Creating the Path toward M&A in Japan

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The acquisition of a company in itself is a complex and extensive process. However, if the acquisition takes place in another country, especially one with significant cultural differences, the right approach is even more important. ***By Dr. Ralf Mayer***

Many managers without experience in Japan will wonder if M&A transactions by foreign investors are taking place, and if they are even possible here. Often, the media-effective takeovers by Japanese companies abroad are well known – such as the acquisition of Sprint by Japan's Softbank, or Toll Group by the Japan Post. On the other hand, acquisitions of Japanese companies by overseas investors are rarely recognized, and only the purchase of Sharp by Hon Hai Precision Industry is likely to be remembered by many.

However, contrary to first impressions, the M&A market in Japan is very active and, according to Thomson Reuters, had about 3,600 transactions announced in 2017. By comparison, in Germany, for example, about 2,350 takeovers were announced during the same period. However, there is one crucial difference: while well over 850 transactions in Germany were made by foreign investors, the number of announced "inbound" transactions to Japan were well below 200. The question therefore arises as to why the country seems so inaccessible to foreign investors.

Entering into Asian markets

Out of a variety of reasons to invest in a firm abroad, growth potential, new market development, and access to technology and innovation are certainly among the most important. At first glance, Japan's overall economic situation does not seem to be very attractive in this respect: Japan's GDP is growing slowly, if at all, and prices are rising moderately at best. However, one has to keep in mind that GDP remains stable despite a shrinking workforce, which is reflected in a rise of GDP per capita. Additionally, Japan's sheer market size, with 127 million consumers who are eager to consume, have high purchasing power, and love high-quality (and high-priced) products, should not be ignored. To illustrate this point, Japan is unsurprisingly the second largest cosmetics market in the world.

Also, in terms of technology development and innovation, Japan is in the lead in many areas. Robotics, battery technology, and iPS stem cell research are just some of the areas where Japanese companies and universities are at the forefront of development. Acquisitions in these areas can significantly enrich one's own technology development and fill the innovation pipeline, also with regard to the home market. Likewise, the acquisition of a Japanese firm brings significant improvement in market access, including additional markets all over Asia where Japanese companies are very active.

Building long term trust

The majority of M&A activity in Japan is characterized by intra-Japanese transactions. Two cultural differences from the Western world in particular can serve as an explanation for this. On one hand, profit is not the most important business goal. The well-being of customers and, in particular, of employees, has a much higher priority. On the other hand, the way of building trust as a necessary basis for a successful business relationship is quite different: While in the western world trust is predominantly formed over common intentions, goals, and ultimately contracts, in Japan confidence arises almost exclusively through personal relationships, thus mutually knowing each other.

Additionally, a divestment is still subject to the stigma of "failure" or "loss of face".
As a result, Japanese companies often acquire foreign firms, but rarely adjust their own portfolio. If they make adjustments, companies will search for a suitable buyer in their own network through their personal contacts that will carry on the company for the benefit of their employees and customers. The commissioning of an investment bank and divestiture to the highest bidder will take place only in exceptional cases.

As a consequence, when addressing a Japanese company as a foreign investor with the aim of a merger or an acquisition, financial synergies and other profit-oriented reasons should not be emphasized, and in general not be the main driver behind the approach. Instead, product and market-oriented rationales, like product synergies (e.g. forward / backward integration), access to markets outside of Japan, or innovations to be used in existing products, must be the primary arguments for a possible M&A. In this context, an employment guarantee that excludes operational layoffs for a

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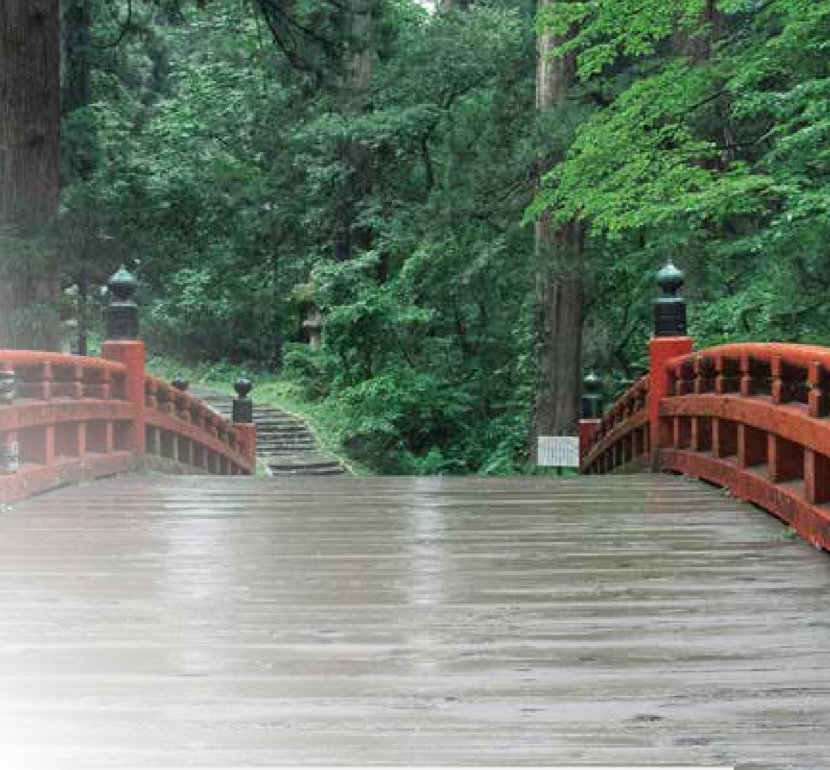

period of time should be considered as a supportive offer. Certainly, companies from countries with strong labor protection laws will have an advantage, since they should have no problem accepting the expectations and wishes of Japanese companies. Possibly, they can even show an M&A case from the past where these measures had been implemented.

With regard to trust however, only long-term oriented strategy leads to success. Realized takeovers of the recent past show again and again a comparable pattern in the approach:

1. Establishment of contact and start of cooperation
2. First financial, possibly joint investments (purchase of shares, JV)
3. Purchase of further shares, and finally acquisition or merger

Examples are Bosch Group (with their 1939 cooperation with Zexel, then increase of their number of shares to 30.1% and finally to 50.1% in 1999), Böhringer-Ingelheim (with their strategic alliance with SS Pharmaceuticals in 1982, acquisition of 9.6% of shares in 1996, then incremental purchase of further shares to 50.1% until 2001, and their eventual full takeover in 2010), as well as the acquisition of Chugai by Roche.

Approaching via a consultant

For the first approach, as well as for establishing a contact, it is advisable to choose an indirect route via a consultant. This is especially important for companies that do not have a branch office in Japan, as the Japanese appreciate having a contact person, or “madoguchi”, located in Japan. A consultant can help with the selection of possible acquisition objects, while offering the advantage of an anonymous approach. Moreover, the consultant can mediate indirectly between all parties, whereby desires, expectations, and even disagreements can be communicated without loss of face. The latter are advantages that should also be considered by companies that are already present in Japan.

Of course, the first contact should not take place under the sign of an acquisition, but with the desire of the cooperation, for example, to market Japanese products in Europe (and vice versa) or to jointly develop new products. Once this step has been taken, the others are usually self-evident, such as the acquisition of shares, a joint venture, or joint production facilities. Once you have established a trustful relationship, mutual successive steps towards increased financial integration become possible.

Perseverance is necessary

M&A in Japan is possible, but only if one considers the cultural specificities of the country! Out of numerous aspects to be considered, the two outlined above are certainly among the most crucial ones. If a company can show synergies beyond purely financial reasonings and accepts the high value of customers and employee protection, these companies are welcome to expand their presence in Japan and Asia and develop new distribution channels and markets. However, an acquisition in Japan must be part of the long-term strategy and needs time and perseverance.

A word on hostile takeovers:

Hostile takeovers are almost impossible in Japan due to the financial interconnectedness, or “keiretsu,” of the companies. Additionally, there is a Japanese company law that allows a very large number of “authorized but not issued” shares. These can amount up to three times of the already issued shares. Since these shares are already approved for issue but are still in the possession of the company, the management can sell these, in principle, overnight to a “White Knight” as a defense measure – and a Japanese “White Knight” will always come to aid.

About San-Ten Consulting:

San-Ten Consulting was founded by **Dr. Ralf Mayer** who has worked for 15 years in different managerial positions in a leading German chemical company and knows the consulting business from both sides. Therefore, we always focus on individual, custom-tailored advice and consultation leading to practical results and implementation. We want to become your long-term partner in Japan and add value to your business, foster partnership, and support your innovation pipeline.

You can find a more detailed background and experience overview of Dr. Ralf Mayer on our website.

Our Competitive Advantages:

- Many years of consulting experience with broad knowledge in the areas of market entry support and innovation management
- Well experienced in market studies, business strategies, joint developments with companies, and joint research with academia in Japan, as well as M&A and CVC
- Insights into several markets and industries on a B2B level, e.g. chemicals, automotive, health care, pharmaceuticals, paint and coatings, and construction industries
- Existing network to many corporations and SME, research institutes, universities, (governmental) institutions, venture capital organizations, and M&A agents in Japan
- Deep understanding of Japanese culture and business customs, as well as intercultural, cross-border management
- Provision of a one-stop solution by cooperating with reliable partners in other consulting areas like legal advice, tax & accounting, communications, back office, or recruitment
- Support of the Master of Business Engineering program at Steinbeis University as well as other universities and NPOs in Japan with lectures and mentorship
- Membership in several foreign chambers of commerce in Japan

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