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Japanese Firms Raise Value through Cross-border M&As

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Within the context of globalization, Japanese corporations have also come to play an important role in global industry reorganization. Just in 2006, there was a succession of major acquisitions including Westinghouse by Toshiba, Pilkington by Nippon Sheet Glass Co. and the Gallaher Group by Japan Tobacco. Cross-border M&As (corporate mergers and acquisitions) by Japanese companies bring the third boom after the bubble economy and IT (information technology) bubble.

However, the image is engraved in our minds that M&As by Japanese companies thus far represent a history of failures. The acquisition of U.S. cinema companies by Sony and Matsushita Electric Industrial and the acquisition of Rockefeller Center by Mitsubishi Estate Co. in the 1980s can be cited as examples. During the period of the IT boom, NTT DoCoMo and others posted massive losses through capital injections in telecommunications companies overseas.

The question remains of whether or not overseas M&As have raised the corporate value of Japanese companies and have had a positive effect on national economy. If there has been a positive effect, what are the factors involved?

The author gauged the excess stock returns of the acquirers at the time of the announcement of cross-border M&As for 438 samples (manufacturing: 329, non-manufacturing excluding financial and trading companies; 109), which are worth 3 billion yen or more during the period of 1988-2005¹. Theoretically, stock prices are determined by total discounted cash flow anticipated in future years. If market is assumed to be efficient, a rise in the stock price due to such announcement reflects the increase in corporate value expected as a result of the M&A².

Positive effect on stock price

The average of 2-day cumulative abnormal returns (CARs), consisting of the day of

¹ Recof Corp. is the source of M&A data. For detailed content, refer to *Research Report on M&A Study* (March, 2007, in Japanese), Chapter 7 of "M&As and Company Management Research Report" of the Japan Center for Economic Research.

² See Healy, Paul M., Palepu, Krishna G., and Ruback, Richard S., 1990, "Does Corporate Performance Improve after Mergers?" NBER Working Paper No. 3348, May 1990.

the announcement and the following day, derived by subtracting the rate of return of the Tokyo Stock Exchange stock price index from the stock returns of the acquiring companies, is 0.47%, which is statistically significant. The overseas M&As of Japanese companies overall created value. The average of 3-day CARs, from the day prior to the announcement through the day following the announcement, increases to 0.72%.

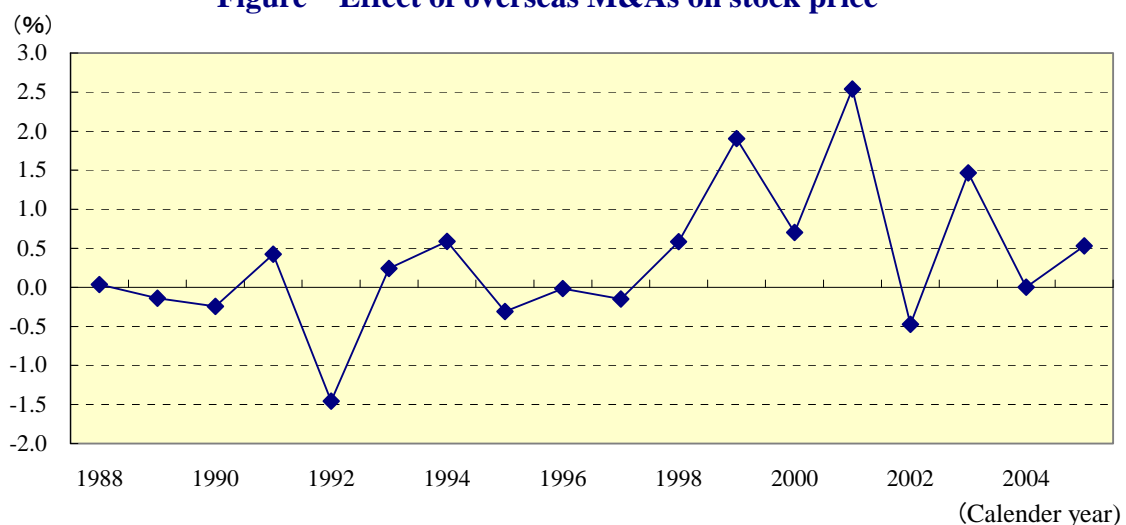
According to studies in the U.S. and Europe, stock prices of the companies targeted for M&As increase by 30-50% while stock prices of the acquiring companies often do not rise at all. In the case of domestic M&As in Japan, however, a positive effect on the acquiring companies has also been confirmed, lending weight to the possibility of a similar tendency in the case of cross-border M&As.

Divided between manufacturing and non-manufacturing industries, the average of 2-day CARs of manufacturing samples is 0.42% (statistically significant). For non-manufacturing samples, the average was 0.60% but not statistically significant. For non-manufacturing samples, the average abnormal return is positive on the announcement day while negative in the two days after, offsetting the positive effect.

The above represents the CARs as simple average results. If we multiply the CARs by market capitalization 20 business days before the announcement and calculate the changes in capitalization per company, we see that, while manufacturing samples record plus 580 million yen in two days (plus 3.09 billion yen in three days), non-manufacturing samples record minus 18.74 billion yen (minus 19.25 billion yen in three days). That is due in part to the exclusion of financial and trading companies from the sample and the weight of the NTT Group is substantially high, dragging the figures down into the minus range.

The below figure shows the movement in the 2-day CARs of manufacturing during the period 1988-2005. The average of the CARs during the first half, 1988-95, was -0.15% and, during the latter half, 1996-2005, it was +0.82%, which is statistically significant. Thus, cross-border M&As are likely to have created corporate value during 1996-2005.

Figure Effect of overseas M&As on stock price



Note: Transitions in CARs on the day of announcement and following day, manufacturing firm samples

Source: Prepared by the author based on Recof Corp., NEEDS Financial Quest

Success through an emphasis on synergy

What are the reasons? The first factor that can be cited is the regional diversification of the target companies. During 1988-1995, which includes the period of the bubble economy, North America accounted for 71% of the total. In the U.S., where market efficiency is high, competition is also intense. It is seldom possible to make “bargain purchases” and, as a result, it seems difficult to generate excess returns. During 1996-2005, however, the share of North America declined to 41% and there was diversification to Europe with 30% and Asia with 23%.

Secondly, viewed in terms of whether M&As consisted of the acquisitions of the entire company or the transfer of the business operations of sectors, the ratio of business transfers rose from 15% to 21% and, moreover, there was also a broad improvement in excess returns during 1996-2005. Meanwhile, CARs in case of the acquisitions of the entire company stay below the overall average. The doubling of the number of M&As acquiring the operations with strategic significance seems to have uplifted the corporate value.

Thirdly, when dividing acquisitions into three categories according to their purposes, focusing on the core business, developing the related business operations and diversifying business portfolios, the ratio of core business focusing rose from 60% to 74%. This reveals an increase in companies aiming to achieve synergy effects. The broad increase in CARs due to the reinforcement of the core business indicates that the strategy of enhancing the synergies of the companies were strongly endorsed by investors, leading to an improvement in corporate value.

The cross-border M&As of Japanese companies at least in manufacturing industries seems to have been moving toward the enhancement of corporate value since mid-1990s. Cross-border M&As are strategically important for Japanese companies as they promote globalization. It will not be possible to avoid the criticism of being one-sided if we react squeamishly to M&As by foreign capital targeting Japanese companies and make vain attempts to eliminate them.

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