

Informal Institutions as Constraints to an Active Market for Corporate Control: The Case of Japan

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Abstract: The market for corporate control serves as an external mechanism for corporate governance and plays a vital role particularly in the market-oriented economies. However, the system is much less prevalent in Japan than its counterparts like USA and UK. This study aims at explaining the state of underdeveloped corporate takeover market in Japan shedding an analytical light on informal institutions including relation or trust among and between groups. Informal institutions work as fundamental building blocks for corporate governance which in turn, have either led the market for corporate control a redundant institution or worked as hindrance to its development in Japan. Support to this argument is provided through analyzing various anecdotal facts from the current affairs as well as a widely-cited case, Livedoor-Fuji TV takeover battle.

Keywords: Corporate governance, corporate takeover, informal institutions, Japan

INTRODUCTION

Corporate governance is a mechanism which ensures checks and balances in the managerial activities and assures dispersed shareholders that firm's assets are effectively utilized to achieve its objectives (Hart, 1995; Kay and Silberston, 1995; Shleifer and Vishny, 1997). The urge for good governance in corporations is ushered by the conflict of interest between principals and agents. Principals do not take part in the day-to-day operations of a firm for various reasons including lack of professional experience. Instead, they appoint professional managers as agent to manage the firm, on their behalf. This separation of ownership and control creates an opportunity for divergence of interests between principals and agents. For example, principals may expect that managers would work to maximize the value of firms, whereas agents might intend to increase their perks through various means, which may decrease the value of the firm in the long run. In order to avoid this sort of conflicts, various corporate governance mechanisms have evolved including product market competition (Allen and Gale, 2000), managerial labor market (Hirschey, 1986), legal, political and regulatory systems (Jensen, 1993) and the market for corporate controls, such as proxy contests, mergers and acquisitions and hostile takeovers.

In the Anglo-Saxon countries, where much emphasis has been put on capital market based institutions, an active market for corporate control plays a crucial role for addressing managerial inefficiency as well as management's self-empire building tendency

(Baker and Smith, 1998). Capital markets are functionally strong and dynamic because of the presence of large and diversified base of investors (Suzuki, 2005). Moreover, shareholders rights are legally protected while the requirement for information disclosure is clearly pronounced (Shleifer and Vishny, 1997). Thus, performance of a firm is believed to reflect in the stock prices. Firms which are undervalued due to managerial inefficiencies become easy preys to prospective acquirers. Replacing existing management, in such instances, promises to improve corporate performance and thereby increases the value of shareholders' stakes in the firm. As a consequence, the threat of managerial job losses stemming from potential takeovers prompts managers for corrective actions and thereby improve firm's performance. In such a market-driven institutional setting corporate takeover is believed to render a strong protection to the interests of a large number of small, non-controlling and dispersed shareholders (Manne, 1965).

Contrasting to its western counterparts, an active market for corporate control is much less prevalent in Japan. This study aims to figure out the factors responsible for hindering the evolution of a strong corporate takeover market in Japan. In so doing, the study first describes the state of takeover market in Japan. It then considers factors that influence the takeover market, shedding analytical light on the structure of corporate governance prevailed in the country. The study then analyzes a widely cited case, Livedoor-Fuji TV takeover battle to acquire Nippon Broadcasting System (NBS). The research finds that

informal institutions such as culture, norms, trust etc., have been transformed into a kind of self-regulating governance mechanism, which in turn, have either restricted the evolution of the market for corporate control or made it a redundant institution for corporate governance. The study finally concludes stating that Japanese economic development requires the market to play an extensive role to speed up the process of corporate finance and governance, because it is argued that Japanese traditional relation-based capitalism has lost much of its ground to keep pace with the dynamic changes of global business environment.

A SYNOPSIS OF CORPORATE TAKEOVER MARKETS

The ongoing deregulation of financial markets in the contemporary global economy has created an impetus to find new skills, strategies, managerial teams and the significant restructuring of corporate assets in order to cope with the dynamic changes in the market. It is comparatively easier for new top-level managers with new business ideas to execute value enhancing activities in shareholders' interests (Jensen, 1988). This, at least, constituted the basic justification for record number of increases in corporate takeovers in the USA in 1980s. During this period, the number of takeovers and the volume of transactions were so high that the decade was characterized a 'takeover mania' (Shleifer and Vishny, 1990).

Japan's corporate governance however, is not built on a system which places much emphasis on the market for corporate control. Rather, the takeover market is so

rare that some scholar venture to assert that, not only such market is absent (in comparative perspective) in Japan, but also its development is highly unlikely (Fligstein, 2001). Though world's second largest economy, Japan is far behind its counterparts as far as the market for corporate control is concerned. For instance, average number of corporate mergers announced in the USA from 1990 to 1994 totaled 2,437 transactions with an average value of US \$135 billion. In contrast, domestic Mergers and Acquisitions (M&A) during the same period in Japan was less than 100 transactions and their value averaged to US \$6.78 billion (approx.) per year. Among these, the number of foreign acquisitions amounted only up to 50 firms with an annual average value of US \$424 million (Milhaupt and West, 2004).

Figure 1 shows a comparative picture of mergers and acquisitions in four industrial countries. The mergers and acquisitions activities in Japan remained significantly low until 1998. Even though the number has increased in the subsequent period to a little extent, Japan remains incomparable to USA and UK, which are the top two countries in the world. Moreover, Japan remains at the bottom of the global chart, not only in terms of the number of deals but also in terms of the total value as percentage of GDP. For example, total M&A activities from 1991 to 1997 accounted for 9.1% in UK, 5.5% in USA, 1.4% in Germany and 0.4% of GDP in Japan. In the period of 1998-2005, the volume has slightly increased for Japan (2.4%). But, substantial increases have been followed in the UK (21.8%), USA (10.7%) and Germany (7.5%). Moreover, in 1998, China recorded three times more value in M&A

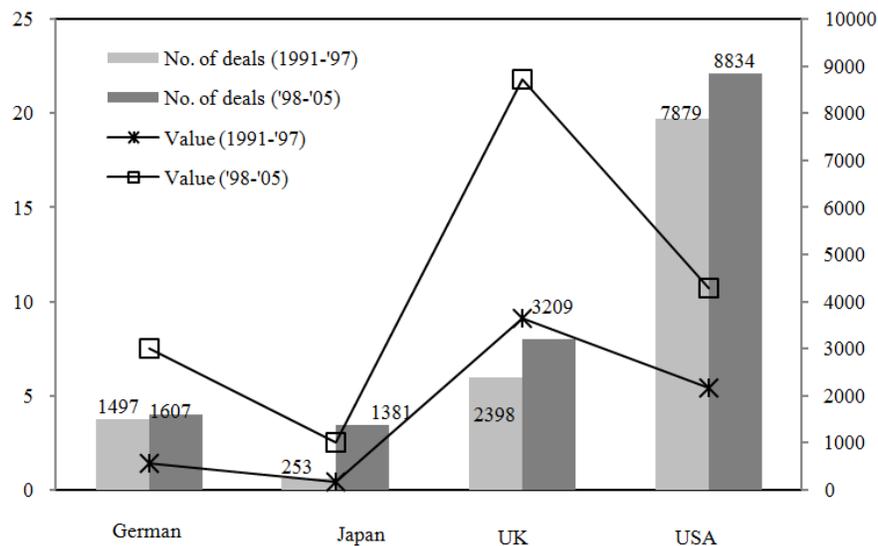


Fig. 1: M&A in four industrial countries
Jackson and Miyajima (2007); Left axis: Value as % of GDP; Right axis: Total number of deals

transactions as percentage of GDP than Japan (Milhaupt and West, 2004).

However, a major share of these M&A activities was friendly mergers rather than hostile takeovers. Hostile takeover is a process in which the acquiring firms attain the controlling share of the target firms without the target firm's management consent. However, hostile takeover sometimes aims for *greenmailing*. Greenmailing is a process in which the bidder acquires the shares of target firm with the intention to sell them back to the target firm at a substantial premium. It has been observed that unsuccessful cases of hostile bids usually end up with *greenmailing*. In this sense, it is difficult to distinguish between *greenmailing* and hostile tender offers and therefore, reported data on hostile takeovers and *greenmailing* is different in different sources. For instance, Kester (1991) shows that between 1984 and 1988 there were at least 22 successful *greenmailing* cases in Japan. Prior to 1990 there were no hostile takeover bids in Japan (Colcera, 2007). Colcera (2007) further notes that between the period of 1990 and 1997, takeover bids increased to about 10 bids/year. However, there has been a substantial increase in the number of takeover bids from about 20 in 1999 to 30 in 2001, 40 in 2004 and 50 in 2005, in Japan. This data is different from Schaik (2008) who contends that in the period of mid 1999 to the end of 2007, thirteen hostile tender offers were launched. Of these, only two hostile tender offers were successful. Two companies increased the dividend payout to successfully avert the bid, whereas in four cases a *white knight* (a friendly firm approaches to rescue the target firm from the grip of acquirer) rescued the target firms. In four cases, the target companies implemented a *poison pill* (a poison pill is a defensive mechanism against hostile takeover in which the target firm issues new shares to existing shareowners except the acquirer at a discount price aiming to dilute the acquiring firm's shareholdings). Another company issued a *poison pill* and set up *white squire* (white squire is similar to *white knight* except that the *white squire* purchases a lesser interest in the target firm while in the case of *white knight* the friendly firms purchase a majority interest).

Culpepper (2011), on the other hand, shows that there was only one hostile takeover completed in Japan during the period of 1990 to 2007. At the same period, there were 162 hostile takeover attempts in the USA, of which 55 were successful. The number of successful hostile takeover during the same period was 45 in the UK and 3 in Germany. Moreover, the number of friendly mergers between 1990 and 2007 were 7,853 in USA, 1,748 in UK, 678 in Germany and 508 in Japan. Data and facts presented above prove that the market for corporate control in Japan is smaller and far less prevalent than countries similar in economic standings.

INSTITUTIONAL FRAMEWORK FOR CORPORATE TAKEOVER IN JAPAN

Several factors have been pointed out to refute the absence of market for corporate control in Japan. These factors can broadly be grouped into formal institutions (formal regulatory restrictions) and informal institutions (social norms and practice) including mutual and cross shareholding, main bank monitoring system and relational contracting.

Formal regulations in and of themselves, however, do not constitute the primary barrier toward corporate takeovers. Even though regulatory provisions in Japan favor incumbent management, the Japanese Commercial Code does not provide incumbent managers with aggressive defensive mechanisms. Kester (1991) notes:

“Despite such legal impediments to mergers and acquisitions activity in Japan, it is difficult to conclude that either the spirit or the letter of Japanese law is fundamentally more inimical to mergers and acquisitions than is, say, American or British law. In the United States, hostile takeovers manage to thrive despite a growing body of state statutes favoring incumbent management even more strongly than the provision noted in Japanese law.”

Due to the rarity of hostile takeover activities Japan's formal postwar institutional mechanisms for hostile takeovers did not evolve at the same pace as it was in the western countries. Most of the disputes arising from the investor-management conflicts, regarding corporate governance, tended to be resolved outside the formal legal system (Armour *et al.*, 2010). There was a single provision in the securities law that dealt with hostile takeover. For instance, under the Securities Exchange Act, a bidder seeking to acquire one-third or more of the shares of a publicly traded corporation was required to make the purchase by means of either market transactions or a tender offer open to all shareowners. Also, there was a judicial doctrine in the Commercial Code that consisted of a *primary purpose* rule applicable in the case of *white knight* defensive measure adopted by a firm against an unwanted bid. The rule entailed that an issuance of stock to a specific shareholder was not grossly unfair if management's primary purpose was to raise capital rather than to maintain control of the company. Until the mid-2000s, these two rules constituted the entire body of Japanese takeover law.

Stirred by the Livedoor-Fuji TV takeover battle for NBS and other takeover incidents in the early 2000s, some changes took place in the corporate takeover laws and defense mechanism. In 2004, the Ministry of Economy, Trade and Industry (METI) of Japan and the Ministry of Justice (MOJ) jointly established a Corporate Value Study Group. The group conducted

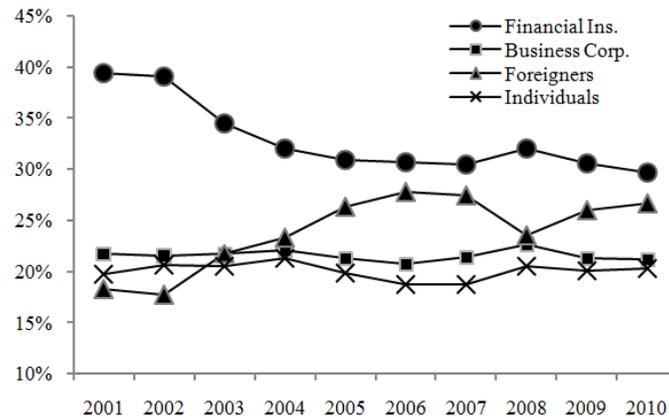


Fig. 2: Market value owned by type of shareholders (Tokyo stock exchange)

extensive research on Anglo-American takeover defenses and legal precedents and issued a major report in March 2005. The report, first, noted that the evolution of corporate takeover measures as well as defense was hampered by the lack of corporate takeover experiences. The group issued some guidelines which entail that the purpose of takeover measures is to maintain and enhance corporate values as well as the interests of shareholders as a whole. Second, the introduction of guidelines should be accompanied by a clear indication of their purpose and contents and should reflect the reasonable will of the shareholder. Finally, the defense measures should not be excessive. Probably, the most notable change about hostile takeover is that the guidelines endorse the use of shareholder right plan (*poison pill*) as a defensive measure and also the guidelines endorse the advance shareholders approval of defensive measure. Needless to say, the above change in the takeover market in Japan was commensurate to larger extent with the American legal system and practices. Besides these changes, American-style board of directors with outside domination to get rid of traditional insider dominion board has been introduced. Other noteworthy reforms, including employee stock option remuneration system, have instigated in order to facilitate a shift towards more market oriented system. Furthermore, shareholders have been authorized with the power to sue against directors.

This implies that legal constraints toward a thriving market for corporate control in Japan are not very restrictive for takeover. Or, if there are any, the development is a very recent phenomenon which cannot explain why the market did not evolve paralleling to western economies. This leads us to look for informal institutions as constraints to an active market for corporate control in Japan.

Like the Anglo-Saxon countries, major portion of firm's financial needs in Japan is not met by individual

shareholders. It has a distinct feature of share ownership in the sense that financial institutions (mainly banks) and corporations comprise major shareowners of firms. Figure 2 shows the share ownership history of Japan. In 1990, financial institutions alone held 43% (in terms of market value) outstanding shares of firms listed in the Tokyo Stock Exchange (TSE). Aggregate shareholding by financial institutions and corporate investors was 73% (in terms of market value) which declined to 51% in 2010. However, the decline cannot be attributed to the rise of individual shareholdings but rather due to the emergence of foreign shareowners, which rose manifolds from 7% in 1985 to 27% in 2010. Individual shareholdings remained almost unchanged in the last few decades. For example, individuals owned 22.3% outstanding shares of Japanese firms in 1985, which declined to 20.3% in 2010. This scenario can be contrasted to that of the Anglo-Saxon countries where major shareholders are dispersed individuals (Suzuki, 2011). This implies that individual shareholders do not supply major portion of funds in Japan, but corporations and financial institutions provide substantial share of firm's financing needs through shareholdings.

The root of corporate shareholding can be traced back to the pre-war *Zaibatsu*-closely held family corporations-which consisted of different firms including banks, trading companies and manufacturing concerns. Major share of these *Zaibatsu* firms were held by a common holding company through head-office, which itself was controlled by a wealthy family (Flath, 2005). In the postwar period, the US occupation authority, after assuming administrative power, dissolved interlocking shareholdings. However, almost all of these former *Zaibatsu* firms were widely existed in Japan in the form know as *Keiretsu*, a well-established networks of horizontally linked firms. Moreover, the bond further tightened as a defensive measure, responding to a potential threat resulting from

a series of high-profile hostile takeovers raids, especially around 2000s (Morck *et al.*, 2000).

At the centre of every *Keiretsu*, there is a financial institution, particularly a bank. Banks play pivotal role as lenders by providing loans to firms and also by holding shares. Consequently, the shareholding bank has enormous latitude to influence the governance systems of a firm. A specific bank works as a *main bank*-a single bank that caters substantial financing needs of a client firms through lending money and holding shares. There is a tightly-knit relationship between the *main bank* and the client firm in the sense that the bank sends directors to represent in the client's board and also provides necessary information for proper management in the case of crisis of the client firms. The *main bank*, also, takes part in rescuing firms during their financial distress (Hoshi and Kashyap, 2001). Thus, information disclosure about the true performance of firms is concentrated on the *main banks'* requirements rather than on individual shareholders. The basic incentives for banks, on the other hand, is provided by the regulatory authority, specially ministry of finance, by creating rents for banks keeping deposit and lending rate below market level (Suzuki, 2011).

The system of *main bank* lending and *Keiretsu* share ownership has a great implication for corporate governance in Japan. The inter-firm network system is characterized by stable shareholdings in the sense that majority shareholders are believed not to sell shares of firms belonging to the network to third parties (Gerlach, 1992; Prowse, 1992). When traded, they are likely to be placed with a previous shareholder, usually a *Keiretsu* member. Gerlach (1992) shows that over 82% of the 10 largest shareholdings in Japanese firms remained stable over the period of 1980-1984, as compared to only 23% in his US sample. This figure remained relatively stable throughout the period of 1969-1986. Nitta (2009) shows that from 1987 to 1992 cross shareholdings were strengthening. Only the period of 1998 to 2004 has seen a relative decline in the status of cross shareholding, even though the magnitude was not substantial. However, since 2005 cross shareholding has been resurging among corporations in Japan. This *Keiretsu* group is believed to offer a host of important advantages to Japanese corporations. The close relationships among banks, shareholders and partners are considered potential source of competitive advantage, particularly in channeling the activities of corporate managers in the direction of long-term growth rather than short term profitability and/or share price increase (Jensen, 1989). In this scenario, stock price is unlikely to give a signal about the true performance of firms. Moreover, a prospective bid remains futile as long as stable shareholders do not move to sell their shares.

Likewise, human resource aspect of Japanese firms is also different from that of Anglo-Saxon countries. Management structure of firms in Japan is founded on some basic pillars. First, an employee's job is secured for a life time. It is an unwritten rule and its practice is observed by the fact that when fresh graduates are recruited they are not paid in commensurate with their performance. Initially, an employee has to accept regulated compensation package which is assumed much less than the market equilibrium. As they grow up with the firm, they are promoted to higher echelon, as well as paid lavishly regardless of their performance. Moreover, external or mid-level career market in Japan is absent compared to the Anglo-Saxon countries. These factors persuade employees to grow up with the firms instead of frequently switching their career to other firms. As a consequence, lifetime employment is a sensible outcome of the system. Secondly, even if Japanese corporate law does not give employees or their representatives any formal status as a constituent of the corporations, in practice it is held that employees are the most important stakeholders. Employee-sovereign corporations are justified on the ground that the contribution and the risk exposure of the core employees are greater than those of shareholders and that employees make a major long-term investment via the sonority-based wage and retirement allowance (Araki, 2005). These informal intuitions work as the basic foundations for the corporate governance and control in Japan, thus yielding very little room for market to flourish. The following section provides evidence supporting this argument by analyzing some cases.

INFORMALITY TRIUMPHS

The beginning-Koito manufacturing: The success in corporate takeover in USA particularly in the 1980s prompted some corporate raiders to venture for raids firms in a land outside the national boundaries, including Japan. One such raider was Mr. T. Boone Pickens who perplexed many Americans in the 1980s through his takeover bids for corporations like Gulf Oil, Diamond Shamrock and Phillips Petroleum. In the same fashion, he transfixed many Japanese by announcing an unsolicited bid to acquire Koito Manufacturing, with the help of a Japanese real estate speculator named Watanabe Kaitaro, in April 1989. Mr. Watanabe had previously attempted without success, though, to increase his stakes in Koito Manufacturing for a year and half. His failure led him to sell his holding in the company to Mr. Pickens who ended up with 20% stake in Koito. This was the first time that a US investor made an unsolicited investment in a Japanese firm.

Koito was not just like any other company in Japan. It was rather a *Keiretsu*, Japanese industrial

groupings or groups of companies, which enjoyed buyer-supplier relations with Toyota Motor Corporation. The idea of an American corporate raider acquiring an unsolicited affiliate of the notable Toyota Motors Corporation triggered a hostile nationalist backlash. In his first meeting with Koito management, Mr. Pickens asked for three seats on Koito's 20-member board by the right of his 20% stake in the company. His request was turned down on the ground of national security. It was argued that Koito supplied interior lighting components for aircrafts and thus, a foreign involvement at board level, in a sensitive firm like Koito, may render a threat to national security. Ironically, Koito rather offered a seat on its board to a Japanese shareholder, who held only a five percent stake in the firm. Mr. Pickens was disappointed by this action and therefore, sold his whole stake in Koito.

Some success stories: Corporate takeover market in Japan may seem not to be as restricted as it was during the raid of Mr. Pickens for Koito Manufacturing. Some success stories, in the case of hostile takeover, existed in this society as well. For example, the German pharmaceutical company Boehringer Ingelheim acquired 35.86% stake of SS Pharmaceuticals, a Japanese firm, through takeover bid in February 2000. This put the acquiring company in controlling position to the acquired firms. Prior to this, in May 1999, Cable and Wireless (C&W) Plc of the UK had managed to win a two months long bidding battle against Nippon Telegraph and Telecommunications (NTT) for International Digital Communications (IDC). C&W Plc's successful bid turned IDC into a subsidiary, in which the former owned 97.69% stake of IDC. This was considered a significant milestone towards corporate reform in Japan. In fact, C&W was not a true outsider rather it was a founding shareholder of IDC.

More stories about failure: The cases like the two success stories mentioned above can be considered sporadic rather than a common trend in Japan. The common trend is to avoid hostile takeover, sometimes sacrificing economic benefits. Oji Paper Company, for instance, launched a hostile takeover bid to acquire Hokuetsu Paper Mills in 2006. But Oji failed to acquire the target stake in the face of strong opposition from the target firm and its rivals. Before the bid, Oji Paper possessed 5.3% of Hokuetsu Paper Mills. In order to increase its share to Hokuetsu, Oji offered a bid with an approximately 35% premium. Hokuetsu, however, employed various tactics to avert the bid. It sought refuge in its local lenders-Hokuetsu Bank and Daishi Bank, which owned a total stake of 2% in the firm. The two declined to sell their stakes to Oji, but agreed to cooperate with Hokuetsu. Other prominent shareholders of Hokuetsu including Ebara Corp., Mitsubishi Paper Mills Ltd. and Nipponkoa Life Insurance Company also

did not like to make the capital gains from selling their shares at a premium price (premium is calculated as any excess of bid price over the market price of stocks). The most impressive tactic Hokuetsu employed was the sale of 24.4% stake at a discount price to Mitsubishi Corp. Hokuetsu issued 50 million new shares to Mitsubishi which effectively diluted Oji's relative stake in Hokuetsu and enabled it to avoid the hostile takeover. The stable shareholders in Hokuetsu like Mitsubishi, Ebara, etc., accounted for more than 40% in voting rights in the company. Oji gave up its takeover bid, upon realizing the difficulty in acquiring a controlling stake from the rest of Hokuetsu's dispersed shareholders.

In a similar case, Futata, a prominent Japanese menswear retailer, rejected an unsolicited bid in 2006 from Aoki, a retailer in the same business and accepted an offer for a merger with its largest shareholder, Konaka. Aoki's offer, involving a 75% premium failed to entice Futata's shareholders. In the same fashion, MAC's (commonly known as Murakami Fund, named after its founder Yoshiaki Murakami) unsolicited attempt to acquire Shoei Company turned into a futile attempt. Shoei Company was a typical creation of the old school consisting of the country's conservative business interests. This should explain MAC's failure to achieve 12.5% premium offer to the firm, in 2000. Shoei was an inefficient company and yet never received complaints about its poor performance from its stable shareholders, like Fuji Bank and Canon. Due to the fact that they belonged to the same *Keiretsu*, companies in the group considered shareholding as a way of cementing business ties with Shoei rather than an investment. Shoei's president was picked from Fuji, which was an indebted firm itself. Eventually, MAC's attempt to acquire Shoei failed largely due to opposition from conservative business interests.

The recent uproar, Livedoor-Fuji TV takeover battle: Probably the greatest uproar in the history of corporate takeover in Japan was closely witnessed during the Livedoor-Fuji TV contest for the acquisition of Nippon Broadcasting System (NBS) in 2005. Fuji TV was a subsidiary of NBS, which had 22.5% stake in Fuji TV and both of them are part of the Fujisankei Communications group. Before Livedoor's acquisition of NBS shares, MAC was the largest shareholder of NBS with 19.5% stake. In May 2004, MAC'S president Mr. Murakami announced that he would seek a seat on the board of NBS. The market capitalization of NBS and Fuji TV at that time valued at 180.4 and 642.2 billion yen, respectively. MAC proposed to turn parent company into a subsidiary to Fuji TV or to integrate the management of both in order to create a joint holding company. Besides resisting this proposal, the management of Fuji TV acquired shares of NBS aiming to raise its stake from 0.03 to 12.4%. MAC still

remained the largest shareholder of NBS. With a view to erode MAC's dominance in NBS, Fuji TV had launched a tender offer to buy shares targeting to increase its stake to 50.12 in NBS.

While the Fuji TV tender offer was still valid, Livedoor launched a bid to acquire NBS. On February 7, 2005 Livedoor purchased 5.4% stake from the open market. In the next day, the bidder purchased another 29.6% of the firm's total shares through 'off-hours deals on Tostnet (a system for trading shares outside the normal working hours). The stakes Livedoor purchased accounted for 45% in terms of voting rights to NBS. Livedoor entered into a contract with Lehman Brothers Holdings Inc. to finance its activities. As per the contract, Lehman Brothers issued convertible bonds worth US \$700 million of Livedoor that enabled it to acquire the necessary stakes in NBS within a few minutes. This stake was particularly significant because of the fact that it entitled Livedoor to have a veto power concerning any special resolutions at a general shareholders meeting.

The bid, undoubtedly, rocked Fuji TV management that believed that by acquiring NBS Livedoor would end up being one of the nation's largest media production companies as it would control majority shares in Fuji TV through NBS. For avoiding this threat, Fuji TV extended the time for tender offer lowering the target stake to be acquired from 50.12% to 25.06%. According to the Commercial Code of Japan prevailed at that time, if the subsidiary can hold minimum 25% stake of parent company, the latter is prohibited from exercising voting rights in the former. Thus, through acquiring 25.06% stake in NBS, Fuji TV wanted to put the cap on Livedoor's ability to hold the upper hand in decision making that particularly affects Fuji TV.

Meanwhile, Livedoor accumulated 40.5% voting right in NBS and thereby, accomplished a rare Japanese hostile takeover. In order to dilute Livedoor's stake, NBS issued sole stock warrants for 47.2 million new shares to Fuji TV for a total of 280 billion yen. If exercised, Fuji TV's stake in NBS would increase to 66% while reducing Livedoor's stake to 15%. However, there were several problems with this warrant issue. First, if Fuji TV exercises the warrant, it would exceed the maximum limit of top ten Shareholders can hold (75%) according to Security and Exchange Commission listing standard. Second, offering a bulk amount of stock warrant to a single shareholder below the market price is a clear violation of principal of equal treatment to all shareholders. On February 24, 2005 Livedoor sued against the warrant claiming that it was illegal because NBS had no clear purpose to use of the money. Tokyo District Court imposed an injunction against the warrant, which was also upheld by the Tokyo High Court.

For rescuing Fuji TV from Livedoor's grasp, stable shareholders stepped forward and sold their shares

responding to Fuji TV's ongoing tender offer. Shareholders including Daiwa Securities, Kodansha Ltd., Tokyo Electric Power Company, Kansai Electric Power Co., Mitsubishi Electric Corp. and many others granted a stake of 25% in NBS to Fuji TV. As a consequence, Fuji TV accumulated its voting right to NBS more than 33%, when tender offer ended. Furthermore, NBS decided to sell core assets such as 56% shareholding in Pony Canyon Inc. to Fuji TV. Selling most valuable assets to friendly firms is called *crown jewel* which is a defense technique against prospective takeover. Surely, this decision stirred up Livedoor that sent a letter to the directors of NBS requesting them to retain key assets of the company otherwise it would be forced to recourse to court for shareholder suit.

On March 26, 2005, Livedoor announced that its stake in NBS reached equivalent to 50% in terms of voting rights. In this circumstance, it was believed by the Fuji TV management that it would target Fuji TV next. Fuji TV thus, resorted to various anti, takeover measures. For instance, Softbank Corp., a Livedoor rival, agreed to rescue Fuji TV. As per the agreement, NBS offered to lend its 13.88% of Fuji TV voting rights to Softbank for five years stock loan agreement. This would increase Softbank's total voting rights in Fuji TV to 14.67%. NBS temporarily succeeded in transferring a bulk of its Fuji TV shares to a safe heaven through this arrangement. It then loaned the rest of its Fuji TV shares-about 9.12% voting rights-to Daiwa Securities SMBC Co. to avert Livedoor's hostile takeover attempt. The two months long battle between Livedoor and Fuji TV over NBS takeover finally ended with an arrangement, where Fuji TV purchased the whole of Livedoor's 50% stake (in terms of voting rights) in NBS along with 12.75% of Livedoor's original shares for 44 billion yen. This made Fuji TV the second largest shareholder in Livedoor after Mr. Takafumi Horie (the founder president of Livedoor). In September 2006, NBS became a wholly-owned subsidiary of Fuji TV.

Livedoor-Fuji TV battle over NBS has profound implications for Japanese corporate governance in general and takeover markets in particular. Livedoor was victorious in the stock warrant case as the courts ruled in its favor. The victory was undoubtedly temporary. Livedoor did not do much to correct the negative sentiments it has created in the minds of typical corporate leaders by inviting them into an unfriendly game like hostile takeover, which are still considered alchemic in Japan. As a result, Livedoor was likely to receive its due retribution. Prosecutors and Security and Exchange Commission (SEC) officials publicly raided the company's head office on the pretext that it misled investors by disclosing wrong information in order to inflate share price of one of its subsidiaries, Livedoor Marketing Co. The investigation

was followed by the arrest of Livedoor's CEO on charges of account fabrication and finally the firm was delisted from the bourse. Corporate analysts and scholars consider it an irony that the target firm survives whereas the acquirer turns into a history of time.

CONCLUSION

The market for corporate control is one of the mechanisms by which corporate governance can be ensured. However, evolution of the system depends on national and cultural constructs of a country. Japanese corporate governance can best be understood as a system that places employees as the central stakeholder rather than putting much emphasis on shareholders' value maximization proposition. Since most successful takeover is accompanied by restructuring of companies, particularly downsizing the workforce, Japanese corporations rather choose not to hurt the employees. The system thus aims to balance the interest of three stakeholders- shareholders, management and employees-to achieve corporate objectives. Moreover, takeover initiatives require not only a developed capital market but also a diversified base of investors. Traditionally, corporate financial need in Japan is not satisfied significantly by the capital market, which is still underdeveloped compared to its western counterparts. Banks provide loans and hold shares of corporations, thus have great influences on their governance. As a result, monitoring activities are undertaken by banks, because they are the largest providers of funds. This tradition has paved the way for the evolution of the 'bank-firm nexus' or in the academic parlance 'main bank' system by which a lead bank lends major portion of a particular firm's total outside finance.

This tradition has an important bearing on the takeover market in Japan. Firstly, a strong tie between firms and banks coupled with reciprocal shareholding weakens the push for corporate information disclosure to outsiders. As such, market price of stock is not believed to absorb true performance of the firm, as it is the case in market-based financial systems. This creates a problem for prospective acquirers to target an undervalued firm. Secondly, banks are lenders and at the same time shareholders. Large stockholding of banks facilitates to establish a long-term partnership with firms. In this sense, trust and reputation have been transformed into a kind of self-regulating governance mechanism that attracts considerable attention for engaging in transactions. Corporate 'herd-behavior' is the safe game for players, because, any detour from the crowd might yield severe penalties.

Evidence supporting the above arguments is provided by presenting some cases relating to corporate takeover in Japan. A careful examination of these cases

shows that shareholders particularly long term and stable shareholders are not interested to materialize capital gain by selling shares to third parties, especially to prospective acquirers. Furthermore, firms belonging to the same *Keiretsu* assume the responsibility to rescue any group firms from the target of hostile takeover. These are the norms and practice of the society, which are embedded to culture. Moreover, these institutions have evolved as self-governing institutions and thereby filled the vacuum of formal institutions. From this vantage point, the research has argued that informal intuitions including trust, norms, values and traditions have contributed much towards the development of what we call Japanese model of corporate governance. Despite that they are informal by nature, very few dare not to comply with them, because breaking the trust invites serious punishment. Therefore, market participants try to shun away from the so-called 'hostility' ensued from hostile takeovers. As a consequence, the rarity of an active market for corporate control is the corollary of the system.

However, some questions remain unanswered in this research. Does an absence of hostile takeover market cost to the existing shareholders too much due to managerial inefficiency? Is there any direct link between hostile takeover and the development of capital market? Can these informal institutions reduce transaction costs involved with formal institutions in the form of enacting and enforcing of laws? These are the issues we like to tackle in our future research.

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