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Business Buy Outs and International Regulation

By KEIZO SAKATA*

I. BUSINESS BUY OUTS IN JAPAN

Business buy outs have many advantages for the purchasing company, the purchased business, and the economy as a whole. The purchaser may benefit from the restructuring of the purchased business. Additional benefits may accrue to the purchaser in saved establishment time, in eased entry into the market, and from the application of capital and technology. The purchased company may also benefit from a business buy out. For example, a buy out may allow the company to continue business, or avoid bankruptcy. The seller of the business may also benefit by protecting the investments of the founders and other shareholders. Furthermore, the threat of a potential buy out makes managers vigilant and serves as an inducement for healthy business operations. The continuation of business following a buy out is also very beneficial for employees, creditors, the local area, and the country as a whole. Until recently business buy outs were disfavored and prevented in Japan. However, the Japanese are beginning to recognize the numerous advantages of business buy outs. An examination of buy outs in Japan over the past ten years illustrates this changing attitude.

A. Increasing Buy Outs

Between 1985 and 1991, the globalization of management strategy and abundant financial resources led to a dramatic increase in the number of Japanese businesses purchasing foreign businesses. However, in the first half of 1991, the number of business buy outs dropped abruptly as capital procurement became difficult due to the collapse of the post deregulation "bubble economy."

During this same time period, only a small number of foreign companies purchased domestic Japanese companies. This can be attributed to a number of factors: high stock prices, mutual retention of stocks,

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characteristics of business ownership in Japan, and excess confidence in Japanese management.

B. Buy Out Size

Some buy outs by Japanese companies have been relatively large in scale. For example, both Sony's purchase of Columbia Pictures and Matsushita's purchase of Universal Pictures can be classified as "large scale." However, while the average foreign business buy out by a Japanese company is mid-scale, buy outs of Japanese businesses by foreign companies are mostly small in scale.

C. Management's Changing Attitude

Japanese management's once unfavorable perception of business buy outs is changing. Three main factors have contributed to this change and have led to a different type of buy out in each case. First, managers have less time to reorganize business structures. This has led to the management strategy business buy out. Second, a number of business owners are having difficulty producing successors for the enterprise, causing the enterprise succession business buy out. Finally, where a business is unable to withstand the intense competition and demands relief, a relief business buy out results.

Yet another factor evidences the changing attitude toward buy outs in Japan. Banks and securities firms are beginning to establish departments to mediate business buy outs. These entities collect sales and purchasing information about businesses entering the buy out market, thus facilitating the process.

II. BUSINESS BUY OUTS BASED ON TRADE OPEN BUYING (TOB)

It can be said that Japan is entering an era of full-scale business buy outs. Buy outs have a number of benefits which were discussed previously. However, there are also a number of problems for both the purchasing company and the business being purchased.

A. Purchase Side

When purchasing a business, the buyer must decide how much information to present to the investors and shareholders. In addition, the buyer must determine whether it is necessary to control stock rigging by the so-called "greenmailers." Other problems with TOB involve determining whether the purchaser must acquire the stocks of the applicant

and whether business buy outs with excessive capital procurement for TOB can be approved.

B. Purchased Company

Business buy outs can also lead to difficulties for the purchased company. The managers of such a company are faced with the question of how much information to present to the shareholders. They must also determine whether a defense against a buy out they judge to be hostile is permitted. If such a defense is permissible and called for, the managers must determine the appropriate defense mechanism.

C. National Economy

Business consolidation may incidentally produce market monopolies and oligopolies and therefore retard the healthy development of the national economy. A number of countries, including Japan, have established anti-trust laws to regulate consolidation. However, the criteria for the application of these laws are often quite vague.

D. Developing a Healthy Global Economy

The increase of international business buy outs results in a number of problems. These problems are largely due to the relationship of various international regulations with the principle of free transfer of capital. Internationally unified regulations of business buy outs, including TOB, may be required to address these problems.

III. REGULATION IDEAS AND METHODS FOR MERGERS & ACQUISITIONS

As indicated previously, there are various problems with business buy outs. In order to solve these problems unified ideas and theories must be considered. It is necessary to consider regulation of the purchaser as well as the purchased company. Additionally, regulation of business consolidation and creation of international provisions for mergers and acquisitions will assist in solving these problems.

A. Ideas for Regulation

The first step in solving the problems associated with business buy outs is compiling unified theories of regulation. These theories may have a narrow focus, for example, ensuring adequate disclosure or protecting shareholders. However, a broader view encompassing the market as a whole and the international economy is necessary.

1. Management Disclosure

A number of businesses procure capital from a wide market through the distribution of stocks and bonds. These businesses must guarantee that management will disclose relevant information to investors. In order to ensure disclosure, management details must be made available to potential investors and the system for supervising business management must be strengthened.

2. Equal Remuneration of Investors

In both Japan and the U.S. numerous corporations hold a large percentage of stock. Individual shareholders, on the other hand, hold a relatively low percentage of stock. Corporations, as major shareholders, greatly influence the transfer of company control. Consequently, information regarding the company and the acquisition of additional shares is often disclosed only to the major corporate shareholders. This unfair treatment of shareholders cannot be sanctioned.

3. Fairness/Equity of the Market

TOB is conducted through the market. Consequently, guaranteeing market transparency and impartiality is a precondition for business buy outs. Unfair dealings such as insider trading and share price manipulation decrease confidence in securities trading. The establishment of the five percent rule, the repayment of marginal profits from short term trading by directors and principle shareholders, and the regulation of speculation are attempts to ensure market confidence.

4. Fair Competition

When companies are consolidated through mergers, business transfers, and the acquisition of controlling shares, it follows that their corporate market share increases. Therefore, monopolies which negatively influence the national economy and damage consumer profits must be eliminated. When the standards regulating monopolies are vague, chaos results from mergers and acquisitions. Thus, it is necessary to clarify the criteria for those antitrust standards and guidelines.

5. Preventing the Subversion of Regulations

The laws regulating mergers and acquisitions differ from country to country. These differences present a problem for international regulation. It is necessary to unify the laws to prevent the subversion of regulations.

6. Freedom of Capital Transfer

Mergers and acquisitions which cross national boundaries represent capital transfer. The freedom of capital transfer must be ensured. National boundaries establish the range of sovereignty and it is natural that the laws of the country are honored. To ensure national stability, regulations established by the Organization for Economic Cooperative Development (OECD), concerning the freedom of capital transfer, are recognized. Although it is natural to honor the country's laws, an individual country's control of domestic business mergers and acquisitions by foreign business has the same result as setting up an actual barrier when the applied criteria are not clear. Such barriers to business buy outs must be avoided.

B. Regulation of the Purchaser

After the 1991 reform of the securities trading law, Japanese regulation of TOB and corporate disclosure appears to be in line with Europe and the U.S. In this regard, Japan does not require disclosure of post-buy out management plans. However, disclosure of such information would allow shareholders to determine whether or not the purchaser is a greenmailer with no intention to preserve or continue business. In order to discourage greenmail, restrictions on the resale of stocks for a fixed period of time must be considered.

In take over bids, the purchaser assumes the additional responsibility of debt repayment. Often businesses are dissolved to meet this obligation. This type of buy out naturally retards the development of the business. Therefore, such a buy out is disadvantageous to the investors, shareholders, employees, consumers, the locale, and even the country. From the viewpoint of social responsibility, it is necessary to prohibit the dissolution of a business involved in a leveraged buy out for a specified period of time.

C. Regulation of the Purchased Company

Hostile takeovers may lead to sluggish business results, low share values, and chaotic operations. In business, especially in Japanese businesses, the ill effects of secure business control resulting from mutual retention of stocks are readily apparent. This is compounded by the fragile monitoring system, cheap dividends, and management disregard of minority shareholders.

In this situation, the manager's unilateral decision to conduct a business defense will not lead to profits for the shareholders or the company.

Consequently, in the case of a TOB business buy out, the company directors should seek input from the shareholders and the company creditors in deciding whether to conduct a defense.

Japanese commercial law provides for the stabilization of shareholders, mutual retention of stocks, and third party allotment of stocks. However, various defense mechanisms such as the establishment of regulations controlling hostile takeovers are not provided. Discussion has just begun on the pros and cons of business defense by self acquisition of stocks.

D. Regulating Business Consolidation

It is necessary to establish guidelines for the regulation of business buy outs by acquiring control through mergers, business transfers, or major stock acquisitions.

E. International Provisions for Mergers and Acquisitions

The need to control business buy outs is recognized internationally. This is illustrated by the third item of the agreement concerning the liberalization of OECD capital transfer. Recently in the U.S., the Exxon-Florio stipulation was revived, giving the President the authority to halt business buy outs that are a risk to the national security technology or economy. However, the criteria of application are not clear. In Japan as well, foreign exchange law provides for the same type of regulation, but as in the U.S., the criteria for application of the law are not clear. Also, clarification of anti-trust regulations is sought from the perspective of international anti-trust policies. Consequently, it is necessary to establish internationally uniform guidelines.

Although business buy out regulations such as TOB regulations exist, when trading of stocks occurs in countries where the foreign regulations do not apply, the effectiveness of the regulations can be diminished. Therefore, it is necessary to consider establishing uniform international TOB regulations.