How Two Young Japanese Internet Companies Are Shaking Up Corporate Governance in Japan

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Two upstart Internet companies that each waged hostile takeover bids for much larger established media companies may have permanently jolted Japan, Inc. into a new era of shareholder activism.

The takeover war -- launched by Livedoor Co. for Nippon Broadcasting System and its partner, Fuji TV, followed by Rakuten Inc.'s pursuit of Tokyo Broadcasting System -- were the hottest topics in Tokyo business news this year. In the end, both challengers enjoyed only limited success, but Livedoor and Rakuten will have a long-term impact on the corporate structure of Japan by emboldening other shareholders to take a more active role in corporate governance, according to Wharton faculty.

"The Livedoor-Fuji takeover battle was an extremely interesting watershed event for corporate governance in Japan," says Wharton finance professor Ayako Yasuda. "Even though it ultimately failed, more attempts are coming."

Livedoor flamboyant chief executive, Takafumi Horie, rattled corporate Japan in March when he attacked Nippon Broadcasting System, the radio division of Fujisankei Communications. The group also owns the nation's largest television broadcaster, Fuji TV, through cross-shareholding. Livedoor's true target was Fuji TV, but after NBS was able to block the takeover bid, Livedoor proposed an amiable settlement. The companies agreed to create a joint committee to consider ways the two firms could integrate some of their businesses. The negotiations so far have failed to produce concrete proposals.

In October, Rakuten, Japan's second-largest Internet portal beyond Yahoo Japan Corp., announced it had purchased 15% of Tokyo Broadcasting, the nation's third largest television network. Rakuten later increased that share to 19% and demanded merger talks. At the end of November, both companies signed a peace pact in which Rakuten promised not to exercise voting rights on its stock in return for negotiations about possible business tie-ups. The agreement points to three potential areas: e-commerce, attracting customers to the web portal and online distribution of televisions programs.

While the two bold takeover moves fell short of total victory and ended in face-saving committee negotiations, the battles are expected to have a lasting effect in new rules that will improve corporate governance in Japan, says Yasuda, adding that the Japanese government is currently working on creating information disclosure rules about defensive anti-takeover measures. "Right now, it is a bit of a no-man's land in Japan, where neither acquiring firms nor target firms need to disclose their intent and strategic plans to shareholders," Yasuda notes.

Meanwhile, she points out, merger and acquisition transaction volumes in Japan are soaring. Deals totaling $171 billion were recorded in October, up 84% over the same period a year earlier, or about 20% of the volume in North America.

Radical Change in the Investment World

According to Jennifer Amyx, a political science professor at the University of Pennsylvania, while Japanese banks and other corporations have undergone restructuring with foreign investment, the Livedoor and Rakuten bids are significant because they were takeover attempts led from within Japan. "There is a shift underway in Japan about the role of shareholders and the importance of getting return on equity," says Amyx. "These are actors within Japan. I think one of the beneficial outcomes is a heightened awareness on the part of CEOs, investors and employees of the radical changes that are occurring in the Japanese investment environment."

Japan's Pension Fund Association voted against 25% of all proposals at shareholders' meetings in the past year. "That is unusual for Japanese institutions," adds Amyx, who is also a member of The Graduate Group in International Studies at Wharton's Lauder Institute. "Historically, they were just stable shareholders." This pattern is rooted in the Japanese tradition of cross-shareholding, in which firms own shares in each other, and vote to back up management at each company if one or the other is ever challenged. "The role of the shareholder was not the kind of corporate governance role that it was in the West."

As a result of the nation's long economic slump, that may be changing. According to *The Economist,* 46% of all listed Japanese equities were held as cross-shareholdings by related companies in 1992. By 2004, cross-shareholdings had dropped to 24%. During the same period, equities held by foreigners rose from 6% to 22%. "There is an unwinding of the cross-shareholdings, and shares are being distributed in a different way," says Amyx. "You have more and more shareholders actively looking for returns as opposed to cementing relationships, which was a key function in the past. It was, 'You hold my shares and I hold yours.' That way you were protected from any intrusion on management."

These changes were not prompted by any official decrees or legislation such as the banking and financial institution deregulation -- known as the Big Bang -- that has been underway since 1996. The motivation for this change, says Amyx, is the depth and length of Japan's financial crisis. "Up until the post-bubble period, companies had main banks that stepped in during hard times with long-term relationships. But the nature and the size and scale of the problems many Japanese firms faced after the bubble were far beyond what a main bank could deal with on its own. They required dramatic restructuring which went beyond just restructuring debt."

Amyx says it is something of a coincidence that Livedoor and Rakuten, the most visible of a new breed of Japanese corporations willing to shake up traditional corporate patterns, are both Internet firms. "It's probably not, however, a coincidence that these are newer companies. I think you see in Japan a tension between old and new. You don't have that history of cross-shareholding [with the new]. They don't have the legacies that weigh them down. They come in with a different mindset."

Older, more established companies, Amyx says, have trouble adjusting to the current ways of doing business, although some of them are beginning to change under duress. She points to Nissan, which underwent a dramatic restructuring under the direction of French investors, as an example.

Yasuhiro Matsumoto, an analyst with BNP Paribas Securities in Tokyo, also says Livedoor and Rakuten differ from typical Japanese companies. Most notably, they are both are run by forceful individuals, Horie at Livedoor and Hiroshi Mikitani at Rakuten, who are able to dictate strategy for the entire firm. Managers at typical Japanese firms, says Matsumoto, seek consensus throughout the firm before taking action.

"They are restless," says Matsumoto of Horie and Mikitani, who are both founders of their firms. "They have no time to waste and they are very much trying to accelerate their corporate growth by aggressively acquiring companies rather than depending on internal growth. Unfortunately, the old establishments

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cannot cope with the rapidly evolving Internet businesses."

The two companies share a primary strategy: acquiring Internet-related and financial companies by tapping capital markets to finance acquisitions through new share offerings. So far, according to Matsumoto, the companies' Internet businesses, including online share trading, are making money. "They should be innovative and quickly grow; otherwise, large established corporations will be able to catch up with them."

He predicts Livedoor and Rakuten will be successful over the next few years, but if they are to continue to grow beyond that, they will need to develop deeper management strength. "As far as they remain marginal players in corporate Japan, such individuals will be able to manage the whole organization. But once they become a major player, they need to have a well-established system to run a large company like the old establishments. And they will be tested then."

Wharton finance professor Franklin Allen notes that both firms' takeover battles appear to have ended in the kind of compromise that plays into the traditional Japanese business culture that values consensus. "What happened in the end is they wound up with a typical Japanese compromise. Everybody was surprised the way it ended."

Both Internet companies learned a lot about high-level corporate gamesmanship, Amyx says, adding that they did not come to the table with solid deals that shareholders in the United States, or anywhere else, would have instantly approved.

She notes that Livedoor's Horie ran for a seat in the Diet this year. He lost, but did well enough to suggest that he is not likely to fade from the national scene soon. And, despite their disruptive behavior and eventual compromise, both companies are viewed positively in Japan. "Livedoor and Rakuten are not seen as pariahs. They are admired by many," says Amyx. "Some people are irritated by them, but they are not going to disappear."

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