Chapter 1

Introduction

The book is about Japan's Banking and Finance with special emphasis on current business and legal issues.

The Commercial Code was transplanted from Germany to Japan in 1899 as a part of the general acceptance of Western law in the Meiji period. The post-war corporate laws in Japan were modeled after those in the United States. For example, the Securities Exchange Law of Japan enacted in 1948 was based upon the laws of 1933 and 1934 in the United States and was imposed by the occupation authorities as a condition for the reopening of the securities exchanges. This Japanese law contained disclosure provisions substantially similar to the requirements of the American law. Germany is a civil law country, while the United States is a country of the common law. Any confusion in the legal concepts in Japan may be attributed to the slight difference in the rules and practices of the two source countries.

The basic assumption of occupation authorities in suggesting the new corporate practice and legislation appears to have been that what worked well in the United States would also work in Japan. No question was raised as to the congeniality of the environment into which the new legislation was being transplanted. If transplanted control methods and corporate practices of Anglo-American origin should not be well adapted to Japanese procedures, then Japanese economy and markets would be prevented from performing their functions as efficiently as required.

On this basis material revisions of laws have been made since then in order to improve and enhance the financial system focusing on its market

functions. Many changes were also made to accommodate new trends occurring in the markets.

About 55 years have passed since the end of World War II and it is now appropriate to evaluate the efficacy of the transplanted systems, practices and laws from the US. The hypothesis established by the occupation authorities at that time is tested in various areas in light of the congeniality of the Japanese environment into which the American system was transplanted. You will see them all in the following chapters.

Chapter 2 is an introduction to Tokyo as the international market. A current subject of debate in the international business world is whether the Tokyo international capital market has what it takes to emerge as a leader in the world's capital market. This article attempts to evaluate whether the Tokyo international capital market can play a major role in the realm of international finance and what it must do to get there. The historical development and relevant laws and regulations governing the operation of this market are discussed.

There are many problems to be resolved. First and foremost is the internationalization of the yen. Secondly, concomitant with the internationalization of the yen is the further internationalization of the Tokyo market as an intermediary in the money supply field. This highlights the disclosure problem. Because of the uniqueness of Japanese accounting standards and the emergence of the International Financial Reporting Standards (IFRS), three different types of disclosures have been created in the Japanese market: (1) those based on the Japanese accounting standards; (2) those based on accounting standards of foreign countries; and (3) those based on the IFRS. As a result, questions arise: How should Japanese authorities handle disclosures? Should all three standards be accepted as legitimate? What are the conditions of acceptance?

Chapter 3 describes Japan's big bang reform. Although ten years have passed since the bubble economy burst, and ¥7.2 trillion in public funds were poured into most of the Japanese banks in 1999 in order to beef up their net worth capital, the profit figures of 131 major banks in 2003 did not show signs of the financial market's complete recovery from the

damage incurred by the bursting of the bubble economy. In 1996, ¥685 billion of tax money was used to liquidate the special housing loan companies (Jusen) that were burdened by enormous debts. At that time, it looked as though that would settle the banks' bad debts, but it turned out that it was only the start.

The August 1995 annual report of the International Monetary Fund (IMF) criticized Japan's Banking Policy Administration for failing to take effective measures against the deterioration of its banking system. The Board asked Japan to take speedy action to correct problematic banks. The report also stated that the market mechanisms that are supposed to help depositors and investors select banks are not working due to the insufficient disclosure about the operating information of banks, and that it is necessary to establish a clear-cut rule specifying how the necessary funds for cleaning up the bad debts of problem banks, including public funds, are to be born by the stakeholders.

In August 1999, it was revealed that the net asset deficiency of the Long Term Credit Bank of Japan, Ltd. (LTCB) at term's end (March 31, 1999) was ¥2.78 trillion. The report also pointed out that the government of Japan established the Financial Revitalization Law to pave the way for nationalization of an asset deficient bank and subsequent transfer of its business to other banks. On September 28, 1999, the Financial Reconstruction Commission (FRC) decided to transfer LTCB to "partners" led by Ripple Wood Holdings, L.L.C. of the United States. A sum of almost ¥4 trillion of public funds was poured into the bank to cover its bad loans, including its secondary losses.

Upon the announcement of the examination results of 19 major banks by the Financial Services Agency (FSA), and immediately after the enactment of the Financial Revitalization Law, the Nippon Credit Bank, Ltd. (NCB) was suddenly nationalized by the FSA on the grounds that the bank was net asset deficient. It is important to note that the net worth ratios of LTCB and NCB were published at 10% and 8% respectively.

As a result, criticisms against Japanese banks, such as claims that they were not disclosing their operations accurately, were heard all over the world. Japan's economy is the second largest in the world, next to that of the United States, and its financial and banking market is one of the major markets in the world. International interest in the Japanese

market and economy is ever-increasing. But Japanese corporate behavior and practice have raised a number of issues. One of the major issues involves Japan's accounting and reporting systems. This article investigates the methods of processing bad loans and the disclosures practiced by Japanese banks. It also studies the legal requirements and accounting standards behind them. It seems that there are systems, as well as rules and regulations, unique to Japan that are substantially dissociated from international standards. On October 17, 1996, the Economic Council, an advisory organization the Prime Minister, to presented a report including a restructuring plan entitled "For the Revitalization of the Financial System of Our Country." The restructuring plan was based on the recognition of the severe crises: while reformation of financial sector is moving at accelerated rates in the United States and European countries, as well as some Asian countries, the move toward reformation of the financial system in Japan is still very slow; Japan is clearly lagging behind in the competition among global markets and systems; and its position in the world financial system and industry is deteriorating relative to those countries. The report stated, "In order to overcome this relative deterioration of our position and make it possible for the users to benefit from more efficient and better financial services, it is necessary for the government to get rid of the excessively protective attitude toward the financial institutions and the traditional convoy system provided under the guidance of the Ministry of Finance; in particular, it is necessary to implement various policies geared toward building a system designed for the benefits of the users, which is based on the market mechanism and the principle of their own risks. It is not enough for the new financial system to be sound and stable; it must be also efficient and revolutionary."

It also stated, "Therefore, the reform must not be gradual or phased; it must be done in one big stroke; the quicker, the better, if Japan is to compete with various countries of the world and it should be done by the end of 1999 in one big change, in the manner of a Big Bang."

This proposal should be given proper consideration because it seeks the reform within a defined time limit, it was not drafted in coordination with any of the related ministries and agencies, and it put forth a clear image of how the Japanese financial system should be in the future. One

noteworthy factor is that it emphasizes the importance of mandating liberalization in order to allow the competition principle to operate and minimizes the use of administrative discretion by specifying by law all the regulative items as exceptions.

The outline of this reform plan is as follows:

Realization of Broader Competition

In order to facilitate the entry of not only the financial institutions but also non-financial institutions into the financial market from the standpoint of promoting competition among financial institutions, all entry restrictions and limitations related to the types of businesses and methods used, as well as approval or permit procedures, will be abolished.

Liberalization of Asset Transactions

In order to improve the functions of the capital market, it is necessary to liberalize the commissions for selling and buying securities, completely revamp the securities taxation system, which include abolishing the securities transaction tax, to liberalize further transactions outside the regular stock exchange, to promote the introduction of new financial technologies, to reform the markets for issuing and trading corporate bonds, and to introduce the stock option system.

Reevaluation of Regulating and Monitoring System

It is mandatory for the Japanese financial system to overhaul its system of regulation and administration in order to survive in the international "inter-system competition." Therefore, it is necessary to refurbish the system's foundation concerning the handling of failing financial institutions, change the administrative practices from the ones in the past which relied heavily on the individual administrator's discretion and were heavily protective of the financial institutions to one based on established rules honoring the market function, and enforce the policy of competition in the financial businesses.

Chapter 4 describes bad loans of Japanese banks. In this chapter, three subjects are discussed on bad loans in Japan. Part One is for "Bad

Loans: A Comparative Study of US and Japanese Regulations Concerning Loan Loss Reserves", Part Two is for "Bank Director's Decisions on Bad Loans: A Comparative Study of US and Japanese Standards of Required Care" and Part Three is for "Case Study of the Long Term Credit Bank of Japan."

Japan's banking policy administration is in the midst of criticism, accused of failing to take effective measures against the deterioration of its banking system. Claims that Japanese banks were not disclosing their operations accurately were heard all over the world.

According to the current accounting rule in Japan and by request of the United States, financial statements of some Japanese corporations written in English must have notations or legends that verify that the statement was prepared in accordance with the Japanese Securities Exchange Law and accounting standard, and not under the accounting standards of any other country. What this means is that the Japanese accounting process is no longer trusted internationally.

This article investigates the methods of processing bad loans and disclosures practiced by Japanese banks. It also studies the legal requirements and accounting standards behind them. The recent bankruptcy case (The Long-term Credit Bank) is closely examined. It seems that there are systems as well as rules and regulations unique to Japan that are substantially dissociated from international standards. In this article, the author compares the differing US and Japanese legal regulations and business practices.

Based on this analysis, the author concludes that it is important for Japan to appropriate the necessary minimum reserves against loan losses through more stringent evaluations of bad loan risks and that Japanese banks must improve their shortcomings to regain their international credibility. He points out that various rules and regulations concerning loan loss reserves in Japan significantly lag behind those of the United States. According to the author, identifying the true status of bad loans and determining how to deal with them can only be accomplished by a thorough examination of the accounting standards in their entirety.

As a result of the extensive failures of financial institutions that have occurred since 1995 in Japan, legal action against previous bank directors is expected to increase in the future. The question is, what

should be the duty of care for a bank director, and in particular, what should be the court standard for determining if the duty of care has been breached by the director. This article examines the laws related to bank directors' responsibilities and discusses some Japanese court cases. The differences in legal systems and the court rulings in Japan and the United States also are compared.

During the second half of the 20th century, the banking business in Japan was under the so-called Convoy System by the Ministry of Finance (MOF). During that time not a single bank failed, which created the myth that "financial institutions never go under." Japan's financial institutions have gone through drastic changes as a result of the fundamental changes in the financial market including the financial relaxation after the "Japanese Financial Big Bang" and the deflation after the "Bubble" burst. In today's environment financial institutions are expected to be managed with tighter controls based on the directors' own responsibilities.

Due to the rampant failures of financial institutions that occurred since 1995 when the Bubble Economy collapsed, the Resolution and Collection Corporation (RCC) was created by the Deposit Insurance Corporation of Japan, a government organization, as the major shareholder in order to expedite the cleanup of defaulted loans. The RCC's responsibilities include:

1. Receiving the defaulted financial institutions' assets and collecting them;
2. Reestablishing bankrupt corporations; and
3. Pursuing the directors involved in the defaulted financial institutions for violating their duties of care.

So far the RCC has received the assets of 172 defaulted financial institutions and has taken 122 legal actions against 86 defaulted financial institutions seeking damages for violations of the duty of care. The issue in each of these legal actions is whether the loan execution judgments of the previous management team constituted violations of the duty of care for directors under the Commercial Code.

Actions against the previous directors are expected to increase in the future. The question is: What is the duty of care for a director of a bank

and, in particular, what should be the criterion for a court in determining whether or not a director of a financial institution has violated that duty. This article discusses the direction Japan should take in the future by examining the Japanese laws related to bank directors' responsibilities and some actual cases in Japan, referencing the bank directors' responsibilities in the United States as well.

The fact that so many questionable loans were made by Japanese banks suggests a strong possibility that the Japanese standard for violations of bankers' duty of care is far too lenient as compared to that of the United States, which has overcome its own bad loan problem. The following analysis is based on the hypothesis that the lenient duty of care standard is the main cause of the large number of bad loans in Japan. Thus the comparison of the legal systems and the court judgments of Japan and the United States is appropriate. Also, this analysis is significant because the GDP of Japan is the second largest in the world and Japanese banks are receiving large sums of money from around the world to operate funds internationally. How the directors of these Japanese banks are operating and whether they are paying full attention to their duty of care should be a matter of grave concern to the international banking world. The total amount of overseas funds Japanese banks have taken in (liabilities) as $523 billion, while the total amount of funds they have discharged (claimable assets) is $564 billion as of June 2004. The reason that such large amounts of funds are flowing into Japanese banks is because foreign lenders trust Japanese banks. However, it is doubtful if those same lenders would continue to trust Japanese banks if they knew that the standard of duty of care required of Japanese Bank Directors is much lower than those required of bank directors in the United States.

Chapter 5 examines disclosure issues in Japan. Part One is for "A Comparative Study of US and Japanese Bank Directors' Duty of Disclosure" and Part Two is for "Case of Seibu Group — Recent Problems on Japanese Corporate Disclosure System."

As a publicly-held company, a bank is required to make timely and appropriate disclosures of corporate information to the public, including investors. In this article, the author studies what a Japanese bank is

required to disclose in regard to its important management information including bad debts in terms of its timing and contents under the Japanese Commercial Law, Securities Exchange Law, Banking Law, and Financial Revitalization Law. After explaining comparable obligations under US law, the author suggests changes to the Japanese policies. It is important to better understand how Japanese banks operate and their required disclosure, if US banks are to compete with their Japanese counterparts, the second largest GDP country in the world. This advance knowledge is critical not only for US investors in Japanese banks but also for US institutional investors involved in transactions with Japanese banks.

The code of ethics of the Japanese Banking Association defines the importance of disclosure by its member banks as follows:

A bank, in consideration of its social responsibility and public mission, is required to obtain broad understanding and trust from the society, in particular, from its shareholders and investors. Fair disclosure of management information for being selected and judged by the market and users should contribute to not only the promotion of the society's understanding of and trust on the bank but also to its own self-cleaning capability in order to achieve healthier management. Such management information disclosures should be geared toward timely and appropriate provisions of various types of information required for rational judgments by shareholders, investor, and users.

Generally speaking, it is not a desirable thing for a bank to disclose all corporate information. It is analogous to individuals disclosing their bookkeeping information, the amount of money they carry in their wallets or the amount of their pay check. However, if we consider that a bank is constantly involved in financial activities on a large scale, we can easily understand why those who are on the opposite side of those deals want such disclosures. It is also not difficult to understand that a bank wants to disclose positive information but negative information as well, because the latter will probably benefit the bank in the long run. Persons on the other side of a bank transaction who want information about the bank include:

1. the "government agency" who is to control the bank's operation;

2. the "auditor" of a company who is to monitor the bank's operation;
3. the shareholder (Incidentally, the shareholder wants such information not necessarily for its desire to participate in the management of the bank but rather for judging the optimum timing for trading the bank's shares.); and
4. the bank's "transaction partner."

The transaction partner wants information in order to decide whether to participate in a deal with the bank or what to do with a deal already in existence. Such information is important for the bank's creditors and the bank's customers (depositors).

However, it is not unusual for a bank to be unwilling to disclose information voluntarily or to want to disclose only beneficial information. Various laws and regulations are set up to prevent banks from controlling information disclosure to their advantage, and those laws and regulations specify the types of information to be disclosed and who should receive them.

For Part Two, the recent Seibu Scandal is introduced as a Japanese disclosure case study. The Seibu case in Japan, has given the investors of the world some reason to doubt the Japanese disclosure system. Seibu, one of the leading Japanese listed companies, had disclosed incorrect information as to its shareholdings by affiliated companies for some 40 years. It is considered to be the Japanese "Enron" Case, as the scandal sent a large shockwave through the Japanese business community and the international investors to Japan.

Yoshiaki Tsutsumi, the former chairman of the board of Kokudo Corp., who led the Seibu Group as the owner in a practical sense, was arrested by the Tokyo District Public Prosecutors Office on March 3, 2005, and subsequently indicted by the same on March 24, 2005, on a charge of violations of the Security Exchange Law concerning the stocks of Seibu Railway Co., Ltd. owned by Kokudo Corp.

There are two parts to the alleged charge. First is that while in fact Kokudo owned approximately 64 percent of the outstanding shares of Seibu, it hid a portion of its shares and reported to the Ministry of Finance (MOF) its outstanding shares of stock as 43 percent. The second

part is a charge of insider trading for selling a portion of the Seibu stocks without disclosing the fact that such falsified numbers had been submitted year after year, "an important fact concerning the business," which Tsutsumi was well aware of.

Chapter 6 considers the difference of sales recognition existing between US and Japan. Trading companies are institutions unique to Japan; nonetheless their importance is recognized internationally. Marked changes have been noted in their amounts of sales. The changes appeared in the list of top 500 corporations of the world in the July 2003 issue of *Fortune* magazine. In the rankings based on the amount of sales for corporations, the Japanese trading companies took a nose dive from their usual high ranking positions. For example, Mitsubishi, which held 10th place a year ago, plummeted to 389th and Mitsui from 11th a year ago to the 171st position.

The five major trading companies had been using the US standard for disclosure, except in regard to sales amount, for which they used the Japanese standard. This was because their position in the industry worldwide was based on the amount of sales. However, when they saw the US standard had adopted a stricter definition, they started to use the US standard for the sales amount.

The problem with the accounting system of Japanese companies is that such an important change is made haphazardly. The definition of amount of sales under the Japanese accounting standard is not clear and is left to each industry's custom. Not providing a set standard that would facilitate a better comparison.

Chapter 7 studies Japanese issues and perspective on the convergence of international accounting standards. While the business activities of corporations are becoming more international every year, the accounting system of individual countries seem to remain very local, differing from country to country. Recently, a cry was heard for the need for an international standardization of the accounting system so that investors can understand and properly compare the performance of corporations of other countries when they seek financing overseas. As a result of these concerns, international accounting standards are gradually taking shape.

The Norwalk Agreement was the result of a joint meeting between the US Financial Accounting Standards Boards (FASB) and the International Accounting Standards Board (IASB) in September 2002. The agreement sought convergence between the International Financial Reporting Standards (IFRS) and US standards, and laid the foundation for further convergence of various international accounting standards. It was decided that the IFRS is to be adopted officially in 2005 as the financial reporting standard for corporations in the European Union whose stocks are traded in markets.

The European Union has asked non-EU entities operating in the European Union to disclose information based on the "IFRS or an equivalent standard" starting in 2005. Currently, more than 250 Japanese corporations and Japanese local governments have issued stocks and bonds in the European Union. Most of these Japanese corporations disclosed financial information using Japanese accounting standards.

Japanese efforts may be successful because Japan is negotiating diligently with the European Union and is asking for its approval of the Japanese accounting standard as an equivalent to the IFRS. If the Japanese accounting standard fails to be recognized as an equivalent of the IFRS, disclosure by Japanese companies based on the Japanese accounting standard currently in the European Union would not be allowed, severely affecting the financing activities of Japanese companies seeking to raise funds in the European Union. Japanese corporations are also concerned about the possibility that Japanese accounting standards could be branded as inferior to the European or US Accounting Standards, thus causing a general mistrust among investors in Japanese capital markets.

There have been divergent opinions from both government and private sectors about the adoption of the IFRS in Japan and no consensus has yet been reached. In the midst of this, on June 24, 2004, the Corporate Accounting Rule Council of the Japanese Government Ministry of Finance (MOF)," published a memorandum titled "Adoption of International Accounting Standards in Japan" (MOF Memorandum). The purpose of the MOF Memorandum was to canvass and compile various arguments about what should be done in Japan, from an official

standpoint, regarding adopting international accounting standards to coincide with the European Union's adoption of the IFRS in 2005.

The Japanese Corporate Accounting Rule Council (the Council) was given the responsibility of setting up the business accounting system and auditing standard. In the MOF Memorandum, as a first step, the Council made a general observation of the international trends surrounding the IFRS, summarized the arguments and comments about the IFRS from a legal standpoint, and provided the Council's comment about future tasks. The Council also provided its opinions regarding the application of the IFRS to foreign as well as domestic corporations.

This article summarizes various arguments existing in Japan on the current issue of standardization as well as the official position of the Japanese government expressed in the MOF Memorandum. The Japanese government's position as expressed in the MOF Memorandum is extremely important to investors in foreign countries. The author analyzes the government's positions and makes comments on the problems and issues indicated in the MOF Memorandum.

Chapter 8 examines shareholders' derivative action in Japan. The New York Daiwa Bank scandal in 1995, which involved Daiwa Bank's concealment of the $1.1 billion in losses from the illegal funding of US Treasury bonds, resulted in the most severe economic penalties ever imposed by the United States on Japan. These penalties included the termination of Daiwa Bank's US operations and a substantiated international distrust of Japanese financial institutions, including their closely aligned governmental regulators, the Ministry of Finance.

In September 2000, a Japanese court handed down a decision in this shareholders' representative action that ordered the defendants, 12 directors of Daiwa Bank, to pay bank damages totaling $775 million (approximately 82.9 billion yen). These damages ranged from $530 million (approximately 56.7 billion yen) to $70 million (approximately 7.5 billion yen) per person, and shocked the international society because of the size of the penalties. The award raised many basic legal and economic issues regarding the shareholders' representative action system in Japan, which was first introduced to Japan by the United States in 1950. Because of the importance of the Japanese economy to the world,

the representative action system's behavior is expected to have a tremendous effect on the international economic society.

The Daiwa decision examined the duties assumed by the directors of a financial institution, which require them to establish an internal control system for monitoring risks and for enforcing laws and regulations, the differences in the duties of care among the directors, and the objectives of the responsibilities, as well as the scope of damages. The court decision also sounded a very important alarm about how Japanese corporations are managed. The environment that allowed Japanese companies to be run so loosely seemed to be the fact that the supervising authorities and the legal system failed to rigorously pursue the lack of risk management and the concealment of responsibilities. The Daiwa case made the point that it is extremely dangerous for Japanese financial institutions to try to operate overseas in this same lax manner. Another such incident could invite international mistrust of the entire Japanese financial system.

In this article, the author compares the differing United States and Japanese reactions to the New York Daiwa Bank scandal on legal, economic, and sociological levels. Based on his analysis, the author concludes that cultural differences between the United States and Japan lie at the heart of the scandalous proportions of the Daiwa Bank incident in New York. Furthermore, the author believes that the Daiwa Bank case offers an important lesson for US and Japanese companies with international operations: "When in Rome, do as the Romans do."

Chapter 9 considers the recent trend in Japanese securities regulations. The Commercial Code was transplanted from Germany to Japan in 1899 as part of the general acceptance of Western law in the Meiji period. The post-war methods of corporate disclosures in Japan were modeled after those adopted by the United States in 1933 and 1934. The Securities Exchange Law of Japan enacted in 1948 was imposed by the occupation authorities as a condition for the reopening of the securities exchange. This Japanese law included disclosure provisions substantially similar to the requirements of the US law.

The basic assumption of the occupation authorities in suggesting the new corporate and securities legislation appears to have been that what

worked well in the United States would work in Japan. No question was raised as to the receptiveness of the environment into which the new legislation was being transplanted. If transplanted control methods and corporate practices of Anglo-American origin should not be well adapted to Japanese procedures, then Japanese markets would be prevented from performing their functions as efficiently as desired.

The original Securities Exchange Law was established under the guidance of General Headquarters (GHQ) after WWII and the securities system operated under the tight guard of the United States. For example, the securities business of securities companies were protected and nurtured by the Securities Exchange Law. However, the guard provided by the United States was removed in accordance with the Peace Treaty of 1951 between Japan and the United States. Arrival of freer financial and securities activities, which took off in the latter half of 1960s, introduced various problems that had never been thought of and that could not be dealt with by the existing Securities Exchange Law. The introduction of foreign securities dealers in Japan was one of those problems, which was eventually addressed by the enactment of the “Law Concerning Foreign Securities Dealers,” a special law of the Securities Exchange Law.

Domestically, an inter-industrial problem developed relating to over-the-counter sales of government bonds at banks, which led to the revision of the Banking Law. Stock price index future trading, which is unrelated to securities, was introduced in 1988, which was then followed by option trading introduced in 1989, the latter being useful economically but more problematic as it is difficult to deal with from a legal standpoint. In 1992, banking operations and securities operations came to be entered mutually through subsidiaries as a reform of the entire financial system across the boarder of the Securities Exchange Law.

When Japan became the world’s second largest economic power, internationalization of Japan advanced with a tremendous momentum. In the Japanese stock market, the number of shares held by non-Japanese investors is about 20 percent and the sales volume held by that 20 percent is about 50 percent. When such a fast change occurs in any economy, laws often lag behind.

A material revision of the Securities Exchange Law of Japan was made in 2004 in response to the changes occurring in domestic and foreign economic and financial trends. The Securities Exchange Law has gone through scores of changes, but the recent change was extensive, in order to improve and enhance the financial system focusing on its market functions, such as enhancement of market monitoring and enrichment of marketing venues for securities.

More specifically, it modified the basic stance taken in the original law, for example, it approved banks' participation in securities business. The changes were also made to accommodate new trends in the market, such as the Takeover Bid (TOB) process, the Proprietary Trading System (PTS), the Green Sheet Market, and the Best Execution Policy of the securities companies. Enhancement of market monitoring through the Securities Exchange Surveillance Committee was another major change in the securities regulation.

Chapter 10 introduces M&A for Foreign Investments in Japan. It discusses M&A climate for foreign investments in Japan. M&A plays an important role in promoting investment in Japan. It takes place in the form of a merger, transfer of business and stock acquisition. Compared to starting a company from scratch, M&A is advantageous in that it allows the founder to effectively use existing business resources; it is also a common practice around the world. In Japan, however, there are few M&As in terms of value and number of cases compared to industrialized nations in Europe and the United States. In particular, there are extremely few M&As of a Japanese company by a foreign company.

M&A should be viewed in a positive light as a means of corporate management to carry out strategic restructuring. For a small or medium sized company or a venture company with strong technology, it should be seen as an important technique for obtaining the necessary financing or business resources to take over or to further develop a business. In addition, the activation of M&A would also enable to introduce a new checking function for business management from outside, which would promote the efficiency of the business.

Activation of M&A in Japan, in macro terms, will rejuvenate the Japanese economy by transferring business resources and introducing

new technology and systems. Employment will also be created. In addition, it will broaden the alternatives for business management and employment formats in Japan and make the Japanese economic and social systems and business practices more transparent in the globalized economic society, thereby helping it be a system that is acceptable to the rest of the world.

There are a few factors that make it difficult for a foreign company to carry out an M&A in Japan.

1. The information on M&A is not sufficient in the market.. Although it is vital to properly collect necessary information regarding firms, when one looks for the appropriate firms as the M&A target, that kind of information is not easily available in Japan. As for information regarding sale of firms, due in part to the negative image, the information rarely appears or circulates widely in the market.

There exists negative image against M&A. In certain cases, employees fearing dismissal put up a protest when their company becomes the target of an M&A but turns out to be abortive. Sometimes the mere rumor of an acquisition is enough for a client to suspend business with the company. The sensitiveness of resistance is even stronger if the buyer is a foreign company. At the root of this issue is the present situation of corporate governance in Japan. Stockholders have little power over management and little awareness of their rights. Consequently, the judgment of management takes precedence. This trend is fueled by interlocking stockholding among Japanese companies. Administrative and legal procedures concerning M&A businesses are not efficient. It is said that M&A professionals there aren’t many good as yet in Tokyo.