fuso Truck and Bus :split-off company) | Transportation machinery | Capital participa-tion | 02/9 | 1200 | Mitsubishi Motors, in process of reconstruction, split off bus and truck division (Jan. 2003), sells off a portion of its stock, uses income to secure funding for automotive division. |
| Growth strategy | IN-IN | Enix | Soft-ware,Information | Square | Soft-ware,Information | Merger | 02/11 | 1309 | First merger in Japan between two leaders in the field of game software. Expansion of scale is main motive. |
| | IN-OUT | Hitachi | Electric Machiney | IBM | Electric Machiney | Business transfer | 02/4 | 2500 | Hitachi purchases HDD business in move to expand scale. |
| | OUT-IN | Wal-Mart Stores | Supermar-kets&convenience stores | Seiyu | Supermar-kets&convenience stores | Acquisition | 02/3 | 2580 | Market entry; expansion of scale. Subsidiary formed in Dec. 2005. |

*Note:* Information on time and value is as reported in Recof MARR. Dates show time of public disclosure, not time when deal was finalized.

*Source*: Recof MARR.

## Figure 2-10. Major M&A Transactions from 02 throuth 03 (continued)

(2) 03CY

| Incentive | Market | Acquiring firm | | Acquired firm | | Form | Time | Value(in 100 billion yen) | Detail |
|---|---|---|---|---|---|---|---|---|---|
| Finance sector(for rehabilitaion by public funds) | IN-IN | Deposit Insurance Corporation of Japan | Service | Resona Holdings | Bank | Acquisition | 03/6 | 19600 | A rehabilitation project using public funds. First application of special assistance under the Deposit Insurance Law. |
| | | Deposit Insurance Corporation of Japan | Service | Ashikaga Bank | Bank | Acquisition | 03/11 | - | Temporary nationalization, calling into question the responsibility of both shareholders and management. Input of about 1 trillion yen in public funds. |
| | | Japan National Oil Corporation | Oil & coal | Japan Oil Development | Oil & coal | Acquisition | 03/7 | 1194 | DES (dead equity swap) was used in acquisition of firm, which had applied for rehabilitation under the Civil Rehabilitation Law. |
| Finance sector(for rehabilitaion of borrower firm) | IN-IN | Mizuho Corporate Bank(Mizuho Holdings) | Bank | Orient Corporation | Other financial service | Investment expansion | 03/3 | 1500 | Second investment expansion for firm, then under reconstruction. |
| | | Mizuho Corporate Bank(Mizuho Holdings) etc | Bank | Nissan Diesel Motor | Transportation machinery | Investment expansion | 03/9 | 1060 | Investment expansion through DES (dead equity swap). |
| | | UFJ Bank(UFJ Holdings) | Bank | Nippon Shinpan | Other financial service | Acquisition | 03/11 | 1000 | Acquisition of Nippon Shinpan, then under reconstruction. UFJ made move in order to strengthen its personal business division. UFJ card and Nippon Shinpan merged in Oct. 2005. |
| | | UFJ Bank(UFJ Holdings)etc | Bank | Misawa Homes Holdings | Construction | Capital participation | 03/10 | 1000 | Misawa Homes Holdings was in the process of reconstruction. |
| Finance sector(securing funds for rehabilitation of borrower) | OUT-IN | Goldman Sachs | Securities | Sumitomo Mitsui Financial Group | Bank | Capital participation | 03/1 | 1503 | Capital participation through a third-party allotment of new shares. |
| Rehabilitaion through investment firm or other source | OUT-IN | Cerberus | Other financial service | Aozora Bank | Bank | Acquisition | 03/4 | 1000 | TOB. Acquisition of stock from Softbank, the top shareholder, with intention to relist. |
| | | Colony capital | Other financial service | Fukuoka Daiei Real Estate | Real estate&hotel | Acquisition | 03/12 | 940 | Acquisition by US investment fund (March 2004). Selection and concentration by Daiei. |
| Buyout by investment firm or other entity | OUT-IN | Ripplewood Holdings | Other financial service | Japan Telecom(Japan Telecom Holdings) | Telecom.&broadcasting | Acquisition | 03/5 | 2600 | US investment firm. Acquisition of Japan Telecom, operator of landline phone and data communication service under Vodafone. Vodaphone retains mobile telecommunication provider(selection and concentration). |
| Growth strategy | IN-IN | Kao | Chemical | Kanebo | Chemical | Capital participation | 03/10 | 2500 | Integration of cosmetics business. Kabebo withdrew from the deal at one point because the Industrial Revitalization Corporation of Japan had attempted to acquire. |
| | | Konica | Chemical | Minolta | Precision Machinery | Merger | 03/1 | 1860 | Management integration by means of a holding company. |
| | IN-OUT | Mitsui & Co | General trading company | Valepar | Mining | Capital participation | 03/4 | 1000 | Capital participation in Valepar, a shareholder of Companhia Vale do Rio Doce, the world leading producer of iron ore. Secured rights to iron ore. |
| Reorganization within group | IN-IN | Matsushita Electric Industrial | Electric Machiney | Matsushita Electric Works | Electric Machiney | Acquisition | 03/12 | 1462 | TOB. Acquisition of group firm, which was made into a consolidated subsidiary. |

*Source*: Recof MARR.

Similar phenomena occurred in 2003. In addition to deals involving banks and investment firms, business rehabilitation efforts were characterized by a clear and growing government presence. One example was a public fund injection[16] into Ashikaga Bank by the Deposit Insurance Corporation of Japan. Transactions involving investment firms also showed a big jump, growing on a quantity basis from 1.5 percent of all deals in 2002 to 5.5 percent in 2003.[16] Among the most important deals involving investment firms were Cerberus' acquisition of Aozora Bank, Colony Capital's acquisition of Fukuoka Daiei Real Estate, and Ripplewood Holdings' acquisition of Japan Telecom. The case of Colony Capital had broader implications than the firm's own revitalization: it also represented an attempt by Daiei to concentrate its resources on its core businesses by selling off Fukuoka Daiei Real Estate, which had been responsible for the Fukuoka Dome and other Daiei projects in Fukuoka. The aim of the Ripplewood Holdings deal, meanwhile, was to assist Vodafone's efforts to concentrate on its mobile telecommunication provider business by selling off Japan Telecom, which had been in charge of landline phone and data communication services under the Vodafone. In addition to the business rehabilitation aspect, investment firms

[16] This case is treated differently depending on whether shareholder responsibility is called into question. Ashikaga Bank was subject to Provision 3, Article 102 of the Deposit Insurance Law. The government chose "temporary nationalization," which calls into question shareholder responsibility as well as managerial accountability. This is a similar measure to the "temporary nationalization" provision, based on the Financial Revitalization Law, which was applied to the Long Term Credit Bank of Japan and the Nippon Credit Bank of Japan. Resona Holdings, on the other hand, was subject to Provision No. 1, Article 102 of the Deposit Insurance Law. Under the "government recapitalization" provision, shareholder responsibility was not called into question, although management did resign. (For details, see Kataoka (2004).)

[16] See Figure 2-6.

seem to have played a key role (buy-out) in helping mature firms to "select and concentrate" by buying up their non-core divisions, as in the Cerberus deal.

On a value basis, more M&A transactions were reported in 2004 than in any previous year. Many large-scale deals were included in the top rankings (Figure 2-11). Rehabilitation schemes, funded largely with public money[17] or by financial institutions, continued to be pursued, as did "select and concentrate" projects[18] funded by investment firms. There was also a notable reorganization in the pharmaceutical industry in anticipation of the amendment of the Commercial Code (the merger of Yamanouchi Pharmaceutical and Fujisawa Pharmaceutical), and a restructuring of the financial services industry as well. Firms took defensive measures to protect themselves from hostile takeovers. The trend in industrial reorganization M&As showed that firms were focusing on corporate growth over the mid- to long-term; it also indicated that the objective of M&A activity began to switch from rehabilitation to growth. Deals involving Japan had been relatively cordial, but some overtures made in 2004 were distinctly adversarial in tone. These included the tug-of-war[19] that Mitsubishi Tokyo Financial Group (MTFG) and UFJ Group entered into with Sumitomo Trust over UFJ Trust Bank in connection with the integration of MTFG and UFJ; the approach by Sumitomo Mitsui Financial Group to UFJ concerning integration, which contained a hostile proposal; and MTFG's capital participation in UFJ Bank. All in all, it was a year that saw some definite changes in stance on the buyer side.

In 2005 the major trend swung toward proactive M&A transactions between Japanese business corporations, grounded in growth strategies for the mid- to long-term (Figure 2-12). Inpex and Teikoku Oil set up a joint holding company to integrate their management; Kao moved to acquire Kanebo. A look at the ranking reveals that most M&A deals were between Japanese firms and were undertaken less to diversify than to strengthen existing businesses.[20] Transactions involving investment firms included, as they did in 2004,[21] large-scale exit deals such as the sale of First Credit, which Lone Star had acquired in 2002, to Sumitomo Trust. This deal was representative of a business model in which the investment firm dispatches board members to the target company, raises its corporate value, retains the investment for a set period of time (in this case, three years) and then "exits" by selling the company to a firm that needs it. In the face of hostile moves, such as Rakuten's capital participation into TBS, many firms turned again to defensive strategies. Several such moves, in fact, ranked among the most important deals of the year. Management buyouts by firms such as World and Pokka were extreme examples of defensive strategy. Ito-Yokado and Seven Eleven Japan established a joint holding company to resolve an awkward ownership structure – the aggregate market value of Seven Eleven exceeded that of Ito-Yokado, its then-parent company – and to block any takeover attempts from unwelcome suitors.

The trends observed in 2005 continued throughout the first half of 2006. The period's top deals were mostly those aiming at synergy through a strengthening of existing businesses and defensive moves in anticipation of possible takeover bids (Figure 2-13). Among M&A deals aiming at the synergy effects, the top ones include not only in-in transactions, such as Seven & I's purchase of York-Benimaru in an effort to build a stronger supermarket division, but large-scale in-out deals, such as Toshiba's acquisition of Westinghouse and the purchase by Nippon Sheet Glass of Pilkington.

[17] Assistance by the Industrial Revitalization Corporation of Japan to Kanebo, Daiei and others.

[18] The Carlyle Group and a consortium formed by Kyocera and KDDI established a company to take over the PHS division of DDI Pocket. KDDI focused its resources on au, its mobile phone division.

[19] UFJ Trust Bank initially announced it would integrate with Sumitomo Trust, but, with the UFJ Group merging with MTFG, it withdrew from the deal. It subsequently formed an alliance with Mitsubishi Trust & Banking, and so became part of the Mitsubishi UFJ Financial Group (October 2005).

[20] Important M&A deals between firms in different industries included those between JA Bank and Mitsubishi UFJ Financial Group, Bandai and Namco, and Seven & I Holdings and Millennium Retailing. Now, however, firms were more likely to seek partners in relatively similar fields of business, with the aim of gaining customers (for example), rather than to venture into an area in which they have little knowledge or experience.

[21] In 2004, Ripplewood Holdings sold its shares in Japan Telecom, which it had acquired in 2003, to Softbank.

To sum up, from the latter half of the 1990s, M&A in the telecommunications and financial services were largely driven by industry consolidation aimed at the exploitation of synergy effects. After that period, there was an increase in rehabilitation projects by financial institutions, public-sector organizations and other entities seeking to increase corporate value. Investment firms played a big part in rehabilitated businesses, not only in the rehabilitation but also, in the "buyout type," in encouraging mature firms to "select and concentrate." There also was an increase in the number of proactive M&A deals by business firms aiming at synergy, even as their own financial conditions were improving. Whereas many deals took place between firms in the same industry, this was not always the case. But even where industries differed, the businesses in which the firms operated were usually similar or related (Seven & I Holdings and Millennium Retailing, for example). Another business model that became well-established during this period was the "exit" by an investment firm from a target company. After dispatching board members to the target firm and helping it regain its feet, the investment firm would sell out once the firm had achieved an increase in corporate value. And, whereas most M&A deals up to this point had been comparatively amicable, managements now showed they were prepared to take hostile action when they judged it necessary to enhance corporate value. In this environment, firms conducted management buyouts, increased cross-shareholding, and other defensive strategies to protect their integrity.

# Figure 2-11. Major M&A Transactions in 04

| Incentive | Market | Acquiring firm | | Acquired firm | | Form | Time | Value(in 100 billion yen) | Detail |
|---|---|---|---|---|---|---|---|---|---|
| Finance sector(for rehabilitaion by public funds) | IN-IN | Industrial Revitalization Corporation of Japan | services | Kanebo boutique (split-off cosmetics business) | Chemicals | Acquisition | 04/2 | 5000 | Rehabilitation Project using public funds. Withdrawal from deal to transfer cosmetics division to Kao. |
| | | Industrial Revitalization Corporation of Japan, etc | services | Daiei | Supermar-kets&convenience stores | Capital participa-tion | 04/12 | 1100 | Rehabilitation Project(with a focus on food super-market ) using public funds. IRCJ, with a new sponsor, accepted a third-party allotment of new shares. Main bank UFJ forgave debt. Board Members of Daiei resign. |
| Finance sector (rehabilitation) | IN-IN | Phoenix capital, Mitsubishi Heavy Industries, Mitsubishi Corporation, Bank of To-kyo-Mitsubishi , JP Morgan securities, China Motor, etc | Other financial services | Mitsubishi Motors | Transportation machinery | Capital participa-tion | 04/5 | 4500 | Phoenix Capital, a Japanese corporate rehabilitation fund. Okazaki factory was closed as part of a large-scale restructuring. |
| | OUT-IN | Merrill Lynch | Securities | Mitsubishi Motors Credit of America Inc.(MMCA), Mitsubishi Motors America Inc. (Mitsubishi Motors) | Other financial services | Business transfer | 04/11 | 2050 | Part of the restructuring of Mitsubishi Motors' North American operations. Sold a portion of its assets to Merrill Lynch, establishing a new joint venture. |
| Finance sector(for rehabilitaion of borrower firm) | IN-IN | UFJ Bank(UFJ Holdings), Mitsubishi Tokyo Financial Group, UBS | banking | Sojitz Holdings | General trading company | Investment expansion | 04/7 | 2500 | Financial assistance to Sojitz, then in the process of reconstruction |
| Buyout by investment firm or other entity | OUT-IN | Carlyle group | Other financial services | DDI Pocket | Tele-com&broadcasting | Business transfer | 04/5 | 2200 | A bridge company funded by a consortium including Carlyle, Kyocera and KDDI acquired the PHS business of DDI Pocket. DDI Pocket went into liquidation. KDDI concentrated its resources on au. (Demand for PHS is expected from China.) |
| | IN-IN | NPI Hold-ings(Nikko Principal Investments) | Other financial services | Bell Systems 24 | Software and Information | Acquisition | 04/7 | 1594 | Nikko Principal Investments, a firm within the Nikko Cordial Group, made the purchase through NPI Holdings, its wholly-owned subsidiary. |
| Industrial restructuring | IN-IN | Yamanouchi Pharmaceutical | Pharmaceuticals | Fujisawa Pharmaceutical | Pharmaceuticals | Merger | 04/2 | 8401 | Merger between Yamanouchi and Fujisawa, Japan's third and fifth largest pharmaceutical makers. Domestic and global reconstruction for survival. Astellas Pharma established in April 2005. |
| | | Dainippon Pharmaceutical | Pharmaceuticals | Sumitomo Pharmaceuticals( Sumitomo Chemicals subsidiary) | Pharmaceuticals | Merger | 04/11 | 2269 | An attempt to improve efficiency and expand in scale (established in October 2005). |
| | IN-OUT | Softbank | Other retailing and wholesaling | JapanTelecom (Ripplewood Holdings investment) | Other financial services | Acquisition | 04/5 | 3400 | Expansion of scale, resulting in Japan's third-largest general communications company after NTT and KDDI. Fund's exit business. |
| | IN-IN | Mitsubishi Tokyo Financial Group | banking | UFJ Holdings | banking | Merger | 04/7 | - | Integration produced a coprehensive financial group with assets of some 200 trillion yen(October 2005). Mitsubishi UFJ Bank(January 2006) and Mitsubishi UFJ Trust Bank were under it. |
| | | Mitsubishi Tokyo Financial Group | banking | UFJ Bank (UFJ Holdings) | banking | Capital participa-tion | 04/9 | 7000 | Japan's first defensive strategy taken to ward off a possible hostile takeover. Acceptance of preferred share with convertion right. |
| | | Sumitomo Trust Bank | banking | UFJ Trust Bank (UFJ Holdings) | banking | Business transfer | 04/5 | 3000 | Move undertaken to expand scale. Acquired Firm withdrew from the agreement, however, merged with Mitsubishi Trust and Banking to form a core unit of the Mitsubishi UFJ Financial Group (Mitsubishi UFJ Trust and Banking Corporation;October2005). |
| Growth strategy | IN-IN | Sumitomo Mitsui Bank(Sumitomo Mitsui Financial Group) | banking | Promise | Other financial services | Capital participa-tion | 04/6 | 2000 | Aiming to secure profit in the personal banking field, Establishment of capital and business alliance. As top shareholder, seconded board members to Promise. |
| | | Mitsubishi Tokyo Financial Group | banking | Acom | Other financial services | Investment expansion | 04/3 | 1379 | Full-scale entry into consumer finance business. |
| | | Shinsei Bank | banking | Aplus | Other financial services | Acquisition | 04/9 | 1000 | Acquisition of Aplus, a subordinate of UFJ. Strength-ened core, non-bank business. |
| | IN-OUT | Sony Corpora-tion America (Sony US affiliate), Commcast, etc | Electric Machiney | Metro Goldwyn Mayer (MGM) | Amusement | Acquisition | 04/9 | 5420 | A consortium set up with partner firms acquired MGM to strengthen film division (April 2005). |

*Note:* Information on time and value is as reported in Recof MARR. Dates show time of public disclosure, not time when deal was finalized.

*Source*: Recof MARR.

## Figure 2-12. Major M&A Transactions in 05

| Incentive | Market | Acquiring firm | | Acquired firm | | Form | Time | Value(in 100 billion yen) | Detail |
|---|---|---|---|---|---|---|---|---|---|
| Defensive strategy | IN-IN | Ito-Yokado | Supermar-kets&convenience stores | Seven Eleven Japan, Denny's Japan | Supermarkets & convenience stores | Merger | 07/5 | 13523 | Established Seven & i Holdings, a joint holding company. Took steps to resolve issue of capital ties and ward off possible hostile takeover. |
| | | Hidezo Terai, President of World (Harbor Holdings Alpha), Chuo Mitsui Capital | Textiles | World | Textiles | Acquisition (TOB,MBO) | 07/5 | 2081 | Management buy-out of a fine company. |
| Growth strategy | IN-IN | Kao, Advan-tage Partners LLP, MKS Partners, Unizon Capital | Chemical | Kanebo cosmet-ics | Chemical | Acquisition | 07/5 | 4400 | Kao acquired Kanebo brand and sales network (Jan. 2006). Hopes to close gap with Shiseido,Japan's leading cosmetics maker. |
| | | Inpex | Mining | Teikoku Oil | Mining | Merger | 07/5 | 3606 | Merge with Teikoku Sekiyu, Japan's third largest oil company. Established Inpex Holdings, a joint holding company, by means of share transfer. Expansion of scale as survival strategy. |
| | | Mitsubishi Chemical | Chemical | Mitsubishi Pharma | Pharmaceuticals | Merger | 05/4 | 2003 | Established joint holding company, Mitsubishi Chemical Holdings, by means of share transfer (Oct. 2005). |
| | | JA Bank | Other financial service | Mitsubishi UFJ financial group, UFJ Nicos (formerly Nippon Shinpan) | Bank | Capital participa-tion | 07/5 | 2000 | Each partner sought synergistic effects by the mutual exploitation of JA Bank's customer base and MUFG's strengths in technology and products. Also UFJ Nicos sought to increase its membership. |
| | | Bandai | Other manufactur-ing | Namco | Amusement | Merger | 05/5 | 1736 | Established joint holding company by means of share transfer. Reorganization of related business. |
| | | Koyo Seiko | Machine | Toyota machine Works | Machine | Merger | 05/2 | 1479 | Keiretsu firm of Toyota Motors; aimed for synergy in steering division etc. New firm, Jtekt, established in Jan. 2006. |
| | | KDDI | Telecom. & broadcasting | Poweredcom | Telecom. & broadcasting | Merger | 05/10 | 1273 | Merger with Poweredcom (Japan's fourth largest land-line telecommunications business), underTepco Jan.2006).Consolidation of three communications giants: NTT, Softbank, and KDDI. |
| | | Rakuten | Software, Informa-tion | TBS | Telecom. & broadcasting | Capital participa-tion | 05/10 | 1110 | Acquiring firms aimed at fusion of television, radio and internet services. |
| | IN-OUT | Sumitomo Corporation US | General trading company | TBC Corporation | Other retail | Merger | 05/9 | 1300 | Strengthening of US tire sales business extending from wholesale to retail markets. |
| | | Sumitomo Trust Bank | Bank | First Credit (Lone Star investment) | Other financial service | Acquisition | 05/10 | 1300 | Fund's exit business (Nov.2005). Acquisition of all shares, reorganization as subsidiary. First Credit specialize in loans secured by real estate. |
| Industrial restructuring | IN-IN | Sankyo | Pharmaceuticals | Daiichi Pharma-ceutical | Pharmaceuticals | Merger | 05/2 | 7968 | Business integration by joint holding company. |
| Group relation strengthening | IN-IN | Tokyo Marine & Nichido Fire Insurance, Meiji Yasuda Life Insurance, Nissei Life Insurance | Life and non-life insurance | Mitsubishi Tokyo Financial Group | Bank | Investment expansion | 05/1 | 2500 | MTFG used income invest in Bank of To-kyo-Mitsubishi; move taken to strengthen financial condition ahead of merger with UFJ Group. |
| | | Sumitomo Life Insurance, Nissei, Mitsui Life insurance | Life and non-life insurance | Sumitomo Mitsui Financial Group | Bank | Investment expansion | 05/3 | 2100 | Move aimed at averting a decrease in Sumitomo Mitsui Bank's equity ratio due to increased disposal of Sumitomo Mitusi Financial Group's non-performing loans. |
| Industrial reorganiza-tion,defensive strategy | IN-IN | Seven & i Holdings | Supermar-kets&convenience stores | Millenium Retailing (holding com-pany for Sogo and Seiyu department stores;investment of Nomura Principal Finance) | Department store | Acquisition | 05/12 | 1311 | Fund's exit business; left two majyor firms at top of industry(other is ieon Group).Produced a comprehen-sive reteiling conglomerate that included department stores. |
| Rehabilitation | IN-IN | Mitsubishi Heavy Industries, Mitsubishi Corporation, Bank of To-kyo-Mitsubishi | Machine | Mitsubishi Motors | Transportation machinery | Investment expansion | 05/1 | 2700 | Expanded investment in reconstructing company by three firms in Mitsubishi Group. |
| Rehabilitaion through investment firm or other source | IN-IN | Daiwa Securities SMBC Principal investments | Other financial service | Sanyo Electric | Electric Machiney | Capital participa-tion | 07/5 | 1250 | Acceptance of preferred stock in resonstructing company(Jan.2006). Board members were seconded. |
| | OUT-IN | Goldman Sachs group | Securities | Sanyo Electric | Electric Machiney | Capital participa-tion | 05/12 | 1250 | Acceptance of preferred stock in resonstructing company (Jan.2006). Board members were seconded. |
| Others | IN-IN | Fuji Television | Telecom. & broadcasting | Livedoor partners (Livedoor sub-subsidiary) | Other financial service | Acquisition | 05/4 | 1033 | The compromise settlement after hostile takeover bid for Nippon Broadcasting System. By acquiring Livedoor Partners, a Livedoor subsidiary holding Nippon Broadcasting system, Fuji made Nippon Broadcasting system its own subsidiary. |

*Note:* Information on time and value is as reported in Recof MARR. Dates show time of public disclosure, not time when deal was finalized.

*Source*: Recof MARR.

## Figure 2-13. Major M&A Transactions in 06

| Incentive | Market | Acquiring firm | | Acquired firm | | Form | Time | Value(in 100 billion yen) | Detail |
|---|---|---|---|---|---|---|---|---|---|
| Industrial restructuring | IN-OUT | Softbank | Other sales and wholesale | Vodafone | Telecom. & broadcasting | Acquisition (LBO) | 06/3 | 19172 | Vodafone became wholly owned subsidiary, effectively withdrew from Japanese market. |
| Growth strategy | IN-OUT | Toshiba | Electricity | BNFL USA Group Inc., Westinghouse UK Limited (BNFL:UK nuclear fuel company) | Electric power & gas | Acquisition | 07/6 | 6210 | Secured stable income base by strengthening nuclear fuel division. |
| | | Daikin Industries | Machine | OYL industries | Machine | Acquisition (TOB) | 06/5 | 2320 | Purchase of OYL, owner of US air conditioner giant McQuay International. Chance to expand to global level and diversify scope of business. |
| | | Marubeni Offshore Production | General trading company | Pioneer natural resources USA | Mining | Business transfer | 06/2 | 1360 | Acquired oil production and development rights. |
| | | Nippon Sheet Glass | Pottery industry | Pilkington | Ceramic | Acquisition | 07/6 | 6160 | Pilkington, as wholly owned subsidiary, had bases worldwide, which could be used to supply products to a broad rande of users, including automakers. |
| | IN-IN | Sumitomo Mitsui Financial Group | Bank | SMBC friend securities | Securities | Acquisition | 06/3 | 3162 | Strengthened ties among banks and securities firms within the group. Move was a response to growing demand for asset management. |
| | | Seven & i Holdings | Supermarkets & convenience stores | York-Benimaru | Supermarkets & convenience stores | Acquisition | 06/4 | 1489 | York Benimaru made into wholly owned subsidiary, positioned as core of acquiring firm's supermarket business. |
| Defensive strategy | IN-IN | Hankyu holdings | Transportation & warehouse | Hanshin Electric Railway | Transportation & warehouse | Acquisition (TOB) | 06/5 | 3921 | Responding to the Murakami Fund's move to acquire stock in Hanshin Electric Railway,Hankyu proposed the idea to Hanshin. Hanshin Hankyu Holdings was formed as a result (Oct. 2006). |
| | | Current Skylark board members. Nomura Principal finance, etc | chain restaurant | Skylark | chain restaurant | Acquisition (MBO,TOB) | 06/6 | 1812 | Japan's largest MBO as of that time |
| | | Ieon | Supermarkets & convenience stores | Origin toshu | chain restaurant | Acquisition (TOB) | 07/6 | 526 | A "white knight" move taken to counter Don Quijote's hostile takeover bid for Origin toshu. |

*Note:* Information on time and value is as reported in Recof MARR. Dates show time of public disclosure, not time when deal was finalized.

*Source*: Recof MARR.

## III The Relationship Between Capital Investment and M&A

The growing market for M&A would seem to indicate that mergers and acquisitions have become generally accepted as a useful business strategy. But capital investment is another important tool for firms pursuing growth. This being so, what is the relationship between M&A and capital investment for a company choosing an proactive stance as part of its mid- to long-term growth strategy? In this section, we explore the connections between firms' M&A choices and their decisions on investing in their own facilities. Data are taken from the Development Bank of Japan's *Survey on Planned Capital Spending for Fiscal Years 2005 and 2006,*[22] carried out in November 2005, and its auxiliary survey.[23]

For the main survey, data were gathered on the estimated value of capital investment for the current fiscal year (FY 2005) and on the planned value for the next fiscal year (FY 2006). The survey was conducted on a company basis. The auxiliary survey is a qualitative survey. Firms were asked, for example, whether they had any specific plans to buy assets or business divisions from another firm, or were interested in such a move in the future.[24] It is hard to find a survey on firms' capital investment plans and the presence or absence of M&A, but these statistics enable us to grasp the relationship between the two. Since the data of capital investment is quantitative, however, it is necessary to convert them into qualitative form. Results for FY 2005, therefore, were compared with those for FY 2004, and plans for FY 2006 compared with estimated results for FY 2005, to change such qualitative data to "increase," "decline," and "level." These were cross-tabulated to understand the linkage between M&A and capital investment.

The results of the survey are summarized in Figures 3-1 and 3-2. Of firms saying they had "specific plans" for an M&A, those which expected an increase in their capital investments for the current (2005) fiscal year were more or less matched by those which expected a decline. If, however, we include firms which said they had "no specific plans, but (were) interested," the share expecting an increase in capital investment becomes dominant. Different results were obtained when firms were asked about the relationship between M&A and their capital investment plans for the next (2006) fiscal year. Here, more firms with "specific plans" for an M&A expected an increase in capital investment than firms which expected a decline; however, those expecting an increase were about equal in number to those forecasting to remain at the same "level" against FY 2005 in capital investment. But when we expand the coverage to include "interested" firms, the share of those expecting "level" in capital investment becomes dominant and those forecasting "level" and "increase" capital investment account for a larger share than the "decline" groups.

Our results show that capital investment by most firms with an interest in M&A as a strategic option was "on the increase" for the 2005 fiscal year and that it would "increase" or remain "level" during the next fiscal year. Only a small percentage expected it to "decline." Most firms reported having a "positive" or "neutral" attitude toward capital investment.

Focusing on firms which said they had "specific plans" for an M&A, however, we find no clear tendency toward either an "increase" or a "decline" in capital investment in FY 2005. And while more firms expected capital investment to increase rather than decline in FY 2006, the share of those answering "level" was also large. First of all, it is not clear whether firms answering that they had "specific plans" in 2005 enforced those plans during the 2005 fiscal year.

[22] These surveys have been carried out since FY 1956. For the year concerned, surveys were sent to 4,249 private firms capitalized at 1 billion yen or more, classified by investment-specific business. Responses were received from 3,291 firms (response rate: 77.5 percent). For the purposes of the survey, "capital investment" is defined as the acquisition of tangible fixed assets of one's own company; the purchase of used assets is included in the definition. That the survey was conducted according to business classifications indicates that both the principal business and side businesses (in the case of diversified firms) were covered.

[23] The official name is *Survey of Attitudes on Capital Investment Behavior*. Surveys were sent to 3,592 companies capitalized at 1 billion yen or more. Responses were received from 1,732 firms (response rate: 48.2 percent). The deadline for responses was November 10, 2005.

[24] For the auxiliary survey, responses on capital investment were based on the firms' principal business.

Next, we cross-tabulated those firms which judged there would be an increase (or decrease) in capital investment during fiscal years 2005 and 2006 with those which reported having "specific plans" for an M&A. We found that 44 percent of firms with specific plans estimated that capital investment would increase in both years, a share some 35 points greater than that of firms expecting a decline for each of the years (Figure 3-3). Since this survey was done as a questionnaire, the responses should be treated with some latitude. However, as mentioned earlier in regard to individual transactions, 2005 was a period when most M&A deals were proactive and based on mid- to long-term growth strategies. This finding, which indicates that firms reporting plans for an M&A continued to be motivated to carry out capital investment, suggests that for firms pursuing a path of expansion, capital investment may have a complementary relationship with M&A entered into as part of a larger growth strategy.[25]

**Figure 3-1. Relationship between Capital Investment (FY 2005) and M&A**

| (Unit: %) | | Acquisition of assets or businesses from other firm | | | Total |
|---|---|---|---|---|---|
| | | Have specific plans | No specific plans, but interested | Have neither plans nor interest | |
| Planned capital investment for FY 2005 (against results for FY 2004) | Increase | 2.1 | 20.1 | 35.9 | 58.0 |
| | Decline | 1.7 | 11.9 | 27.8 | 41.4 |
| | Level | 0.1 | 0.1 | 0.3 | 0.5 |
| Total | | 3.9 | 32.1 | 64.0 | 100.0 |

*Source*: The Development Bank of Japan, Survey on Planned Capital Spending for Fiscal Years 2005 and 2006.

**Figure 3-2. Relationship between Capital Investment (FY 2006) and M&A**

| (Unit: %) | | Acquisition of assets or businesses from other firm | | | Total |
|---|---|---|---|---|---|
| | | Have specific plans | No specific plans, but interested | Have neither plans nor interest | |
| Planned capital investment for FY 2006 (against results for FY 2005) | Increase | 1.8 | 8.3 | 16.4 | 26.4 |
| | Decline | 0.8 | 7.4 | 18.0 | 26.2 |
| | Level | 1.6 | 15.6 | 30.2 | 47.4 |
| Total | | 4.1 | 31.3 | 64.6 | 100.0 |

*Source*: The Development Bank of Japan, Survey on Planned Capital Spending for Fiscal Years 2005 and 2006.

**Figure 3-3. Capital Investment (FY 2005/FY 2006) and M&A**

| (Unit: %) | Acquisition of assets or businesses from other firm |
|---|---|
| FY 2005/FY 2006 | Have specific plans |
| Increase + Increase | 44 |
| Increase + Decline | 18 |
| Decline + Increase | 29 |
| Decline + Decline | 9 |
| Total | 100 |

*Source*: The Development Bank of Japan, Survey on Planned Capital Spending for Fiscal Years 2005 and 2006.

[25] The academic research contains reports that in the United States, the IT-centered increase in capital investment that took place from the late 1990s through 2000 was accompanied by similarly high activity in M&A, also primarily in IT (Yamashita and Ishizaki, 2003).

## IV Analysis of the Effect of M&A on Financial Performance

As we saw in Section II, in M&A deals in which both sides are business corporations or financial institutions, the firms on the buyer side tend to look for synergy in the deal.[26] But does M&A actually result in better performance? In this section we look at M&A transactions between business corporations. Focusing on mergers/acquisitions and business transfers, we analyze whether there has been any improvement in the performance of buyer-side firms (including the seller side in business transfers).

### 1. Review of the Literature and Empirical Results

There have been number of studies that have examined whether M&A improve the performance of firms.[27] Nagaoka (2005), in an empirical analysis to exmaine whether M&A between listed business corporations made improvements in performance, found that while the growth rate of sales did increase after a merger/acquisition, a equal merger worked instead to push sales growth rates down. In case where the firm's share owned by board members increased, a equal merger tended to raise the growth rate of sales. In equal mergers, therefore, the success of an M&A hinges largely on management incentive. An analysis limited to management integration was made by Hosono, Sakai, and Tsuru (2006), who focused on credit unions (shinkin banks). In their analysis, the financial improvement effect caused by integration is expressed as the difference between the weighted average of financial indicators for the acquiring firm and the acquired firm prior to integration and the financial indicator for the integrated company. The larger the performance gap between the acquiring and acquired firms, the greater the improvement effect in the financial performance. They state that this finding is the result of the acquiring firm's high-quality business resources being reflected in the post-integration entity.[28] But we can also interpret it to mean that even in a merger, the financial improvement effect is greater when there is a clear difference in power balance (performance) between the acquiring and acquired firms.

There are a number of problems with Nagaoka's analysis (2005). In addition to the growth rate of sales, Nagaoka quantitatively examined the effect of M&A on the growth rate of employment and the operating profit ratio. He found no significant improvement in the latter two. If no improvement is evident according to the financial indicators, the empirical result is certainly not robust. Furthermore, M&A involves the transfer of assets and liabilities on the balance sheets between acquiring firms and acquired firms. In a merger, because two firms become one, the growth rate of sales should, in the simplest sense, rise. In measuring the financial improvement effect of M&A in this paper, we place greatest emphasis on ROA as a proxy variable for profitability; partly as a robustness check, we use the operating profit-to-sale ratio (Profit), labor productivity, and ratio of general expenses to sales (Cost).

Few prior studies have expressly analyzed the behavior of acquired firms to distinguish between within and outside of the corporate group; virtually none have examined firms on the buyer side.[29] It may be assumed that the power balance is clear[30] when a strong capital relationship ex-

[26] In the auxiliary survey to the *Survey on Planned Capital Spending* carried out in November 2005, the greatest number of companies responding that they either "have specific plans," or "have no specific plans, but are interested" in acquiring assets or business divisions from another company cited as their reason for the acquisition the desire to "obtain not only assets, but also market, know-how, employees and other resources."

[27] Analyses of acquired firms have been made by Asaba (2005) and Fukao, Kwon, and Takizawa (2006).

[28] As stated in Hosono, Sakai, and Tsuru (2006), this is known as the "relative performance hypothesis." For details, see Akhavein, Berger, and Humphrey (1997).

[29] In their examination of an improvement in the financial performance of acquired firms, Fukao, Kwon, and Takizawa (2006) investigated an improvement effect in the financial performance of acquired firms by distinguishing whether the acquired firm belongs to the same corporate group or is a non-group firm. However, their different effect did not statistically significant.

[30] The auxiliary survey to the Survey on Planned Capital Spending of November 2005 contained questions on decision-making within the corporate group. Regarding decisions on capital investment and fund-raising, only 15 percent of firms industry-wide reported that such decisions were left to the discretion of the subsidiary. Of the more than 80 percent that remained, 56 percent said that subsidi-

ists, such as between a parent company and its subsidiary (or between a top shareholder and a corporate affiliate), and that the acquiring company has more information on the acquired company if the latter belongs to the same corporate group. If this hypothesis is correct, we can find the result that the improvement in performance of the acquiring firm is significant when the acquired firm belongs to the same corporate group. Whether or not the acquired firm is listed gives an indication of whether it is subject to market discipline. A firm's listing status may also influence the financial improvement effect brought on by an M&A. We empirically investigate the effect of M&A by distinguishing whether the acquired firm belongs to the same corporate group or is a non-group firm and whether or not they are listed on an exchange.[31]

## 2. Description of Data and Estimation Equation

This paper deals with mergers/acquisitions (excluding equal mergers) and business transfers (buyer and seller sides).[32] Corporate financial data were obtained from the Development Bank of Japan's Corporate Databank. The database covers firms (excluding financial companies and insurance companies) currently listed on either the first or second section of the Tokyo, Osaka, or Nagoya stock market. The sample period was from 1980 through 2004. Information on M&A was obtained from Recof's *Databook on M&A by Japanese Corporations* (for the years 1988 through 2002) and the Recof periodical *MARR* (for 2003). For the following analysis, we combine information from these two sources, and pool the financial data of firms which have conducted M&A and those which have not.[33] Analysis was made using a fixed-effect model adjusted for corporate characteristics.

The model is as follows:

$$Y_{i,t} = \alpha + \beta_1 * M\&A\ Dummy\ 1_{i,t} + \beta_2 * M\&A\ Dummy\ 2_{i,t} + \beta_3 * Asset_{i,t\text{-}1} + \beta_4 * Salegrowth_{g,t} + \sum_x \beta_x * Year\ Dummy_{x,t} + e_{i,t}$$

$i$: company; $t$: year; $g$: industry

The dependent variable $Y_{i,t}$ stands for financial indicators of corporate performance. As explained in the previous section, for these we use ROA,[34] profit, labor productivity,[35] and cost. Since the data we use are financial data for each company arranged in time series (panel data), $Y_{i,t}$ indicates financial indicators for company i for year t. For independent variables we use, in addition to *M&A Dummy* $1_{i,t}$ (dummy for year M&A announced) and *M&A Dummy* $2_{i,t}$ (dummy for year over M&A announced), $Asset_{i,t\text{-}1}$ (real total assets: log and single lag), $Salegrowth_{g,t}$ (nominal sales growth rate), and $Year\ Dummy_{x,t}$. This paper uses two M&A dummy variables to indicate the presence or absence of M&A: the first (*M&A Dummy* $1_{i,t}$) equals 1 only for the year when the M&A is announced, and the second (*M&A Dummy* $2_{i,t}$) equals 1 for the years following the announcement. We do this because at the time the M&A is announced, the company is likely to be expending a great deal of money ahead of its implementation, conceivably with negative effects on its corporate financial performance. Practically speaking, however, improvements in organizational reform and human resources tend to be made in stages, and the effects of M&A emerge gradually as well. If the above hypotheses are correct, we can anticipate that the coefficient $\beta_1$ will be negative and the

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aries were given a certain amount of discretion, but the parent company retained the authority to order changes; 29 percent said that management was consolidated on a group-wide basis. Parent companies clearly retain a certain degree of authority over their subsidiaries.

[31] We group the firms into four categories, according to whether they are: 1) listed companies which were subsidiaries (affiliates), 2) listed companies which were not subsidiaries (affiliates), 3) companies which were subsidiaries (affiliates) but unlisted, and 4) companies which were neither subsidiaries (affiliates) nor listed.

[32] Equal mergers were excluded because of a report in a prior analysis (Nagaoka (2005)) that the desire of both board members to retain joint management can cause corporate governance to become inefficient.

[33] Outliers are defined as a sales growth rate of more (less) than ± 100%. These were eliminated from the data.

[34] ROA: (operating profit and loss + nonoperating income) / total assets.

[35] Labor productivity: added value [operating profit and loss + employment costs + rent + tax and dues + patent royalties + depreciation allowance] / number of employees, converted into real figures using a GDP deflator to obtain a logarithm.

coefficient $\beta_2$ will be positive. Moreover, corporate growth depends on other factors besides M&A. We introduce a number of variables to control these other factors so that we may extract the improvement in financial performance of M&A, and only M&A, on corporate performance. First, if the firm is large in scale already, it is assumed to have reached the stage of maturity in terms of growth. We introduce $Asset_{i,t\text{-}1}$ in order to provide for the possibility that growth will slow. Performance is also affected by the ups and downs of the industry as a whole, as well as by the state of the macroeconomy. To control this, we introduce $Salegrowth_{g,t}$ as a proxy variable for the former and $Year\ Dummy_{x,t}$ as a proxy variable for the latter.

### 3. Analysis of the Effect of M&A on Corporate Financial Performance

In this subsection, we examine whether the financial improvement effect of M&A is influenced by certain characteristics of the acquired firm. In particular, we conduct an empirical analysis according to whether the acquired firm is a member of the same corporate group and whether it is listed on a stock market.

Figure 4-1 shows the results for acquired firms, both group and non-group, which are listed on a stock market. Looking first at ROA, we see that for both group and non-group firms, the improvement effect on ROA is negative during the year the M&A is announced, although the improvement effect for group firms is statistically insignificant. In the years after M&A announcement, however, the result of the group M&A shows a statistically significant positive effect (0.5 percent). For operating profit-to-sales ratio, all M&A dummies are statistically significant, with the financial improvement effect of post-M&A amounting to 2.4 percent when a firm was acquired from within the group and a significantly lower 1.1 percent when it was from outside of the group. The improvement effect was 0.09 percent (group) and 0.04 percent (non-group) when measured in terms of productivity, and –2.6 percent (group) and –0.8 percent (non-group) in terms of cost; both of these findings are significant.

The empirical result of acquired firms, both group and non-group, which are not listed on a stock market are shown in Figure 4-2. The coefficient of the post-M&A dummy is a significantly positive on ROA, profit, and labor productivity for group firms. No significant results were obtained for non-group firms, the value being negative for ROA, profit, and labor productivity.

Comparing the coefficient of the post-M&A dummy on the basis of whether or not the acquired firm is listed (comparison of Figures 4-1 and 4-2), we see that for group firms, there is no big difference in ROA when the acquired firm was in the same group, regardless of its listing status. However, the coefficients for listed firms are more statistically significant, and the empirical results show that a merger/acquisition with a listed company produce more substantial improvement effects on profit (+1.7 percent), labor productivity (0.04 percent), and cost (–2.1 percent). A comparison of coefficients for non-group firms shows that improvement effects are significantly greater for listed firms. No significant results were found when a company acquired an unlisted firm.

From the above analysis of each category – group and non-group, and listed and non-listed – we found the empirical result that the greatest significant improvement to the acquiring firm's financial performance occurred when the acquired firm was a listed group firm.[36] The improvement effect on profit, labor productivity and ratio of cost to net sales was largest in a listed group firm and was robust as well. When comparing the empirical results for cases where the target firm was a group or non-group firm, we found that the improvement effect of M&A was larger in case of the former, regardless of whether the acquired firm was listed or not. Viewed from the perspective of listing status, the improvement effect for case where the target firm acquired the listed firm was larger on the whole, for both group and non-group firms.

These findings demonstrate the veracity of

[36] In this paper, our most important consideration in judging the effectiveness of M&A is whether or not the M&A has caused ROA (return on assets) to improve. The improvement effect of an unlisted group firm is slightly larger than a listed group firm. But latter case is more statistically significant.

the hypothesis explained in the preceding subsection. The fact that two firms are in a parent-subsidiary relationship (or a top shareholder-affiliate relationship) means that there is a clear power balance between the two and information(going beyond financial statement) on the acquired firm is accumulated through the dispatching of board members from the parent firm to the subsidiary. Listed firms, meanwhile, are subject to market discipline from the stock market. The results of the empirical analysis thus suggest that the clarity of the power balance, the amount of information on the acquired firm available prior to the M&A, and the existence or nonexistence of market discipline all greatly influence the extent that M&A will improve the performance of the acquiring firm. If the power balance is clear, and the acquiring company has collected sufficient information on the firm it intends to acquire, restructuring will be led by the acquiring firm and the acquired firm's profitable and unprofitable business divisions can be discrened and which to retain and which to dispose of can be decided by the acquiring firm. If, on the other hand, the acquired firm is listed on a stock market, the management of listed target firms are likely to show a greater profit-orientation as a result of the discipline exerted by the stock market.[37]

The next question we examine is this: When a company is considering an M&A, which type of firm should it acquire in order to gain the greatest improvement effect from the transaction: firms which were subsidiaries (affiliates) but unlisted, or listed firms which were not subsidiaries (affiliates) – that is, should it be a firm with which it has a clear power balance and about which it is well informed, or a firm which operates under market discipline? To perform this comparison, it is necessary to examine the empirical results for the above two cases. In terms of ROA, the most important barometer of profitability in this paper, we confirmed a significant improvement effect when M&A takes place within the group but unlisted. In terms of labor productivity, the improvement in the financial performance is significantly larger in case of the unlisted group firm. The improvement on profit is larger in the case of the listed non-group firm, although the results of both cases were statistically significant. The issue of robustness is one that needs further investigation. The results for ROA suggest that a clear power balance with the target firm, and the accumulation of information on it prior to the M&A, is a more important condition for improving the effect of the M&A to the acquiring firm than that the target firm be listed.[38]

The empirical result in this paper – that information on the target firm is of key importance in maximizing the benefits of an M&A to the buyer – may provide a valuable suggestion on how to deal with the company to be acquired, namely that the acquiring firm should not move too quickly to complete the acquisition. The financial improvement effect of M&A are likely to be greater when the buyer begins its connection with the target by means of capital participation, and follows this with investment. Information on the target firm is collected gradually over this period, increasing the probability of a successful outcome. Only at this stage should the acquiring firm go ahead with the acquisition.

The finding that listing is comparatively unimportant may point to the immaturity of the Japanese stock market. Because of long-term cross-shareholdings and other factors, many of the stockholders in the Japanese market have held their shares for long periods of time; this may have prevented market discipline from functioning. If discipline improves in the future, and the number of firms with diverse shareholders increases, firms selecting a target for M&A may come to place greater emphasis on the target's being listed.

[37] The Cabinet Office (2004) pointed out that clashes in organizational culture and interests were important reasons for the failure of M&A.

[38] Tohmatsu Consulting's Survey on M&A Trends (F*ebruary 2006)* investigated the attitudes of companies with experience in M&A. There were 104 responses. Asked what they found hard to accomplish during the target selection phase, many respondents mentioned the difficulty of obtaining information on the target firm, pointing to problems like "predicting the effect of integration on the basis of limited information," "finding promising targets," and "obtaining adequate, good-quality information."

**Figure 4-1. Merger/Acquisition when Acquired Firm is Listed**

| | ROA | | Profit | | Labor Productivity | | Cost | |
|---|---|---|---|---|---|---|---|---|
| | M&A (Group) | M&A | M&A (Group) | M&A | M&A (Group) | M&A | M&A (Group) | M&A |
| M&ADummy1 | -0.002 | -0.010 ** | -0.019 *** | -0.027 *** | -0.023 | -0.021 | 0.020 *** | 0.022 *** |
| | (0.71) | (0.03) | (0.00) | (0.00) | (0.49) | (0.58) | (0.00) | (0.00) |
| M&ADummy2 | 0.005 ** | 0.004 | 0.024 *** | 0.011 *** | 0.093 *** | 0.043 ** | -0.026 *** | -0.008 * |
| | (0.03) | (0.21) | (0.00) | (0.00) | (0.00) | (0.05) | (0.00) | (0.08) |
| Asset | -0.005 *** | -0.005 *** | 0.003 *** | 0.003 *** | 0.090 *** | 0.090 *** | -0.002 *** | -0.002 *** |
| | (0.00) | (0.00) | (0.00) | (0.00) | (0.00) | (0.00) | (0.00) | (0.00) |
| Salegrowth | 0.00002 *** | 0.00002 *** | 0.00001 * | 0.00001 * | 0.00011 *** | 0.00011 *** | -0.00001 * | -0.00001 * |
| | (0.00) | (0.00) | (0.08) | (0.08) | (0.00) | (0.00) | (0.06) | (0.06) |
| Constant | 0.173 *** | 0.173 *** | 0.010 | 0.010 | 7.687 *** | 7.690 *** | 1.026 *** | 1.026 *** |
| | (0.00) | (0.00) | (0.33) | (0.30) | (0.00) | (0.00) | (0.00) | (0.00) |
| R-sq | 0.24 | 0.24 | 0.06 | 0.06 | 0.16 | 0.16 | 0.04 | 0.04 |
| obs | 50494 | 50494 | 50494 | 50494 | 50328 | 50328 | 50494 | 50494 |

*Notes*: 1. Upper figures are coefficient values; lower figures are P values.
2. *** indicates P value of 1% level and significant; ** indicates 5% level and significant; * indicates 10% level and significant.

**Figure 4-2. Merger/Acquisition when Acquired Firm is Unlisted**

| | ROA | | Profit | | Labor Productivity | | Cost | |
|---|---|---|---|---|---|---|---|---|
| | M&A(Group) | M&A | M&A(Group) | M&A | M&A(Group) | M&A | M&A(Group) | M&A |
| M&ADummy1 | 0.000 | 0.008 ** | 0.004 | 0.001 | 0.022 | 0.034 | -0.004 | -0.005 |
| | (0.96) | (0.02) | (0.54) | (0.84) | (0.54) | (0.21) | (0.58) | (0.37) |
| M&ADummy2 | 0.006 * | -0.004 | 0.008 * | -0.001 | 0.057 ** | -0.018 | -0.005 | 0.005 |
| | (0.06) | (0.17) | (0.10) | (0.82) | (0.04) | (0.37) | (0.33) | (0.21) |
| Asset | -0.005 *** | -0.005 *** | 0.003 *** | 0.003 *** | 0.090 *** | 0.091 *** | -0.002 *** | -0.002 *** |
| | (0.00) | (0.00) | (0.00) | (0.00) | (0.00) | (0.00) | (0.00) | (0.00) |
| Salegrowth | 0.00002 *** | 0.00002 *** | 0.00001 * | 0.00001 * | 0.00011 *** | 0.00011 *** | -0.00001 * | -0.00001 * |
| | (0.00) | (0.00) | (0.08) | (0.08) | (0.00) | (0.00) | (0.06) | (0.06) |
| Constant | 0.173 *** | 0.173 *** | 0.008 | 0.008 | 7.683 *** | 7.680 *** | 1.028 *** | 1.029 *** |
| | (0.00) | (0.00) | (0.41) | (0.43) | (0.00) | (0.00) | (0.00) | (0.00) |
| R-sq | 0.24 | 0.24 | 0.06 | 0.06 | 0.16 | 0.16 | 0.04 | 0.04 |
| obs | 50494 | 50494 | 50494 | 50494 | 50328 | 50328 | 50494 | 50494 |

*Notes*: 1. Upper figures are coefficient values; lower figures are P values.
2. *** indicates P value of 1% level and significant; ** indicates 5% level and significant; * indicates 10% level and significant.

However, even if market discipline should improve, the cost of listing on a stock market, with investor relations included, remains high and many fine firms wish to be listed but do not have the wherewithal. Others make a strategic decision not to be listed. Should this situation continue, firms considering acquiring an unlisted firm should find that the gradual approach described above – from capital participation through investment expansion – will ultimately provide them with the greatest financial benefit.

## 4. Analysis of the Effect of Business Transfers on Corporate Financial Performance

Business transfers involve the transfer of assets on the division level, rather than on the level of firms in their entirety. This is an important means by which firms pursue efficiency in the allocation of their assets. For this reason, we need to consider how business transfers bring improvement not only to the buyer side but to the seller side as well.

The empirical results on business transfers are shown in Figures 4-3 and 4-4. While the improvement on ROA was statistically insignificant

for buyer and seller alike, the post-M&A coefficient was positive. We now examine the results for indicators other than ROA, for both the buyer and the seller sides. M&A Dummy 2 for the buyer side reveals significant beneficial effect on both profit and labor productivity for deals outside of the corporate group. On the seller side, there is also a beneficial effect on profit and labor productivity, regardless of whether the sale takes place within or outside of the group.

This transfer of assets at the level of the division, rather than the company, may not improve finances to the extent of causing a statistically significant increase in ROA. We confirm, however, that it does improve performance in other indicators – profit ratio and productivity – for the seller as well as the buyer. The desire to strengthen existing businesses is one of the most common reasons recently given for attempting an M&A (Figure 4-5). Business transfers, by which firms can strengthen their core businesses and sell off non-core ones, can thus be viewed as contributing to the profitability of buyer and seller firms alike.

**Figure 4-3. Business Transfer between Two Listed Firms: The Buyer Side**

| | ROA | | Profit | | Labor Productivity | | Cost | |
|---|---|---|---|---|---|---|---|---|
| | M&A(Group) | M&A | M&A(Group) | M&A | M&A(Group) | M&A | M&A(Group) | M&A |
| M&ADummy1 | -0.002 | 0.000 | 0.002 | -0.007 | 0.090 * | -0.047 | 0.000 | 0.005 |
| | (0.70) | (0.94) | (0.85) | (0.30) | (0.08) | (0.24) | (0.98) | (0.53) |
| M&ADummy2 | 0.005 | 0.001 | -0.001 | 0.011 ** | 0.035 | 0.071 ** | 0.001 | -0.006 |
| | (0.30) | (0.80) | (0.89) | (0.05) | (0.36) | (0.02) | (0.89) | (0.32) |
| Asset | -0.005 *** | -0.005 *** | 0.003 *** | 0.003 *** | 0.091 *** | 0.090 *** | -0.002 *** | -0.002 *** |
| | (0.00) | (0.00) | (0.00) | (0.00) | (0.00) | (0.00) | (0.00) | (0.00) |
| Salegrowth | 0.00002 *** | 0.00002 *** | 0.00001 * | 0.00001 * | 0.00011 *** | 0.00011 *** | -0.00001 * | -0.00001 * |
| | (0.00) | (0.00) | (0.08) | (0.08) | (0.00) | (0.00) | (0.06) | (0.06) |
| Constant | 0.173 *** | 0.173 *** | 0.008 | 0.009 | 7.672 *** | 7.684 *** | 1.028 *** | 1.028 *** |
| | (0.00) | (0.00) | (0.43) | (0.39) | (0.00) | (0.00) | (0.00) | (0.00) |
| R-sq | 0.24 | 0.24 | 0.06 | 0.06 | 0.16 | 0.16 | 0.04 | 0.04 |
| obs | 50493 | 50494 | 50493 | 50494 | 50327 | 50328 | 50493 | 50494 |

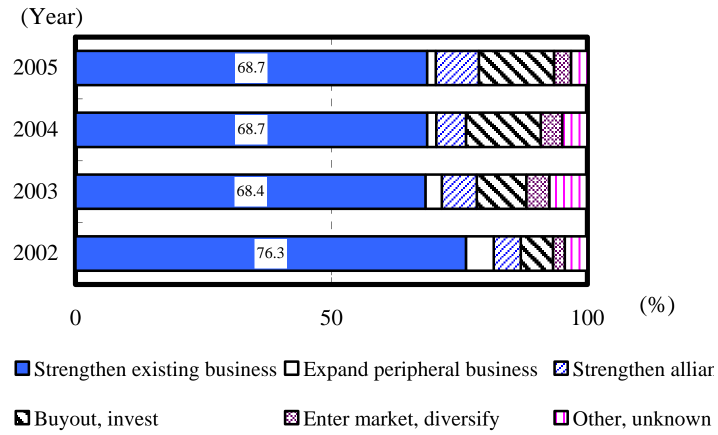
*Notes*: 1. Upper figures are coefficient values; lower figures are P values.
2. *** indicates P value of 1% level and significant; ** indicates 5% level and significant; * indicates 10% level and significant.

**Figure 4-4. Business Transfer between Two Listed Firms: The Seller Side**

| | ROA | | Profit | | Labor Productivity | | Cost | |
|---|---|---|---|---|---|---|---|---|
| | M&A(Group) | M&A | M&A(Group) | M&A | M&A(Group) | M&A | M&A(Group) | M&A |
| M&ADummy1 | -0.005 | -0.001 | -0.021 *** | -0.011 | -0.142 *** | -0.067 | 0.009 | 0.001 |
| | (0.23) | (0.86) | (0.00) | (0.15) | (0.00) | (0.12) | (0.18) | (0.89) |
| M&ADummy2 | 0.002 | 0.004 | 0.020 *** | 0.018 *** | 0.113 *** | 0.092 *** | -0.003 | -0.008 |
| | (0.51) | (0.30) | (0.00) | (0.00) | (0.00) | (0.00) | (0.45) | (0.22) |
| Asset | -0.005 *** | -0.005 *** | 0.003 *** | 0.003 *** | 0.091 *** | 0.091 *** | -0.002 *** | -0.002 *** |
| | (0.00) | (0.00) | (0.00) | (0.00) | (0.00) | (0.00) | (0.00) | (0.00) |
| Salegrowth | 0.00002 *** | 0.00002 *** | 0.00001 * | 0.00001 * | 0.00011 *** | 0.00011 *** | -0.00001 * | -0.00001 * |
| | (0.00) | (0.00) | (0.08) | (0.08) | (0.00) | (0.00) | (0.06) | (0.06) |
| Constant | 0.173 *** | 0.173 *** | 0.008 | 0.008 | 7.679 *** | 7.678 *** | 1.028 *** | 1.028 *** |
| | (0.00) | (0.00) | (0.42) | (0.45) | (0.00) | (0.00) | (0.00) | (0.00) |
| R-sq | 0.24 | 0.24 | 0.06 | 0.06 | 0.16 | 0.16 | 0.04 | 0.04 |
| obs | 50494 | 50494 | 50494 | 50494 | 50328 | 50328 | 50494 | 50494 |

*Notes*: 1. Upper figures are coefficient values; lower figures are P values.
2. *** indicates P value of 1% level and significant; ** indicates 5% level and significant; * indicates 10% level and significant.

## Figure 4-5. Objectives of M&A




*Source*: Recof MARR

## Conclusion

M&A have become a widespread tool to accelerate corporate restructuring. Yet, to date, there has been insufficient research on whether M&A contribute to the efficient allocation of resources and to increased profitability. Accordingly, this paper aimed to examine the situation of Japan's M&A market in recent years and to conduct an empirical analysis of whether M&A have led to an improvement in acquiring firms' profitability, productivity, etc. The following is a summary of the findings of this papers as well as an outline of future research tasks.

(1) Japan's M&A market has expanded, reflecting legal changes with regard to the M&A environment as well as an increased awareness of the need to improve profitability. The objectives firms pursue when conducting M&A can be divided into the exploitation of synergy effects, the raising of corporate value (through business rehabilitation, buyouts, etc.), and defensive strategies. Looking at major individual cases, clear changes in the underlying objectives over time can be observed. From the second half of the 1990s up until around 2001, M&A were largely driven by industry consolidation aimed at the exploitation of synergy effects as well as by the advance into overseas markets. From 2002 onward, M&A have focused on corporate rehabilitation led by the government, banks, and private investment funds. And since around 2005, more proactive M&A as part of medium- to long-term growth strategies have dominated.

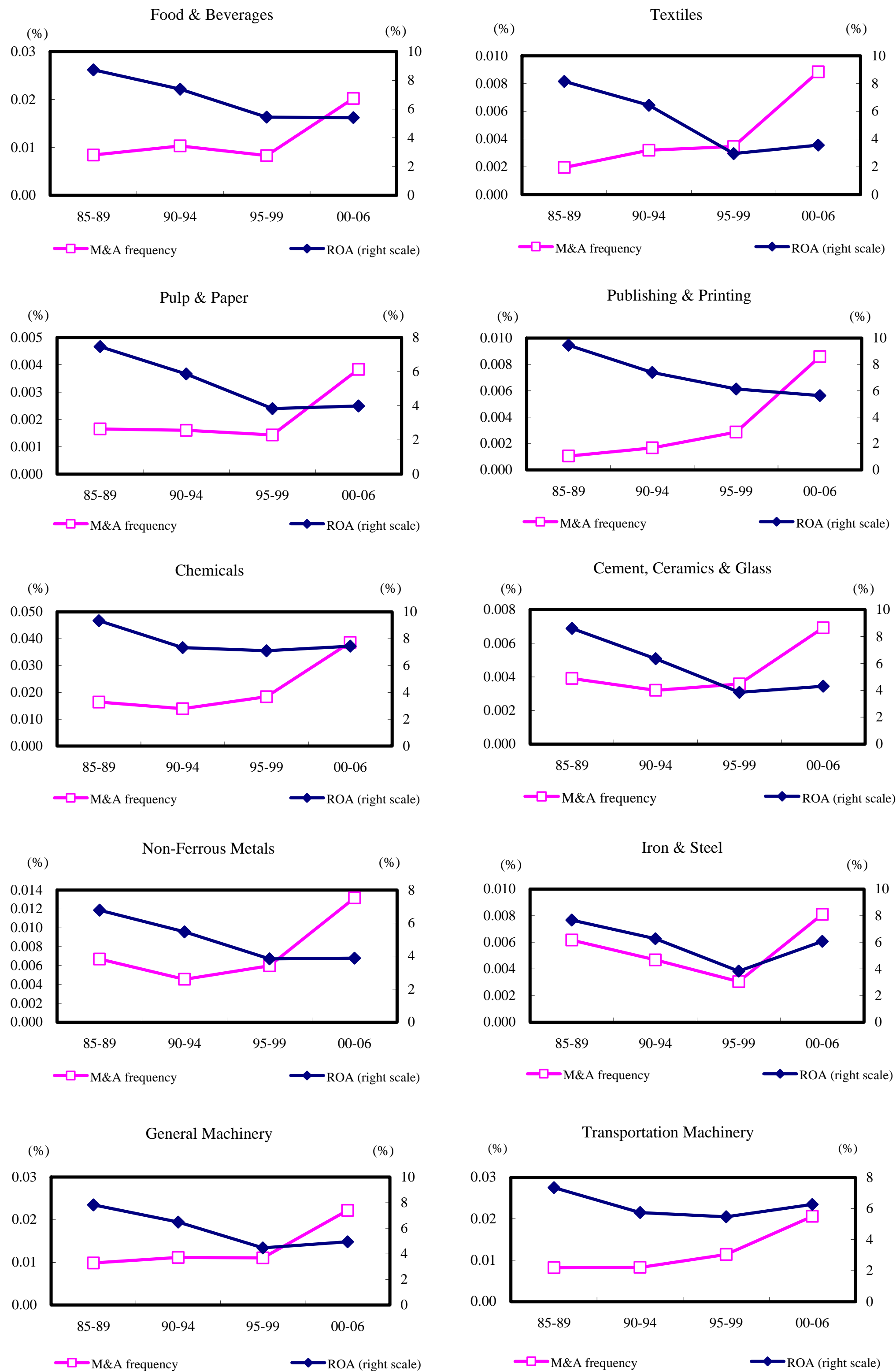
(2) The examination of the relationship between M&A and business fixed investment using data from the Development Bank of Japan's *Survey on Planned Capital Spending* suggested that M&A and fixed business investment may not be substitutes but important complimentary tools in firms' growth strategies.

(3) The results of the empirical analysis indicate that with regard to acquisitions, the improvement in performance of the acquiring firm was statistically significant and largest in the case when the acquired firm was an intra-group firm listed on the stock exchange, and this result was robust. Next, the comparison of the estimation results of non-listed intra-group firms and of listed non-group firms confirmed that the former experienced a significant improvement in ROA. This suggests that a clear balance of power and the amount of information available vis-à-vis the acquired firm were more important for an improvement in the financial performance of the acquiring firm than market discipline. The accumulation of information is one of the beneficial effects of a relationship with the acquired firm that begins with a capital participation and a gradual increase in the investment. With regard to market discipline, its role may become more important in the future for the selection of M&A targets as the Japanese stock market becomes more mature. Nevertheless, if may be conjectured that even if the role of market discipline were to increase, there will still be firms which will not list because of the costs involved and for strategic reasons, and in this case, a gradual approach may still provide the greatest financial benefits for the acquirer.

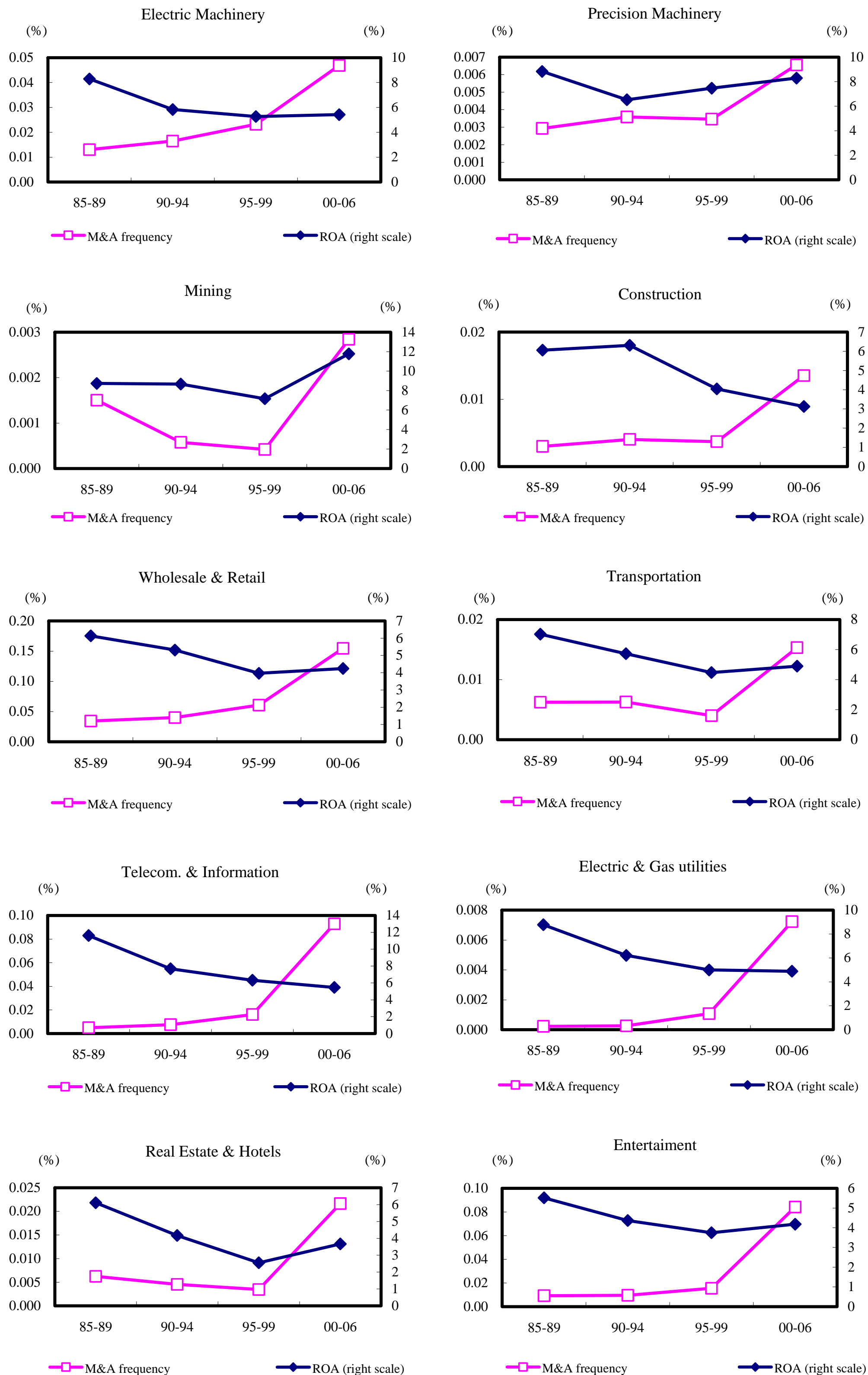
(4) With regard to business transfers, buyers of assets in non-group M&A and sellers of assets in the case of both intra-group and non-group M&A were found to register improvements in operating profit-to-sales ratios and labor productivity. Given that M&A activity in recent years has concentrated on the strengthening of core business areas, acquisitions of businesses related to core business areas and the sale of non-core businesses were shown to lead an improvement in profitability both for sellers and buyers.

This paper examined the characteristics of target firms in M&A that contributed to an improvement in the financial performance of acquiring firms as well as the relationship with the target firm that is important for ensuring the success of an M&A deal. Questions that this paper did not address are the possibility that the improvement effects of M&A may differ depending on the characteristics of the acquiring firm (such as whether it is a foreign-owned or Japanese firms, differences in ownership structure, etc.) as well as the extent to which M&A activity affects industries and the economy overall. These are issues left for future research.

## Appendix 1 Number of M&A by Industry and ROA



## Appendix 1 Number of M&A by Industry and ROA (continued)

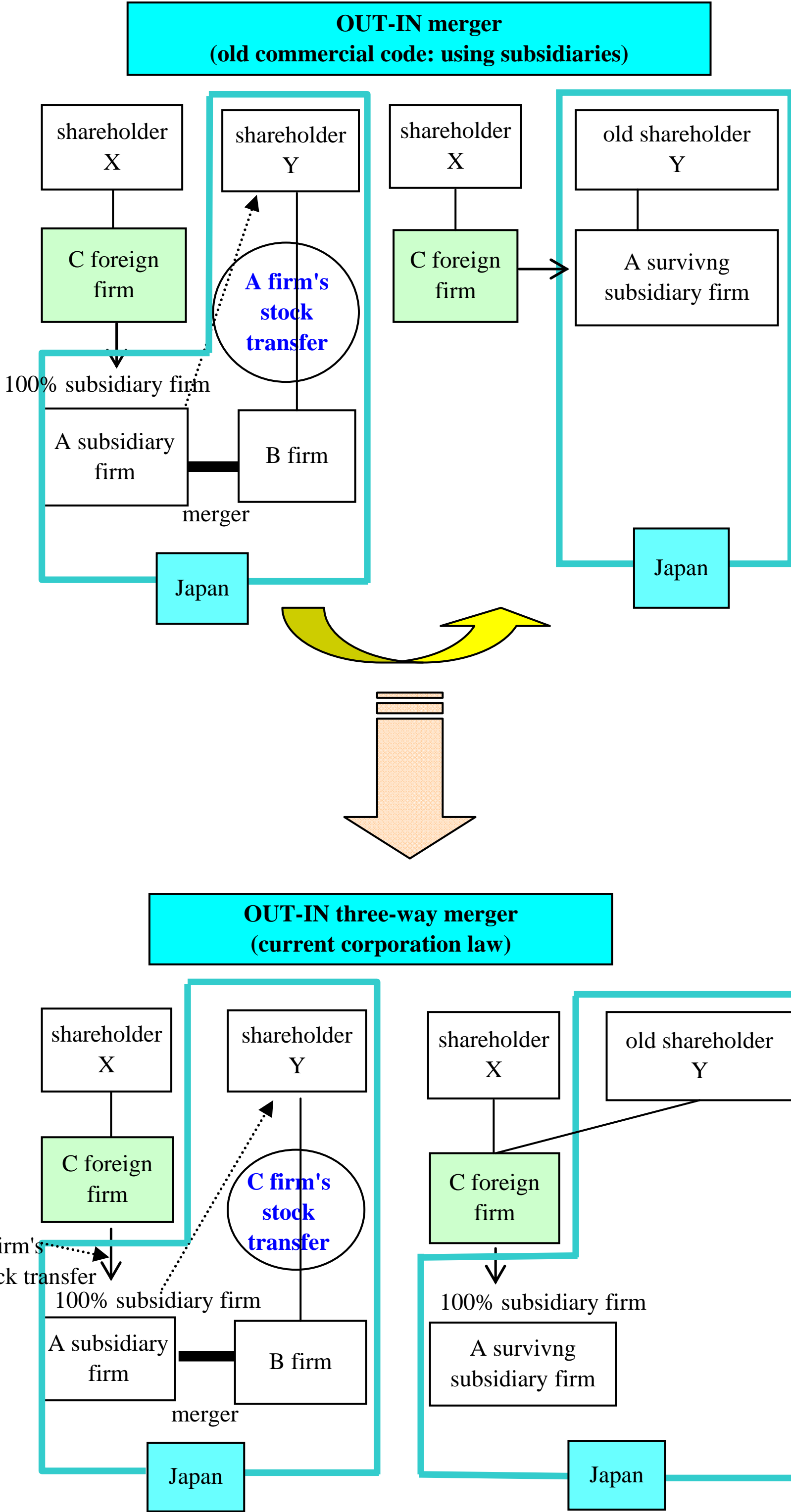



*Notes*: 1. Figures for ROA are five-year averages (or a six-year average for the most recent period).
2. "M&A frequency" is defined as the number of M&A transactions / number of firms during each period. The number of M&A transactions constituting the numerator is the aggregate value for five years (or for six years for the most recent period). The number of corporations constituting the denominator is the number of firms covered by the Statistical Survey on Establishment and Enterprise Census carried out during each period (86, 91, 96, and 01; simple surveys excluded).

*Sources*: Recof MARR and the Ministry of Internal Affairs and Communications, *Establishment and Enterprise Census*.

## Appendix 2 Three-way Mergers

(Comparison with Mergers Using Subsidiaries in the Former Commercial Code)

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