

# Holding Company or Outright Merger? —Alternatives for Corporate Integration—

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After the ban on holding company was lifted in 1997, some new changes have been observed in corporate organization in Japan. After surveying the general backgrounds and current situation of the deregulation of holding company, this paper analyzes how and why Japanese firms specifically select one of the two choices between direct merger to form a single legal entity and holding company structure, when they aim to integrate the whole organization.

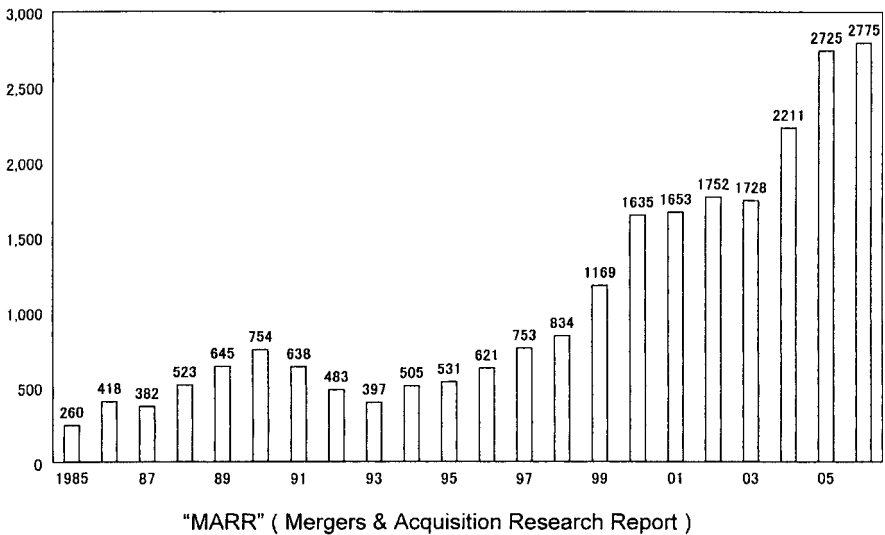
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## 1. System Conversion in the Japanese Economy

The Japanese “bubble economy” of the late 1980’s was an economy boiling furiously, with a soaring in stock and land prices. It was, in a sense, the climax of the post-war Japanese economy. The bubble, however, burst at the beginning of 1990’s, and was followed by severe and continued decline in stock and land prices. In fact, the prices of stocks and real estate properties dropped to one fifth and one third, respectively, of their apex during the bubble years. The 1990’s is called “the lost decade”. Many companies went bankrupt and many employees lost their jobs. This marked a total and irreversible departure from the way of the Japanese economy that had thrived for half a century since the end of the Second World War.

Following the Restoration years after World War II, the Japanese economy achieved long and sustained high growth to become one of the world’s leading economic powers. It is well known that the Japanese economy, in contrast to the Anglo-Saxon economic model, built a uniquely Japanese economic system based on “long-term commitment” in terms of employment, transaction and equity relationship. It includes, for example, mutual shareholding, formation of conglomerates or corporate complexes, *keiretsu* or bilateral transaction with affiliates, and the so-called “Japanese system of management”. It was on these foundations that

**Table 1** The number of M&A cases in Japan

the Japanese model of corporate governance was constructed. The end had come, however, to the prosperity and growth during the fifty years of the post-war period with the collapse of the bubble at the beginning of the 1990's, which disabled the Japanese economic system on the whole and transformed it in every respect.

What has changed the most, then? As one can read in newspapers, there has been marked increase in M&A as well as the introduction of diversified employment relations. New schemes have also been adopted in corporate governance. Actually, corporate management has changed drastically, paying more serious attention to shareholders than before. Needless to say, such a shift in employment practice and corporate governance implies that the Japanese economy, albeit partially, has begun to introduce an Anglo-Saxon style economic system.

Among such changes, the increase in M&A cases seems to represent most symbolically the structural transformation of the Japanese economy. This recent trend of active M&A cases is strikingly impressive and it is accelerating together with the changes in the mindset of the corporate executives who take it for granted "to sell and buy companies". As an example, Table 1 shows the increase in the number of M&A transactions in recent years. There are now five times more M&A cases than occurred in the early 1990's.

In retrospect, the various changes in the Japanese economy after the collapse of the bubble appears to have made a big stride in deregulation in 1997 with the historic turning point to "allow Pure holding companies". Thus, the long-held wish of the business community and MITI for liberalization of the establishment of holding companies, prohibited for half a century, was finally realized. It was a cue to bring about all at once a series of system changes followed by passages of new

laws in an overwhelming stream to guarantee “freedom of management” to satisfy the business communities. Consequently, liberalization of the holding companies has become an event that symbolizes the system transformation of the Japanese economy after the collapse of the bubble. In the following sections we will study the situation by focusing on holding companies.

## 2. Two Functions of Holding Companies and the “Three Prohibited Types”

Now more than one hundred pure holding companies were created in Japan as far as the cases reported in newspapers. Then, how are holding companies utilized by Japanese corporations today? Generally speaking, holding companies have two functions or purposes, namely, (1) to integrate existing companies into one, and (2) to reorganize internal organization of a company.

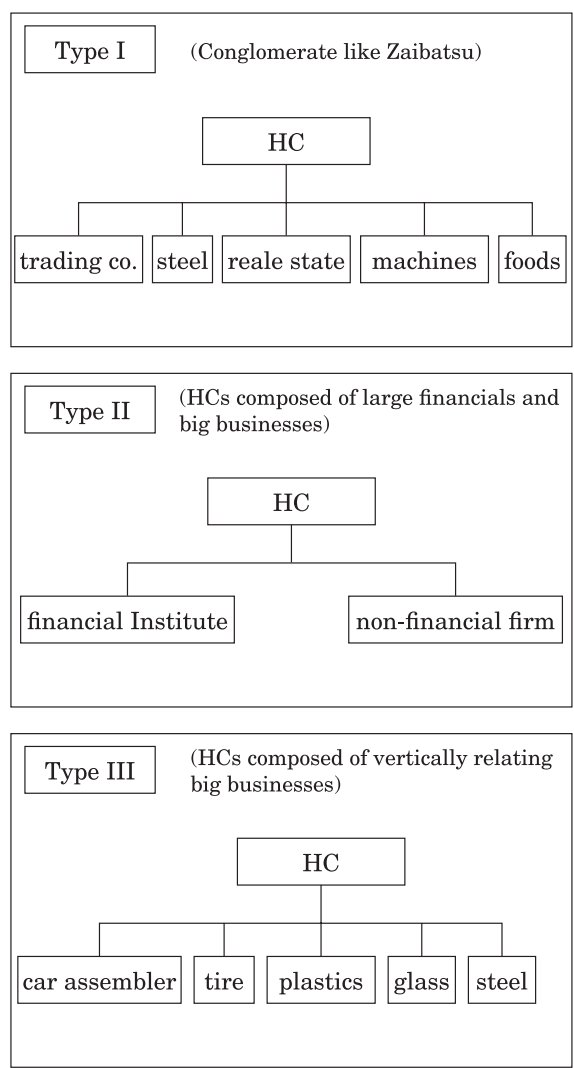
The former (1) represents the cases where existing companies establish jointly a holding company to consolidate among themselves, which may lead to reorganization of the industry they belong or concentration of economic power if it takes place among mutually competing enterprises. The latter (2) represents the cases where the parent company of a corporate group transforms itself into a pure holding company aiming at more streamlined management of the group. In this latter case, it is just an internal matter of a corporate group pursuing its “group strategy”. Thus a holding company may have either of the two distinct functions, and it is important to consciously discuss the two functions separately.

In any event, we will exclude the latter cases from our study as they belong to the sphere of internal group strategy of individual corporate groups, and instead we will focus our attention in our subsequent arguments on the former cases where existing companies unify themselves by forming a joint holding company. Integration of existing corporations through a holding company apparently reorganizes the state of order in the industry and creates a source of dynamism for development of the industry involved.

However, since integration of existing large companies through a holding company will create a big scale corporate entity, and such a big entity might lead to excessive concentration of economic power, the Fair Trade Commission made public the “three prohibited types” of holding companies as a negative guideline when the creation of holding companies was allowed in 1997. That is to say, in spite of liberalization, it was prohibited to establish such holding companies as may “raise concern with excessive concentration of business controlling power”. Table 2 illustrates the three prohibited types of holding companies.

It is somewhat strange in this respect that the prohibited types fail to include the category of ‘horizontal integration’ among companies in the same industries. “Concern with excessive concentration of business controlling power” should be typically the greatest when horizontal integration among companies takes place. It would be normal for a corporation to choose a company in the same business sector as a merger target in order to expand its market share as well as to raise its ranking in the industry.

**Table 2** Tree prohibited types of holding companies



Nevertheless, despite strong concerns predicting a concentration of economic power, this very category was excluded from the prohibited types. Rather, efforts were made intentionally to promote corporate reorganization through horizontal unification using holding companies with a view to strengthening international competitive power. This is evident in the list of the established holding companies where most of the cases represent horizontal integration among companies in the same industries.

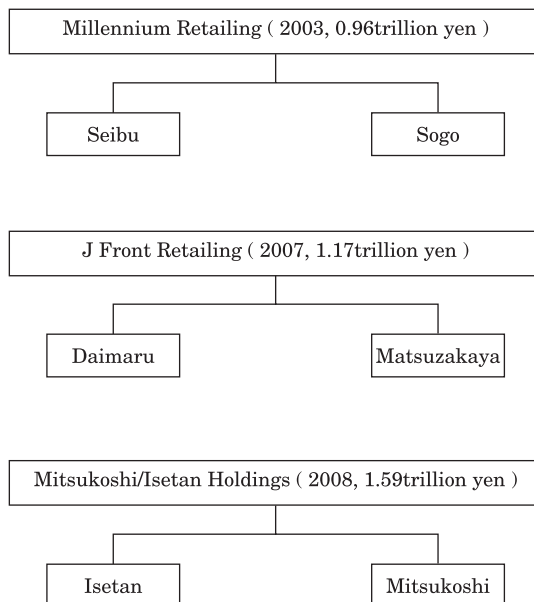
### 3. Alternatives in Corporate Integration

Existing corporations that intend to join together can choose between outright merger (M&A) and holding company creation. Until the holding company method was allowed in 1997, merger was the only way for corporate amalgamation in Japan. Today, while direct merger is still increasing, there is at the same time active use of this new alternative of a holding company for corporate integration.

Such examples include the birth of “mega banks” through unification of huge banks. In September, 2000, the first mega bank, Mizuho, was born through setting up the joint holding company, integrating the three existing large banks. Or, most recently, in the Japanese department store business, integration and reorganization applying the holding company formula is vigorously implemented, and will eventually result in just four big survivors, each with annual sales of approximately a trillion yen as shown in Table 3. The question, then, would be why they have chosen unification through holding companies instead of outright merger. In other words, what is the difference between unification by a holding company and direct merger? What has been the rationale for unifying parties in selecting between alternatives of a holding company and outright merger?

A well-known argument is that a holding company, in comparison with direct merger, can provide a more considerate approach to “equal standing” and “face

**Table 3** Integration of department stores through HCs



Among the Big Four, Takashimaya stands solely with annual sales of 1.05 trillion yen.

saving” of the parties involved and that it facilitates “buying time” until fusion is really completed. In other words, a holding company is preferable to direct merger because it can avoid prospective frictions arising from differences in corporate culture and personnel administration, which represents the so-called “alternative form of merger” theory. For instance, a book titled “*New Trends in Corporate Organization*” (MITI Industrial Policy Bureau ed. 1995), emphasizing “economic utility of a pure holding company”, pointed out the following:

- “(1) When two corporations with different corporate culture and labor practice merge, they typically encounter difficulty in unifying personnel and organizational administration, creating enormous obstacles against intended unification. By leaving each corporation as it is and establishing a pure holding company, a result identical to direct merger can be obtained while avoiding frictions that would otherwise stem from all these processes to consummate merger.
- (2) Furthermore, even if merger is the ultimate objective, friction during the interim period may be reduced to minimum by provisionally making use of a holding company” (Page 35).

The above is the well-known argument of the “alternative form of merger”. This is a commonly and widely accepted view. But, is it a persuasive argument? In real-world unifications, there is no such thing as truly “equal standing” in the first place. In most cases, the winner that becomes the ultimate survivor is already determined. Corporate culture and working conditions will typically be adjusted to reflect those of the surviving corporation that enjoys advantageous status. The argument for preservation of equality and face saving is just a kind of theoretical window-dressing and there is little reason to emphasize it. It cannot be denied that such an argument has so far been unduly emphasized as the “economic utility” of a holding company.

Moreover, the argument for “buying time” seems questionable in view of today’s severe global competition for survival. It is a matter of critical importance whether non-merger unification, which aims to achieve substantially the same effects, can generate benefit of rationalization to the same extent as direct merger does. If early harvest of the fruits of unification is sought, direct merger is without question better. Nevertheless, most of the holding companies that we believe selected the style as a matter of convenience to buy time, continue to keep that structure in practice. With the period of “buying time” being over, why do they not proceed to the next step or direct merger? Or why do they not abolish holding companies? Of course, it has been rare that affiliated companies kept the same situations and relations with the parent. Most of them promptly studied and implemented reorganization or reshuffling of group companies as an inevitable process. It presents a critical challenge how much and how quickly group companies are restructured. The framework of the holding company, however, remains without anything done about it.

In summing up, consideration of equal standing and face saving, if it exists at all, is just a temporary fiction, as the situation does not allow the luxury of “buying time”. However, in spite of it, why do corporations like to select a holding company for integration? Or what are the criteria for judgment that favor a holding company over direct merger? For instance, Mizuho, as is mentioned above, was born by utilizing a holding company but Mitsui-Sumitomo, other mega bank, first had chosen direct merger and later decided to make a holding company. What is the difference between them?

#### **4. A Case Study; Integration of Japan Storage Battery and Yuasa Storage Battery**

I have told above that the true “equal standing” hardly exists, and it was only a kind of nominal claim or factious imagination. So, as the material which considers the former argument, I will introduce one unique case in which a holding company was employed to evade the so-called friction of “merger on equal terms”. It is the example of integration of Japan Storage Battery and Yuasa Storage Battery, which had long competed for the top in the field of accumulator and industrial battery. Both companies integrated themselves by establishing a joint holding company, “GS Yuasa Corporation (GYC)” in 2004 that aimed at expansion of firm size, intensity of research and development investment, and efficiency of management in facing the severe international competition in a global market.

Both companies are formally established at the boom time after World War I, with Japan Storage Battery founded in 1917 and Yuasa Storage Battery in 1918, and they are thus the enterprises with pride and tradition. They illustrate really similar history from the prewar through the postwar decades and, except for Japan Storage Battery being stronger in the domestic market while Yuasa Storage Battery having advantages in foreign markets, the product categories and competitive areas were close to each other. They have competed for many years and there was nothing to choose between them. In fact, before their integration in 2004 they remained a close rival in terms of capital stock, total assets, consolidated sales figures and the number of employees. Indeed, the stock exchange ratio at the time of the establishment of the joint holding company was calculated by the third party with 1 to 1. It should have been the unusual case of an integration of both companies that should be a true “merger on equal terms”.

Why then do both companies integrate by choosing a holding company system rather than a straightforward merger? Below is the report of a result from a hearing interview that I had at GS Yuasa Corporation.

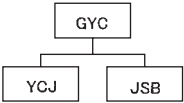
First, when they got integrated, the major reason why a holding company was specifically chosen was the “speed” of the process. Once the integration proceeded various tasks to tackle should be on the table, which include the reorganization of product portfolio, the reconstruction of personnel system and organization, and the readjustment of middle term planning. The companies thus concluded that they integrated first as they were under the holding company, and then started taking

care of all the remaining matters. In seeking the speed of integration the principle was “in the beginning was an integration.”

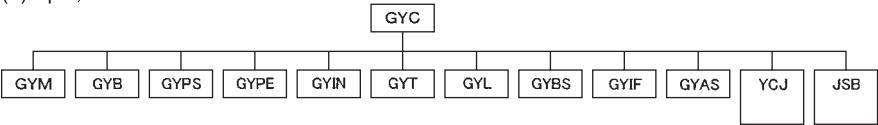
The second reason that was cited was the value of the merger of the “equal standing.” They were actually the equals as far as their substance is concerned. If they had selected a straightforward merger, then, one company had to be designated as a continuing company and the other extinguishing one. In order to avoid

**Table 4** The integration of YCJ and JSB

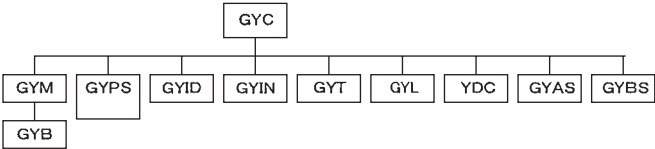
(1) April, 2004



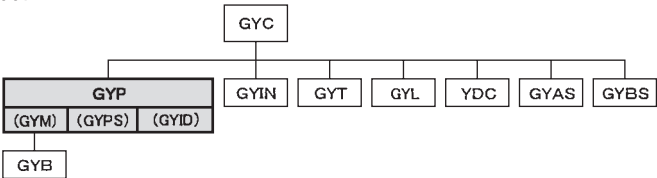
(2) April, 2005



(3) April, 2006



(4) January, 2007



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|------|----------------------------|------|-----------------------------|
| GYC  | GS Yuasa Corporation       | GYT  | GS Yuasa Technology         |
| YCJ  | Yuasa Corporation          | GYL  | GS Yuasa Lighting           |
| JSB  | Japan Storage Battery      | GYBS | GS Yuasa Business Support   |
| GYM  | GS Yuasa Manufacturing     | GYIF | GS Yuasa Information        |
| GYB  | GS Yuasa Battery           | GYAS | GS Yuasa Accounting Service |
| GYPS | GS Yuasa Power Supply      | GYID | GS Yuasa Industry           |
| GYPE | GS Yuasa Power Electronics | YDC  | Yuasa Development           |
| GYIN | GS Yuasa International     | GYP  | GS Yuasa Power Supply       |

that conflict they chose the way in which the two companies jointly established a holding company with stock transfers. In that holding company the equality principle was respected especially in the allocation of officers' positions and numbers. Interestingly, although the current headquarter of the holding company is located at the former site of Japan Storage Battery, the first headquarter office was located at some place other than old two offices for a year since the integration.

Right away after the integration both companies found out that the usage of business and technical terms were not similar. Because this was the integration of the companies with long history, "corporate culture" so to speak naturally differed. For instance, while one used "principle management," the other called the same content as "target management." Designating the Defense Ministry, the big client for them, one had a special term "marubo," while the other employed "marusen" in cant. Even ordinary terms such as quantity were dissimilar with the contrast of "numbers and quantity" and "physical quantity." However, in the subsequent course of a new company's history those differences gradually disappeared. As for the working conditions of employees, wage systems and welfare benefits, the attempt of harmonizing them into one and keeping the "equal balance" luckily went smoothly, because the two companies had long competed in the similar circumstances.

The development of the restructuring of major subsidiaries after the integration can be summarized in Table 4. After a year since integration, as the first step of reorganization, the holding company (GYC) shuffled existing businesses of both companies (YJC and JSB, including businesses of their subsidiaries), creating new ten subsidiaries through the way of corporate split-up. One more year after that, then, the both companies merged under the holding company to become GYPS, and GYPS further proceeded reorganizations in which it acquired two subsidiaries, GYM and GYID, to form GYP. As the result, today under the holding company, the seven major operating subsidiaries including GYP with 81 other subsidiaries and 46 affiliated companies are operating to form a corporate group.

Interesting as it is GYP, instead of the holding company (GYC), standardizes all the personnel recruitment and employment matters of the abovementioned major subsidiaries and sent out its employees to other companies within the group. This is because the company is still obliged to hold on to the continuity and uniformity of working conditions of employees, which has become mandatory due to the relationships with former labor unions of both of the former companies.

In any case, as this particular example illustrates, the choice of a holding company was the speediest and most rational when two companies of almost equal conditions attempted their integration. But this sort of the integration of both "equal" companies was rather rare. On most cases the companies that aim to integrate were unequal in terms of their conditions. Why then the companies deliberately select the holding company?

5. Unlimited Open Organizational Structure

When considering these topics of the reasons for the choice of holding company, it seems necessary to differentiate the circumstance into two separate categories: the integration of the rival enterprises within the same industry and that of the enterprises in different industries.

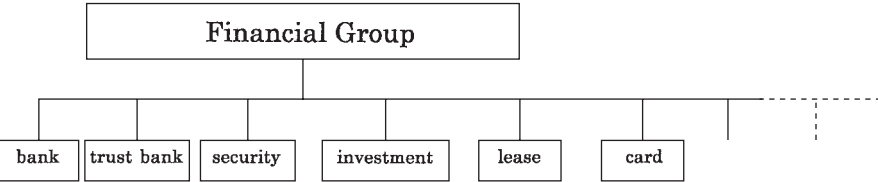
In case of the integration of the companies in the same trade, the reasons why they tend to choose integration by a holding company seem to the significance of ‘brands and goodwill’ that should be independent and continuing as is the case of consumer-oriented industries and retail businesses. As has been mentioned above in the context of department stores, long-established brands and royal customers should be retained and maintained through the integration with a holding company. By choosing the holding company rather than an outright merger the new company delivers a message of continuing commitment to independent brands and goodwill to its customers.

On the example of the companies in different industries, as has been the case of “financial conglomerates” to engulf banking, trust banking, securities dealing and leasing, there should be necessities to organize those varied businesses under a pure holding company. In other words, heterogeneous group companies need to be affiliated to the holding company as they are. What is important then is that, as is illustrated in Table 5, the pure holding company as an organization can hold a numerous number of businesses underneath. In general, a pure holding company is a structure that allows unlimited affiliation regardless of the types of businesses. By taking an ‘endless structure’ form of the pure holding company that firm secures adequate room to add new businesses. Needless to say, even in the case of the integration of companies within the same industry, the holding company is an appropriate choice when the expansion into new businesses is planned.

One more reason can be cited why a company adopts the holding company as a means of integration and continued to hold on to that organization even after completing the planned integration. It is just because an integrating company is not a free-standing “corporation,” but it is a “corporate group.” The corporation that attempts the integration is a parent company and also an operating holding company of the corporate group with subsidiaries enclosed. A new holding company is established when the two holding companies get integrated.

In other words, major Japanese enterprises have already embraced many

Table 5 Financial holding company



subsidiaries and affiliates under their controls with forming their own corporate groups. For instance, Hitachi and Sony is well known for having the biggest numbers of subsidiaries and affiliates, almost one thousand, respectively. Toyota and Panasonic also embraces some hundreds of them. In short, a company has already existed as a parent company and also an operating holding company. The product of integration among holding companies is no more and no less than a new holding company. The new holding company should be transformed into a pure holding company, rather than an operating holding company, though.

As has been examined, rational and positive reasons can be listed for the question why enterprises choose a holding company, not a straightforward direct merger. Further reasons might be counted why they continue to keep that organization even after the integration processes. Scholars have explained the reasons why enterprises choose the holding company, not the outright merger, from the perspective of ambiguous concepts such as “temporary postponement” of that merger or “equality and face saving.” This conventional line of argument that presses the theory of the holding company as ‘a substitute of merger’ should be more carefully scrutinized.