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Trends and Determinants in the Japanese Cross-Border M&As

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This paper provides an overview of the recent trends in the Japanese cross-border M&A activity in 1988-2004 and investigates the factors influencing them. We develop classifications of theoretical foundations and factors of M&A activity and their application for the Japanese case. The article examines two categories of the Japanese M&As—transactions with Japanese companies as a target (sales) and transactions with Japanese companies as an acquirer (purchases). In the Japanese cross-border M&A sales in order to determine factors of changes we look into industrial and institutional structures of M&A transactions. The findings show that beyond the changes in macroeconomic conditions, the recent trends of cross-border M&A sales in Japan were determined mainly by the changes in legislative and corporate environment. For Japanese outward M&A flows we test the standard gravity model. The results show that the volume of the Japanese cross-border M&A purchases is significantly larger in countries with larger and developed markets, a higher degree of investor's protection and a higher liquidity of capital markets. The main factor affecting the location of Japanese M&A purchase in developed markets is the bilateral trade flow between Japan and a target country.

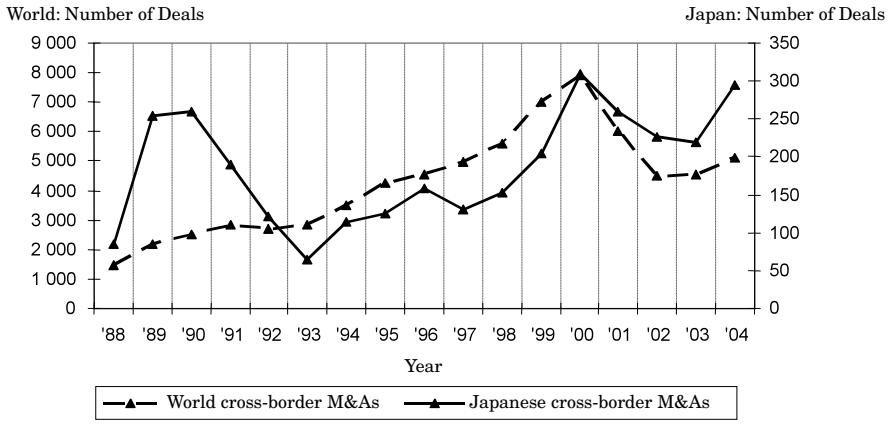
JEL Classification: F21, G34
Keywords: Japan, Mergers and Acquisitions (M&As), Foreign Direct Investments (FDIs)

1. Introduction

Traditionally, it has been illustrated that M&A activity tends to occur in waves.[1] The cross-border M&As involving Japanese companies reflect the cyclical nature of M&As, though they significantly differ from the world cross-border M&As' trends (Fig. 1).

The 1990s and 2000s witnessed sharp fluctuations in world cross-border M&A activity. UNCTAD stated, that during the past two decades "two big waves can be identified in the world M&As: one in 1988-1990 and another in

[1]See Graham and Krugman (1993) for an explanation of such waves in cross-border M&A activity as a part of FDI, Crook (1995) for empirical results, Harris and Ravencraft (1991) for links between acquisition waves and booms in stock market, Resende (1999).



Data source: based on UNCTAD data, MARR, 2, 2004, MARR, 2, 2005, *Japanese M&A Yearbook* (2003).

Figure 1. World and Japan cross-border M&As

1995-2000".[2] Note, that the second wave was 3 times more prominent and therefore diminishes the first wave (as shown on Fig. 1). While the first wave was strongly influenced by the United States, a boom in domestic M&As in developed countries made a significant contribution to the second wave of M&A activity. It was also said, that both of these waves were caused by the growth of global financial markets, new means of financing M&As, major technological developments, industry consolidation and changes in regulatory environment.

A sharp decline in world M&As after 2001 can partially be explained by a worldwide trend of slowdown in corporate restructuring.[3] According to the UNCTAD statistics, in 2003 worldwide M&As totaled US$ 296,988 million, which was 4 times lower in comparison to 2000. The number of completed deals in 2003 was 4,562, which is also 2 times lower than in 2000. Subsequently, in 2004 a higher economic growth in the main acquiring and host countries, improved corporate profitability and higher stock valuations combined with other factors are said to have opened a new wave in cross-border M&As.[4]

In contrast to the world cross-border M&A transactions, in Japanese cross-border M&As 3 distinct waves can be identified: in 1988-1989, 1993-1996 and in 1997-2000. In Japan until the 1980s the M&As "were virtually non-existent" (Nakamura (2002)). Surprisingly, despite the fact that Japan holds the second largest GDP in the world, currently the developed and even some developing countries are leaving Japan far behind in the cross-border M&As (Table 1).

Such evidence requires a separate and deeper examination of the existing trends in the cross-border M&As in Japan and the factors affecting these trends. This article looks into two categories of the Japanese M&As—transac-

[2]UNCTAD, World Investment Report 2000, p. XIX.

[3]UNCTAD, World Investment Report 2004.

[4]UNCTAD, World Investment Report 2005.

Table 1. Cross-border M&A indicators in selected countries in 2004

	M&As in world purchases, (%)	M&As in world M&A sales, (%)	M&As in GDP, (%)
World	100	100	0.93
USA	28.9	21.5	0.7
UK	12.43	15.3	2.71
France	3.9	5.3	1.0
Germany	4.9	9.4	1.32
Netherlands	2.4	3.5	2.3
Brazil	2.4	1.74	2.61
Singapore	3.06	0.31	12.01
Japan	**1.0**	**2.3**	**0.2**

Source: Author's own calculations based on UNCTAD and World Bank data.

tions with Japanese companies as a target (sales) and transactions with Japanese companies as an acquirer (purchases). First, we discuss existing theoretical approaches to cross-border M&A flows and develop a general classification of the factors influencing M&A transactions. Second, we determine the factors of the Japanese cross-border M&A sales by examining the industrial and organizational structure of transactions and specific features of the Japanese corporate and financial markets. And third, for the Japanese cross-border M&A purchases a quantitative assessment of selected determinants is provided.

The financial data for this paper were obtained from the *Nihon Kigyo no M&A Data Book 1988-2002* and *Mergers and Acquisitions Research Report* (*MARR*) No. 2, 2004, No.2, 2005 published by Recof Corporation. We focus our analysis on all cross-border M&A transactions with the disclosed value involving Japanese companies that were announced from January 1, 1988 to December 31, 2004.

The paper proceeds in the following order. Section 2 introduces a literature survey on theoretical approaches of M&As and a classification of the factors influencing M&A activity. The data examination on the recent trends of the Japanese M&A sales is presented throughout Section 3. Section 4 describes the data sets and analyzes the Japanese cross-border M&A purchases, presents our econometric methodology and derived empirical results. The last section is summary and conclusion.

2. Literature Survey

Modern economic studies on cross-border M&As are based on several interrelated theories suggesting their own approaches to the motives and determinants of cross-border M&A transactions. These main theories include the corporate control view, imperfect markets theory, ownership-location-internationalization (OLI) theory, transaction costs economics, entry mode view, profit maximization theory, growth maximization theory and others.

The corporate control view highlights the role of M&A as a corporate re-

structuring vehicle (especially in cases of bankruptcy), where the market price of a company's shares serves as an indicator of managerial efficiency (Manne (1965)). According to this view, M&As facilitate channeling corporate assets by reallocating control over companies and act as an important mechanism of corporate governance (Rossi and Volpin (2002)). In cross-border transactions the ownership structure and corporate governance become critical for international corporate strategy, as countries differ in their institutional environment and type of corporate governance mechanisms (Porter, 1990). As a result, changes in regulation and environment in corporate control markets may have a significant impact on M&A activity.[5]

In 1980-1990s M&As were often examined as a mode of entry for FDI, with dominant theoretical foundations based on the ownership-location-internalization (OLI) framework and transaction cost theory. In OLI theory cross-border M&A are viewed as an instrument for an international diversification strategy of a firm (Dunning (1993), Wilson (1980)). Cross-border M&As have been motivated by a reduction of transaction costs for entering new markets and a gain from their competitive advantages (Wilson (1980), Dubin (1975)).

According to imperfect market theory, multinational firms obtain a competitive advantage over local firms in the host country due to existing imperfections in product, labor and capital markets (Froot and Stein (1991), Kindleberger (1969)). Hence, the entry mode[6] view emphasizes the main advantage of M&A over greenfield investments[7] and joint ventures—speedy access to proprietary assets. By possessing specific ownership advantages that allow investing abroad, the firm chooses the entry mode and location taking into account different factors in the host country.

Under the profit maximization assumption, an acquisition takes place when the price, the acquiring firm is willing to pay for the acquisition, is higher than the price that the seller wants to charge[8] (Aliber (1970), Dunning (1992), Dubin (1980)). As the ownership of Western corporations is separated from control, most top managers' rewards are more related to the size of the firm over its profitability. Under such circumstances, these managers may lead firms to maximize growth investing more heavily with lower rates of return (Dubin (1980)). While profit maximizing firms will be motivated by firm level variables, growth maximizing firms will be more influenced by behavioral and industry level factors.

The broad range of existing theories suggests that cross-border M&As are influenced by different factors which can be classified by the level of their origin. These factors are summarized in Table 2 below and divided into three categories: country level, industry level and firm level determinants. Country

[5]See Milhaupt and West (2001) for a recent overview of Japanese M&A in the context of corporate control mechanism.

[6]See Shimizu et al (2004) for a complete survey of literature on cross-border M&A as mode of entry in a foreign market.

[7]Start-up investments in new facilities.

[8]In contrast to Japanese M&As, as lots of companies in Japan were overpriced.

level variables describe differences between acquiring and target countries and reflect globalization and internationalization of world markets. Industry level variables reflect barriers for entry and patterns of oligopolistic behavior. Firm variables are related to the concept of transaction costs and imperfections of markets.[9] In the present study we focus mainly on factors of country

Table 2. Determinants of cross-border M&As

Level	Determinant (variable)	Related studies
1. Country	1. Exchange rate	Froot & Stein (1991), McCann (2001), Kang (1993), Blonigen (1997), Goldberg (1993), Swensson (1993)
	2. Labor costs	Cushman (1987)
	3. Interest rates	Aliber (1970)
	4. Tax preferences	Slemrod (1989), Swensson (1994), Razin et al (1998), Wolfson (1992)
	5. Access to sources of financing	Klein (2002), Giovanni (2004)
	6. General economic conditions—market size (GDP), market growth (GDP growth rate), market capitalization, business cycle stage	Vasconcellos & Kish (1998), Giovanni (2004), Dubin (1980)
	7. Specific features of corporate control mechanism in host country	Milhaupt & West (2001), Higgins (2003)
	8. Regulatory constraints	Dubin (1980), Danbolt (1995)
	9. Legal protection of shareholders	La Porta et al (1998), Coffee (1999), Rossi & Volpin (2003), Milhaupt & West (2001)
	10. Information transparency	Rossi & Volpin (2003), Roll (1986)
	11. Stock market prices fluctuations	Harris & Ravencraft (1991)
	12. Bilateral agreements	Vasconcellos & Kish (1998), Giovanni (2004), Danbolt (1995)
	13. Bilateral trade flows	Baldwin & Ottaviano (2001), Bjorvatn (2004), Markusen (1996)
	14. Location and cultural distance	Dubin (1975), Kogut & Singh (1988), Angwin (2001), Brouthers & Brouthers (2000)
	15. Export ratio	Bjorvatn (2004)
2. Industry	1. Industrial shock effects[10]	Resende (1999), Town (1992), Nakamura (2002)
	2. Sectoral division	Wilson (1980), Kogut & Singh (1988)
3. Firm	1. Asset size	Dubin (1980), Kogut & Singh (1988)
	2. Country experience	Very (2001), Dubin (1980), Barkema & Vermeulen (1998), Brouthers & Brouthers (2000), Banerji & Sambharya (1996)
	3. Multinational experience	Wilson (1980)
	4. Technological intensity	Kogut & Singh (1988), Brouthers & Brouthers (2000)
	5. Degree of product diversification	Barkema & Vermeulen (1998)

Source: developed by the author.

[9]See Hymer (1960) concept of emphasizing industry and firm variables as determinants of FDI.
[10]Shocks can be defined as a sudden revaluation of a current order (Nakamura, 2002), e.g. oil shock in 1970s and IT revolution in 1990s. As a result of shock, shareholders of a company value their stock lower than the potential acquirer.

and industry levels.

In the case of examining M&A activity of an individual country, cross-border acquisitions involving national companies as a target (M&A sales) and cross-border acquisitions involving national companies as an acquirer (M&A purchases) have different trends as a result of influence of different factors and therefore will be discussed separately in later sections of this paper.

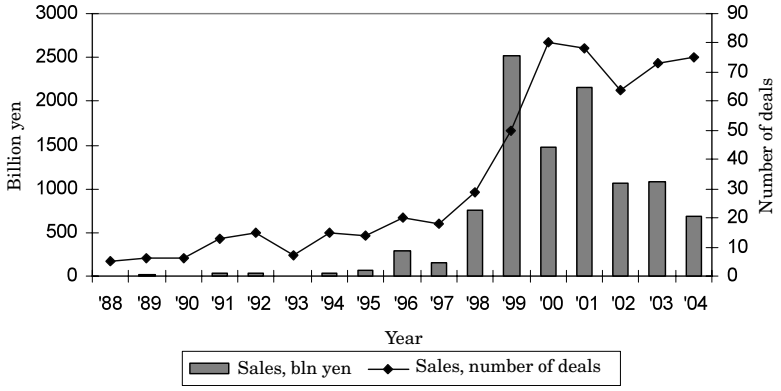
In an overview of Japanese cross-border M&As in general, we note that from 1988 to 2004, the aggregated value of the Japanese cross-border M&A purchases amounted to 20.3 trillion yen and the number of transactions was 3171. The Japanese cross-border M&A purchases exceeded sales by two times in value and 2.5 times in regards to the number of transactions. In the Japanese M&A sales the highest average deal price (30,749 mln. yen) was observed in banking and finance, while in the Japanese M&A purchases the highest average deal price (20,948 mln. yen) belongs to service and communication sector.

First, we discuss foreign acquisitions of Japanese companies and then proceed to examine transaction involving Japanese companies as acquirers.

3. Foreign Acquisitions of Japanese Firms (M&A Sales)

Until 1996 foreign acquisitions of Japanese companies remained very low. Thereafter, since 1998 the Japanese M&A market finally started developing dramatically. During 1988-2004, the total number of the cross-border M&A sales in Japan increased from 5 in 1988 to a 75 in 2004 (Fig. 2), and the value of the transactions increased by 142 times, from 4.8 in 1988 to 682 billion yen in 2004. The number of deals reached its peak of 80 deals in 2000, while the highest value of 2518 billion yen was observed in 1999 due to several mega-deals during this year.[11]

In the breakdown by sector (the bolded section of Table 3 below), considering the *transaction value* column, during 1988-2004 the major part of target



Data source: Nihon Kigyo no M&A Data Book 1988-2002,MARR, 2, 2004, *MARR,* 2, 2005.

Figure 2. Cross-border M&A in Japan (sales), 1988-2004

[11]Data source: *Nihon Kigyo no M&A Data Book 1988-2002, MARR,* 2, 2004, *MARR,* 2, 2005.

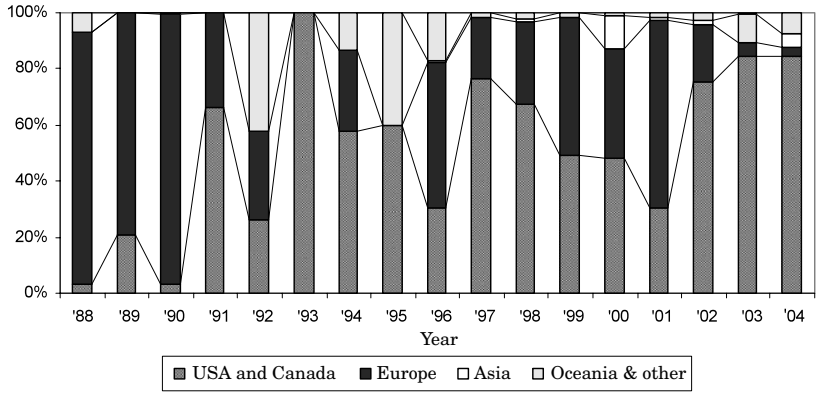
Table 3. Total Japanese cross-border M&A transactions during 1988－2004

Transactions / Industries	Japanese companies as a target				Japanese companies as an acquirer			
	Transaction value, mln. yen	%	No. of deals	%	Transaction value, mln. Yen	%	No. of deals	%
Primary industries	101,036	1.0	17	3.0	1,254,131	5.7	168	6.4
Machinery and electrical	1,989,042	19.1	135	24.0	4,781,616	**21.6**	723	**27.7**
Secondary industries	543,831	5.2	69	12.3	4,156,789	18.7	553	21.2
Service and communication	1,646,255	15.8	81	14.4	4,518,343	**20.4**	216	8.3
Banking and finance	5,442,598	**52.3**	177	**31.5**	2,410,774	10.9	167	6.4
Real estate and construction	139,447	1.3	20	3.6	692,181	3.1	73	2.8
Trade	342,680	3.3	21	3.7	3,921,178	17.7	540	20.7
IT	201,601	1.9	36	6.4	136,449	0.6	121	4.6
Warehouse and transport	5,447	0.1	6	1.1	299,188	1.3	45	1.7
Total	**10,411,937**	**100.0**	**562**	**100.0**	**22,170,649**	**100.0**	**2,606**	**100.0**

Data source: Nihon Kigyo no M&A Data Book 1988－2002, MARR, 2, 2004, MARR, 2, 2005.

firms belonged to banking and finance (52.3%), followed by machinery and electrical (19.1%). In terms of the *number of deals,* the prevalence of transaction in banking and finance still remains, although they only accounted for 31.5% (Table 3). The majority of deals in the financial sector can be explained by the fact that, basically, for many years foreign financial companies have been seeking ways to enter the extensive and profitable Japanese financial market. Recent changes in corporate environment and legislation finally allowed them not only to achieve their aim, but to acquire Japanese financial institutions burdened with significant bad loans at a comparatively low price. The successful acquisition of the Japan Long-term Credit Bank in 1999 by Ripplewood Holdings (USA) created a wave of M&As in the banking and financial sectors.

Figure 3 represents the division of the annual M&A transaction value by the nationality of the acquiring firms. In 1988-1990 European companies dominated in M&A deals in Japan with a share of 80-90% of the total deal



Data source: Nihon Kigyo no M&A Data Book 1988-2002, MARR, 2, 2004, *MARR,* 2, 2005.

Figure 3. M&A transaction value by the nationality of the acquiring firm, 1988-2004

value for those 3 years. Since 1991 companies from the USA have become a major participant in the Japanese M&A market. Companies from Asia didn't play an active role in acquiring Japanese companies, only in 1992 and 1995 the share of companies from China and Hong Kong reached 40% of the total deal value.

Table 4 below shows the breakdown in the number of M&A transaction by industry and acquisition type. The majority of the deals include 2 types of acquisitions; *acquisition* of more than 50% of Japanese company's stock (40.5% of total number of deals) and acquisition of *minority interests* (32.9%). Though, the predominant types of acquisition differ from industry to industry. Acquisitions of more than 50% shares of the target company dominate in secondary industries (49.2%), IT (46.5%), trade (43.4%) and machinery and electrical (41.5%). Large share of acquisitions of more than 50% of a company's stock in manufacturing emphasizes corporate restructuring as a major motive in undergoing transactions.

Table 4. Number of cross-border M&A sales by industries and acquisition types (1988−2004)

Acquisition Types / Industries	**Acquisition** (%)	**Transfer** (%)	**Minority interest** (%)	**Increased interest** (%)	**Merger** (%)	Total (%)
Primary industries	29.7	35.1	24.3	0.0	10.8	100.0
Secondary industries	49.2	23.3	21.3	2.9	3.3	100.0
Machinery and electrical	41.5	22.2	28.6	5.1	2.6	100.0
Banking and finance	32.2	15.1	45.3	6.4	1.0	100.0
Real estate and construction	38.1	41.2	20.6	0.0	0.0	100.0
Trade	43.4	20.0	28.3	3.3	5.0	100.0
Service and communication	39.6	15.2	38.6	3.0	3.6	100.0
IT	46.5	14.0	36.0	2.3	1.2	100.0
Warehouse and transport	33.3	0.0	66.7	0.0	0.0	100.0
Total	**40.5**	**19.7**	**32.9**	**4.2**	**2.7**	**100**

Data source: Nihon Kigyo no M&A Data Book 1988−2002, MARR, 2, 2004, MARR, 2, 2005.

*Acquisition-purchase of more than 50% shares of the target.

Transfer-purchase of operating assets of the target.

Minority interest-purchase of less than 50% shares of the target.

Increased interest-purchase of additional shares of the target, but no more that 50% of the total.

Acquisitions of *minority interest* (Table 4) are more popular in tertiary industrial sector, banking and finance (45.3%) and warehouse and transport (66.7%). Acquisitions by *transfer* have large share in real estate and construction accounting to 41.2% of the total number of deals. The percentages of the acquisitions of *increased interest* and *merger* deals are relatively low.

As we have already noted, the market for foreign acquisitions of Japanese companies started to develop only in the late 1990s. Other recent studies on the Japanese M&As outline specific features of the Japanese corporate control market as major obstacles for cross-border M&A inflow. These obstacles include and are not limited to the following:

- cross-shareholding as a substitute for defensive tactics to combat hostile

takeovers (Sheard (1989), Kleinert (2001));[12]
- overpricing of Japanese companies (Fukao (2004), Nakamura (2002));
- close relations between corporations and their main banks (Aoki (2000), Shibata (1998), Hoshi and Kashyap (2000));
- invisible barriers to efficient transfer of corporate assets[13] (Milhaupt and West (2001), Higgins (2003));
- legal protection of minority shareholders[14] leading to high stocks concentration (Milhaupt and West (2001));
- lack of professional advisors specialized in mergers and acquisitions (Milhaupt and West (2001), Hadjan (2000));
- complex transaction procedures and differences in Japanese and international accounting standards (Shibata (1998)) that limit financial disclosure and information transfer;

Moreover, in many cases, "M&As were avoided because they pose employment risks to both managers and employees" (Higgins (2003)).

The main-bank system and long-term shareholding in Japan were designed as a substitute for the corporate control market, which functioned sufficiently for a long period of time. During the recovery period after World War 2 such a governance system corresponded with the production technology needs extremely well and facilitated high economic growth by channeling large amounts of funds into the industries targeted by the government. However, "with economic downturn as a result of changes in technology, competitive environment and government policy, the lack of mergers and acquisitions left Japanese companies without an adaptation mechanism and system could no longer function effectively" (Milhaupt and West (2001)).

Japan's economic downturn manifested itself in a stable trend to a complete breakdown of all macroeconomic indicators. Many companies went bankrupt and cost of capital increased along with a sharp decrease in profits. GDP growth rates fell to the lowest value during all postwar period (-1.1% in 1998). As a main factor for the stagnation of the Japanese economy, most economists emphasized the banking system. Fluctuations in prices of financial assets played an important role in the worsening of characteristics of the business cycle in Japan, and these shocks were spread throughout bank loan operations (Bayomi 1998, Woo 1998).

Traditionally, the practice of issuing loan in Japanese banks was based not on objective analysis of clients' financial documents, but on established long-term relations between a company and its main bank. Therefore, under

[12]Moreover, cross-shareholding intensified after the 1960s as a defense against the liberalization of the capital markets.

[13]The fact that in 1990-2000s the average premium paid for share in a tender offer was negative (Milhaupt and West 2001), implies existence of below-market tender offers.

[14]This constraint becomes inconsistent with "law and finance" theory (La Porta et al. 1998) where legal protection of minority shareholders is associated with more dispersed ownership and larger capital markets.

the availability of excess funds and low lending rates in the end of 1980s, profitability and project's payback had very little economical impact on the banks' decisions. When the burst of the bubble caused devaluation of real estate, it was extensively used as a collateral for bank loans, and when the Bank of Japan raised official discount rate in December 1989, most Japanese companies became unable to repay high interest rates on their loans and asked their main banks to issue a new loan in order to cover these repayments. Together, long-term stable relations between banks and corporations, confidence that the situation would improve and lack of analytical approach to lending have led to issuing new loans to insolvent clients. Even when the situation grew worse, the existing policy of preventing bankruptcy and supporting their clients didn't allow banks to reject a new loan and write off the debts announcing bankruptcy. Hiding bad loans from bank balance sheets became a very popular practice among banks and was indirectly approved by financial authorities. As a result, nobody could have imagined the real scale of the crisis at hand.

As the banks were suffering from bad loan problems, large corporations with financial difficulties were trying to reduce their transaction costs by introducing new technology, which they could obtain from foreign partners, and/or by restructuring existing management system. Japanese corporations with a stable customer base, established supply channels and infrastructure, and with reliable and dedicated employees have been viewed by foreign companies as a profitable purchase and as the fastest way of entering relatively closed Japanese market. Moreover, financial difficulties significantly reduced the price of Japanese companies.

As a result, increasing competition from foreign companies along with financial difficulties and over-capacity of large corporations pressured Japanese industries to restructure. Therefore, the corporate restructuring as a result of economic downturn played a main role in the increase of Japanese cross-border M&A sales.

The corporate restructuring was facilitated by institutional reforms of the 1990s (Table 5).

In order to revitalize the economy by attracting capital from overseas and re-allocating capital within the country, the Japanese government has taken strategic steps to stimulate the market for corporate control through an institutional reform towards deregulation. These changes provided an incentive for an increase in domestic M&As and the cross-border sales of Japanese companies. As a result of liberalization, the excessive capacities of Japanese corporations motivated foreign investors to choose acquisition over investing in new facilities.

A new corporate legislation was approved on June 29, 2005, and is scheduled to be enforced in 2006. In the area of the M&As, the legislation allows to use foreign shares as well as cash to be offered to shareholders of the non-surviving company target in a merger. It also enables triangle mergers, in which a foreign company sets up a Japanese subsidiary, transfers its shares to this affiliate, and then uses this arrangement to gain leverage in merging with a separate Japanese firm. Though, the portion of the law enabling such merg-

Table 5. Changes in the institutional environment

Area of changes	Year	Description of the changes
Securities and exchange law	1972	Permission of tender offers
Securities and exchange law	1990	Removal of the requirement on mandatory notification with the Ministry of Finance about placing a tender offer[15] and mandatory publishing offer in national newspapers
Foreign Exchange and Foreign Trade Control Law	1990	Removal of the restrictions on capital flows transactions
Commercial Code	1997	Removal of the ban on pure financial holding companies
Commercial Code	1999	Introduction of share-for-share exchange between companies[16]
Accounting standards	April 1999	Introduction of consolidated accounting and cash flow statements
Commercial Code	October 1999	Allowed acquisitions of the entire shares of another company without need for cash or necessary 100% shareholders' approval
Civil Rehabilitation Law	2000	Promotion of acquisitions of financially troubled firms by providing more flexible and efficient reorganization procedures, introduction pre-packaged bankruptcy with the reorganized firm emerging under new ownership
Commercial Code	2001	Allowed companies the transfer of the whole or a part of its business more speedily
Accounting standards	2001	Introduction mark to market accounting for financial assets
Securities and exchange law	2001	Development of treasury stock system
Securities and exchange law	2002	Introduction of new stock option system（Stock acquisition rights）
Securities and exchange law	2002	Introduction of class share system
Industrial Revitalization Special Measures Law	April 2003	Allowed to use the stock of an acquiring party（including foreign companies）for financing M&A deals[17]

Source: Nikkei, Milhaupt C., West M. Institutional change and M&A in Japan: diversity through deals, Working Paper, 93, Columbia Law School, 2001.

ers will be enforced only in spring 2007, because of the anxiety of foreign hostile takeovers of Japanese companies. The delayed enforcement was designed in order to give Japanese companies the time to prepare different countermeasures for possible hostile takeovers, such as "poison pills" and "golden shares," or equities that accord veto rights to "friendly shareholders" at shareholder meetings. The law also greatly eases the standards on plans for simple corporate mergers and splits that do not have to be put to a vote at shareholders meetings.

Recently, some new methods of financing M&A transactions have been developed. Following the example set by Livedoor Co. when it purchased a large portion of shares in Nippon Broadcasting System Inc. in 2005, an increasing number of companies have started financing their takeover deals by issuing moving strike convertible bonds that allow investors to convert the instruments into stock at lower prices when share prices are down.

Changes in corporate environment represent the third important factor

[15]This requirement was abolished only for Japanese bidders.

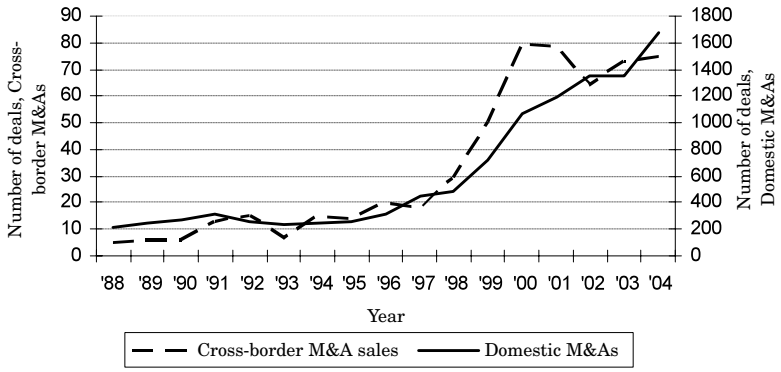
[16]Before it was impossible, as there were always shareholders who refused to sell their shares. According to the new rule, an acquired company can become a wholly owned subsidiary of domestic or foreign company through share exchanges. As a result, foreign companies became able to create their own subsidiaries in Japan through mergers and acquisitions.

[17]However, the use of stock from a non-Japanese firm is restricted to stock-for-stock exchanges with bankrupt companies and also non-Japanese companies cannot use this scheme on a tax-deferred basis.

for the increase in the Japanese cross-border M&A sales in the late 1990s. Companies started to reduce the number of their outside directors, the management structure became more flexible and the cross-shareholding ratio fell from 18% in 1987 to 13% in 1998.[18] Likewise, long-term shareholding by financial institutions decreased from 46% to 40%. In the end of the 1990s a significant number of foreign advisors on M&As opened their branches in Japan and already, by 2000 they had become the most popular advisors in the Japanese M&A market.

As a result of the changes in legislative and corporate environment, the institutional structure of the Japanese cross-border M&A sales has shifted. The share of business transfers increased from 0% in the end of 1980s up to 21.3% in 2004. On the other hand, the share of acquisitions decreased from 57.1% to 32%.

Evidence shows that the increase in the Japanese cross-border M&A sales was accompanied by a sharp increase in domestic M&A deals (Fig. 4) which was mainly due to corporate control restructuring and reorganization of companies with financial difficulties under the changes in institutional and corporate environment. Along with the tendency towards liberalization those changes created an opportunity for foreign companies to enter the Japanese M&A market.



Data source: Nihon Kigyo no M&A Data Book 1988-2002, MARR, 2, 2004, *MARR* #2, 2005.

Figure 4. M&As in Japan, 1988-2004, number of deals

The cross-border ratio[19] for the M&A transactions involving Japanese companies as a target rose from 3% in 1990 to 11%[20] in 2000 which demonstrates growing attractiveness of Japan as a target market for cross-border M&A deals. Despite a very low number of the cross-border sales comparing to domestic M&A deals, during 1997-1999 their annual growth rates exceeded the domestic M&As' growth rates (60.5% for cross-border sales comparing to 32.2% for domestic deals). The main motives for the domestic M&As in Japan

[18]See Milhaupt and West, 2001, p.38

[19]Number of cross-border deals as a percentage of all completed deals.

[20]Calculations are based on *Nihon Kigyo no M&A Data Book 1988-2002, MARR* #2, 2004, *MARR* #2, 2005.

were ongoing companies' restructuring, disposal of troubled companies and industry consolidation.

Thus, economic downturn resulted in financial difficulties of Japanese companies, which finally gave foreign companies the ability to enter Japanese markets, especially the financial market. Hence, the changes in legislation and corporate environment have become one of the main accepting factors of an increase in the Japanese cross-border sales.

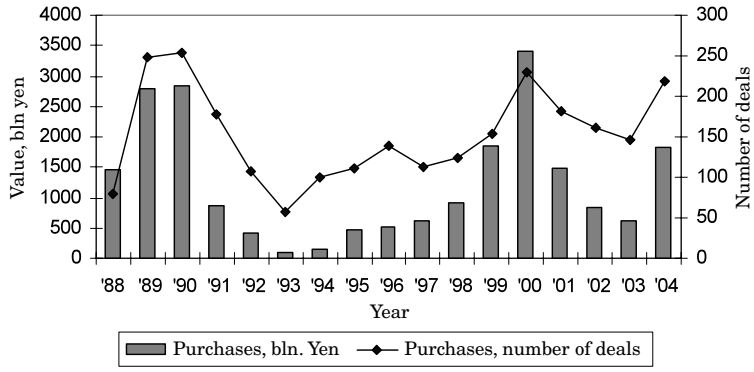
However, since 2001 the cross-border M&A sales in Japan have started to decrease gradually. It partly can be explained by the slowdown in Japanese corporate restructuring caused particularly by massive liquidity flows from the banking system. Hence, in 2001-2002 when recapitalized banks, gradually removing bad loans from their balance sheets, became able to start lending again, resulting in many companies with financial difficulties not needing foreign investors anymore. One of the reasons for the delayed development of the Japanese M&A market lies in the key difference between Western corporate governance system, which gives priority to the profits of shareholders, and the Japanese system, which gives priority to the interests of stakeholders-employees, business partners or managers. Moreover, in keeping with the traditional approach, government and Japanese companies still stand against vertical integration and the Western business model and consider acquisitions to be admissions of failure by the seller.

4. Acquisitions of Foreign Firms by Japanese Companies

In contrast to the Japanese cross-border M&A sales serving as a corporate restructuring vehicle, the main functions of the Japanese cross-border M&A purchases were international diversification, market expansion and, in some cases, reduction of production costs during economic recession.

Though, traditionally, Japanese Transnational Corporations (TNC) prefer greenfield investments to cross-border M&As, especially when investing in developing countries, cross-border M&As as a part of foreign direct investment flows represent an important activity of Japanese firms. During 1988-2004 the number of Japanese cross-border M&A purchases experienced three waves, shown on Figure 5. In terms of the value of the Japanese M&A purchases 2 peaks can be observed－2,837 bln. yen in 1990 and 3,408 bln. yen in 2000.

In the late 1980s Japanese companies were increasingly using M&As as the fastest way to take advantage of increased market opportunities as M&As enable sidestepping of permits and licensing procedures in a new market in conflict with greenfield investing. As financial liberalization progressed along with yen appreciation and low costs of capital which caused excessive funds availability in the banking system, many Japanese companies were involved in acquiring foreign companies, especially in the US (Fig. 7). In 1990, during the last growth of the economic bubble, the number of foreign purchases was at a peak. They reached 254 deals followed by a sharp decrease due to the burst of the bubble. Soon thereafter a slight rise in 1994-1996s was due to increasing investments in Asian countries, as Japanese companies were seeking



Data source: Nihon Kigyo no M&A Data Book 1988-2002, MARR, 2, 2004, *MARR* #2, 2005.

Figure 5. Cross-border M&As in Japan (purchases), 1988-2004

for opportunities to both lower their production costs and enter promising markets for the future (Fig. 7). Unfortunately, the Asian crisis changed this tendency and during 1997-1998 the Japanese M&A purchases were gradually declining until 2000. A significant rise and sharp decrease in Japanese M&A purchases during 2000-2004 requires a better understanding of the factors affecting these activities.

As shown in Table 3 (Section 3 of our paper), the main targets for the Japanese outward M&A deals during this period were machinery and electrical (21.6% of the total value), service and communications (20.4%), and secondary industries (18.7%). In terms of the number of deals, the largest share of the target companies belonged to machinery and electrical industry (27.7%), secondary industries (21.2%) and trade (20.7%). Transactions in service and communication accounted to only 8.3% of the total number of deals due to a mega-deal involving NTT Docomo acquiring a US company in 2001.

As shown in Table 6, in contrary to the M&A deals with Japanese companies as a target (Table 4) where the *acquisitions* of more than 50% of shares

Table 6. Number of the cross-border M&A purchases by industries and acquisition type (1988－2004)

Acquisition type / Industries	Acquisition (%)	Transfer (%)	Minority interest(%)	Increased interest(%)	Merger (%)	Total (%)
Primary industries	31.4	18.2	44.3	4.4	0.7	100.0
Secondary industries	44.2	18.1	35.3	1.7	0.6	100.0
Machinery and electricals	43.5	12.3	40.3	2.5	1.4	100.0
Banking and finance	27.4	8.8	59.3	3.2	1.4	100.0
Real estate and construction	69.2	13.3	17.5	0.0	0.0	100.0
Trade	28.9	10.7	57.5	2.2	0.8	100.0
Service and communication	44.2	18.1	35.3	1.7	0.6	100.0
IT	28.4	8.1	62.2	1.4	0.0	100.0
Warehouse and transport	51.2	8.5	40.2	0.0	1.2	100.0
Total	**38.4**	**12.9**	**45.5**	**2.2**	**1.6**	**100.0**

Data source: Nihon Kigyo no M&A Data Book 1988－2002, MARR, 2, 2004, *MARR,* 2, 2005.

were the most popular type, except real estate and construction, Japanese companies acting as acquirers tend to purchase *minority interests* (45.5% of the total value). Especially, the share of the acquisition of *minority interests* is high in IT sector (62.2%), banking and finance (59.3%) and trade (57.5%). Similar to the Japanese cross-border sales, the share of acquisitions of *increased interests* and *mergers* again remains very low. One of the reasons for the existing investment breakdown may be due to specific features of transactions financing and business practice. Purchase of minority interests minimizes the investor's risk, releases him from control obligations and at the same time facilitates export-import transactions (e.g., in the trade sector).

Specific features of the M&A financing in Japan are related to existing bank-based financial system and domination of financial institutions as top shareholders. Therefore, relative access to credit funds is especially important for Japanese companies. Most M&A transactions of Japanese companies (including both domestic and cross-border) use cash as a method of payment—as opposed to share transfers. Despite recently taken liberalization measures, the number of transactions through exchange of shares in Japan remains very low (Table 7).

Table 7. Japanese M&As through exchange of shares, number of deals

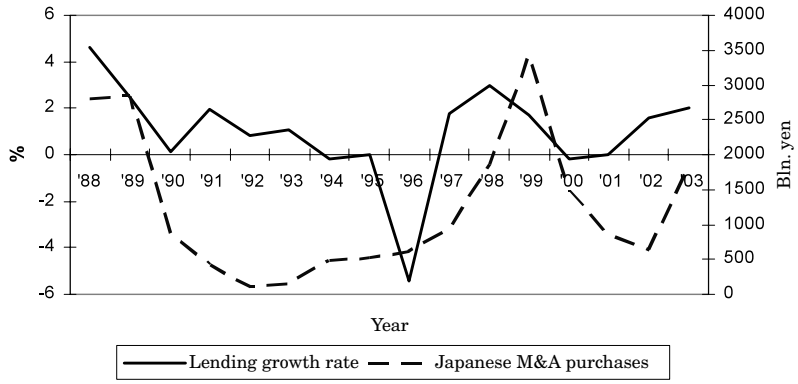
Year / Transactions	1999	2000	2001	2002	2003	2004
M&As through exchange of shares	14	31	27	36	21	77
Total M&As	1169	1635	1653	1752	1728	2211
M&As through exchange of shares, (%)	1.20	1.90	1.63	2.05	1.22	3.48

Data source: Nihon Kigyo no M&A Data Book 1988—2002,MARR, 2, 2004, *MARR*, 2, 2005.

The sources of financing M&A deals are considered in the number of studies as an important determinant of cross-border M&A flows. For instance, Klein et al. (2002), using bank-level and firm data found financial conditions of the banking system statistically and economically significant in reducing number of Japanese FDI projects into the United States in 1990s. In the case of imperfect capital markets with constraints on the availability of credit resources, banking crises have a strong influence on investments outflow.[21] Consequently, the problems in the banking sector from the late 1990s to the beginning of 2000s expressed a reduction in lending growth rates due to accumulation of bad loans (Fig. 6), and can partly explain the decline in the Japanese cross-border M&A purchases.

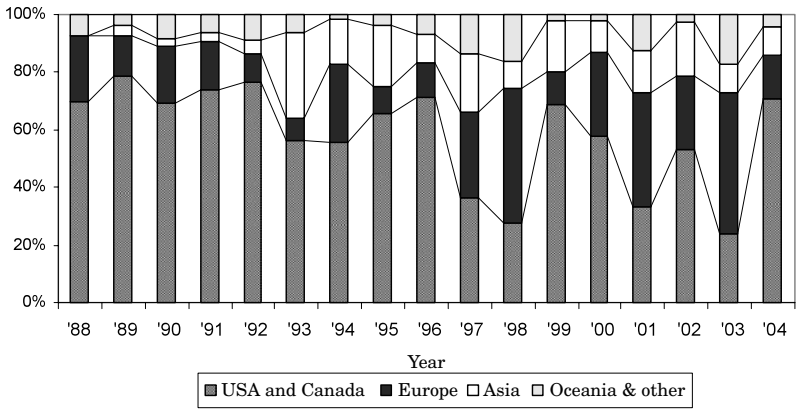
The breakdown of M&A deals valued by the nationality of the target firms (Fig. 7) shows that during 1988-1996 the USA accounted for the majority of the deal value (56-76%). Although, since 1997 the share of European companies as a target started to increase significantly and reached 49% in 2003. The share of Asian companies as a target began to rise since 1993, fluctuating from

[21]For example, Giovanni (2004) also considers financial sector to be a possible reason for the changes in M&A activity in the 1990s.



Data source: Nihon Kigyo no M&A Data Book 1988-2002, MARR, 2, 2004, *MARR,* 2, 2005; *Nikkei.*

Figure 6. Japanese M&A purchases and lending growth rates (1988-2004)



Data source: Nihon Kigyo no M&A Data Book 1988-2002,MARR, 2, 2004, *MARR,* 2, 2005.

Figure 7. The Japanese M&A transaction value by the nationality of the target firms, 1988-2004

29.6% in 1993 to 10% in 2004.

For deeper understanding of the structure of trends in Japanese outward M&A activity, we examine the factors of the distribution of the outflow value. In order to estimate the effect of determinants of the Japanese cross-border M&A purchases, we test the gravity model including the factors presented in Table 2, Section 2 of our paper.

Our sample contains all the cross-border M&A transactions with the disclosed value involving Japanese companies that were announced from January 1, 1988 to December 31, 2004 and reported in Nihon Kigyo no M&A Data Book (1988-2002) and Mergers and Acquisitions Research Report (MARR) published by Japan-based Recof Corporation.

For independent variables several data sources were used. The data on real GDP, GDP growth, market capitalization, were obtained from the World Bank's World Development Indicators (WDI) database. The data on trading volume on the Tokyo Stock Exchange comes from IMF's International Financial Statistics (IFS) database. Bilateral exchange rates volatility was calcu-

lated using the annual average exchange rates taken from Pacific Exchange Rate Service Database.[22] The bilateral trade indicators were calculated using trade flow data from Japanese Customs's Trade Statistics Database and total import of target countries data from EconStat Global Database. Based on the respected legal systems in each target country obtained from La Porta et al (1998), a legal origin dummy was constructed. Differences in wages in the manufacturing sector were calculated using the ILO Laborsta Internet Database.[23] These data were not available for some countries and using this variable reduced our sample size. Data on Bilateral treaties for the avoidance of double taxation was taken from UNCTAD Country Report (Japan). Data on the distance between countries were calculated using USDA distance calculator.[24]

The specification used combines the standard gravity-type variables with other macroeconomic variables. The equation is similar to the standard 'gravity' equation originally developed in the studies of international trade.

$$\text{Log M\&A}_{i,t} = \alpha + \beta_0 \log \text{GDP}_{i,t} + \beta_1 \text{Bilateral Trade}_{i,t} + (\beta_1 \text{Log TRADE}_{i,t}) + \beta_2 \text{Wage}_{i,t} + \beta_3 \log \text{Dist}_i + \beta_4 \text{Legal Origin}_i + \beta_5 \text{BTT}_i + \beta_6 \log \text{TV TSE}_t + (\beta_6 \text{Credit Growth}_t) + \beta_7 \text{EXR}_{i,t} + \beta_8 \text{GDP GR}_{i,t} + \beta_9 \text{MC}_{i,t} + \varepsilon$$

where, i denotes the target country and t denotes the time.

The dependent variable represents the annual value of the M&A deals between Japanese companies and target companies in country i.

Log $\text{GDP}_{i,t}$	-logarithm of targets' real GDP taken in current prices, US dollars;
Bilateral $\text{Trade}_{i,t}$	-the value of imports by country i from Japan as a percentage of total imports by country i;
Log $\text{TRADE}_{i,t}$	-logarithm of the total export and import annual values between Japan and target country i;
$\text{Wage}_{i,t}$	-difference in wages in manufacturing sector between Japan and target country as a percentage of wages in Japanese manufacturing sector;
Log Dist_i	-the distance in kilometers between Japan and target country (distance between Tokyo and the capital of target country);
Legal Origin_i	-a dummy variable that equals one if the origin of the company law is the English common law and zero otherwise;
BTT_i	-a dummy variable that equals one if there is a bilateral double taxation treaty between Japan and target country and zero otherwise;
Log TV TSE_t	-logarithm of trading volume in million of shares in TSE,

[22] http: //fx.sauder.ubc.ca/data.html

[23] http: //laborsta.ilo.org/

[24] http: //www.wcrl.ars.usda.gov/cec/java/lat-long.html

	1st Section, (Yearly Average);
Credit Growth$_t$	-annual bank lending growth rate in Japan;
EXR$_{i,t}$	-percentage of volatility of target's currency to Japanese yen exchange rate comparing with previous year;
GDP GR$_{i,t}$	-real GDP growth rate;
MC$_{i,t}$	-market capitalization in current US$ of country i as a percentage of real GDP in current US$ of country i.

Some of our independent variables were obtained from recent studies on cross-country determinants of the world M&A flows. We modified the model used by Giovanni (2004), Rossi and Volpin (2004), Vasconcellos and Kish (1998), Nakamura (2002), Portes and Rey (2005) for cross-country analysis of determinants of the world M&As, having it adjusted for an individual host country. The independent variables were developed and are listed in Table 2 which summarizes previous studies on determinants of FDI including M&As. Our independent variables are as follows:

1. *Bilateral trade* represents one of the most important factors influencing M&A flows, as FDI and international trade are positively correlated. Therefore, since M&As represent a part of FDI flows the inflow of M&As to a target country is expected to be positively correlated with trade flows between Japan and target country.

2. The target country's *real GDP* and *GDP economic growth* variables describe the market size and changes in economic conditions in a target country. Basic investment theory suggests that countries with larger economies invest more in each other due to economies of scale in production and distribution. Thus, the correlation between GDP variables and M&A volume is expected to be positive.

3. *Legal Origin* variable was introduced by La Porta et al.(1998) and identifies company law or commercial code of the target country. It has been argued that countries with English common law offer greater protection to investors and stimulate larger capital markets[25] than countries that are primarily institution-based and with commercial codes based on German or French families of civil law (Allen and Gale, 2000; La Porta et al. 1998). As greater investor protection increases capital market efficiency, its impact on the inward M&A activity will be positive.

4. The ratio of *stock market capitalization* to GDP represents a measure of capital market liquidity (Rossi and Volpin 2003, Globerman and Shapiro 2004, Giovanni 2004). M&A inflows are expected to be greater to the countries with more liquid stock markets and positively related to M&A value in a target country.

5. *Volatility of exchange rates* of the host and target countries' currencies creates additional risk in investment transaction. Moreover, the degree of

[25]The average ratio of stock market capitalization to GDP for the common law countries, 110.6% is over two-thirds larger than 68.7% capitalization-to-GDP ratio for civil law nations (Megginson (2004)).

exchange rate volatility may be an indicator for financial crisis in a target country. On the other hand, high exchange rate volatility may reduce the price of the target company in terms of home currency of the host country, and increase the value of expected future cash flows from the acquired firm. Consequently, the impact of exchange rate volatility on M&A value can be both positive and negative.

6. The existence of *bilateral tax treaties* between the host and target countries provides the elimination of double taxation in M&A transactions and can be used as a measure of tax influence. In his cross-country analysis of determinants of the world cross-border M&A, Giovanni (2004) found that the bilateral tax treaties have positive effect on M&A inflows by offering additional tax gains to acquiring companies.

7. Standard investment theory predicts that a lower *labor cost* in a target country has a positive effect on investment decision by reducing production costs and therefore we expect a negative correlation between the difference of wages in the host and target countries and a M&A value. However, as the majority of the deals were concluded with the US and European companies, the effect of this variable on M&A flows may be implicit.

8. In the gravity model of investment flows *distance* between the host and target countries is positively correlated with investment volume.

9. *Credit growth rate* variable was included in order to reflect the influence of the availability of credit funds on Japanese outward M&A flows, since bank loans were main sources of financing Japanese M&A purchases in the end of1980s to the beginning of 1990s.

10. In addition to target countries' variables, we include *trading volume of shares* in Tokyo Stock Exchange as an indicator of financial crises in Japan in the beginning of 1990s and 1997.

The means and correlation coefficients for the independent variables are

Table 8. Correlation matrix, independent variables

	Mean	STD D	Log GDP	Bilateral Trade	Wage	Log Dist	Legal Origin	Log TV TSE	BTT	EXR	GDP GR	MC
Log GDP	11.39	0.67										
Bilateral Trade	8.00	7.13	−0.25									
Wage	43.62	40.14	−0.19	0.06								
Log Dist	3.86	0.21	0.17	−0.63	−0.17							
Legal Origin	0.48	0.50	−0.22	0.40	−0.04	−0.27						
Log TV TSE	4.72	0.17	0.05	−0.02	0.03	−0.11	−0.07					
BTT	0.91	0.29	0.06	−0.10	−0.35	0.39	0.22	0.01				
EXR	10.68	8.82	0.06	−0.03	−0.29	0.09	0.04	0.10	0.06			
GDP GR	3.70	3.54	−0.10	0.34	0.06	−0.25	0.16	0.01	−0.10	−0.10		
MC	0.81	0.72	−0.04	−0.02	−0.04	−0.01	−0.09	−0.24	−0.27	−0.12	−0.02	
Log M&A	3.71	1.04	0.39	0.06	−0.09	0.01	0.09	0.20	0.12	−0.03	0.02	−0.06

Source: Author's own calculations.

presented in Table 8. The highest correlation is observed between trade and distance variables; therefore distance in some cases is excluded.

The model is estimated by pooling all data across the target countries during a 17 year period (1988-2004). Due to the limited time period for our sample, we used OLS estimation, which we believe is suitable in our case and provides a fair structure of the effects. The results from the econometric analysis are presented in Tables 9 and 10.

Table 9. Determinants of the value of the Japanese cross-border M&A purchases, OLS estimates

Specifications / Independent variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Log GDP	0.49 (0.04)*	0.20 (0.06)*	0.47 (0.05)*	0.15 (0.08)**	0.46 (0.05)*	0.48 (0.05)*	0.47 (0.05)*	0.21 (0.09)*
Bilateral Trade	0.20 (0.04)*		0.26 (0.05)*		0.26 (0.06)*	0.37 (0.08)*	0.26 (0.05)*	
Log Trade		0.33 (0.06)*		0.45 (0.09)*				0.40 (0.11)*
Wage			−0.16 (0.06)*	−0.03 (0.05)	−0.14 (0.06)*	−0.06 (0.06)	−0.10 (0.05)	−0.04 (0.07)
Log Dist				0.17 (0.07)*		0.19 (0.07)*		0.14 (0.08)**
Legal Origin		0.16 (0.04)*		0.08 (0.05)	0.18 (0.05)*	0.12 (0.06)*	0.18 (0.05)*	0.16 (0.07)*
BTT					0.07 (0.05)			
TV TSE		0.15 (0.04)*		0.16 (0.05)*	0.17 (0.05)*	0.20 (0.05)*	0.17 (0.05)*	0.26 (0.05)*
EXR						−0.04 (0.05)		−0.03 (0.06)
GDP growth rate		−0.11 (0.04)*					−0.10 (0.05)	
MC								−0.01 (0.06)
Intercept	−5.36 (0.78)*	−6.75 (1.16)*	−5.67 (0.99)*	−10.19 (1.71)*	−9.86 (1.53)*	−12.53 (1.78)*	−9.56 (1.52)*	−12.13 (1.88)*
Adjusted R^2	0.244	0.319	0.30	0.359	0.355	0.359	0.355	0.400
F−Statistics	67.48	40.62	46.04	31.49	30.01	21.79	30.21	18.55
N of observations	422	424	322	327	318	261	319	212

*-*significant at 5% level,* **-significant at 10% level

Source: Author's own calculations.

Table 9 presents 8 specifications with different combinations of variables used. The correlation between bilateral trade variable and M&A purchases is highly significant and positive. In particular, according to the specification (3) and (4) in Table 9, a 1% increase in share of imports from Japan in total imports of a target country is associated with a 0.26% increase in Japanese M&A inflow into the target country. Meanwhile, a 1% increase in bilateral trade turnover between Japan and a target country is associated with a 0.45% increase in the Japanese cross-border M&A purchases. This result is consistent with Giovanni (2004) and Rossi and Volpin's (2003) results for their cross-

Table 10. Determinants of the value of Japanese cross-border M&A purchases in developed countries, OLS estimates

Specifications / Independent variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Log GDP	0.48 (0.05)*		0.53 (0.06)*		0.49 (0.05)*	0.48 (0.06)*	0.51 (0.06)*	
Bilateral Trade	0.34 (0.05)*		0.31 (0.06)*		0.19 (0.07)*	0.15 (0.06)*	0.28 (0.06)*	
Log Trade		0.56 (0.06)*		0.50 (0.06)*				0.65 (0.05)*
Wage			−0.07 (0.06)	−0.02 (0.06)			−0.02 (0.06)	−0.04 (0.06)
log Dist				0.18 (0.06)*				
Legal Origin		0.8 (0.06)		0.15 (0.06)*	0.19 (0.07)*	0.19 (0.08)*		
BTT					0.02 (0.05)		0.04 (0.06)	
Credit Growth		0.21 (0.05)*		0.22 (0.05)*	0.20 (0.05)*	0.16 (0.06)*	0.17 (0.06)*	0.19 (0.05)*
EXR						0.03 (0.06)		
GDP GR		−0.02 (0.05)						−0.05 (0.06)
MC							0.17 (0.06)*	0.16 (0.06)*
Intercept	−6.88 (1.15)*	−2.96 (0.70)*	−7.40 (1.19)*	−7.21 (1.78)*	−7.25 (1.14)*	−7.59 (1.34)*	−7.47 (1.21)*	−3.42 (0.60)*
Adjusted R^2	**0.367**	**0.386**	**0.408**	**0.367**	**0.384**	**0.420**	**0.465**	**0.501**
F−Statistics	59.31	35.41	42.53	33.51	28.35	24.92	25.52	35.09
N of observations	231	220	182	225	220	212	170	171

*-*significant at 5% level,* ** -significant at 10% level

Source: Author's own calculations.

country M&As' determinants.

Real GDP of the target country has a strong influence on the value of the Japanese M&A purchases, though it becomes less significant in specifications (2) and (4) in Table 9, when TRADE variable is used. As expected, the coefficient for GDP variable shows that the Japanese M&A purchases are larger in countries with larger economies.

Legal origin variable is also positive and significant in the majority of the specifications, and our results are consistent with Rossi and Volpin (2003). As there are more M&As in countries with common law origin, the Japanese M&A purchases follow the same trend.

Labor cost determinant is negatively correlated with the M&A value, but the correlation is generally lower than in cross-country M&A studies, which suggests that Japanese companies are not using M&As mainly for reduction of production costs, in contrast to Japanese FDI in general, as they tend to be involved in M&A purchases more in countries with larger and developed mar-

kets.

Despite the fact that Japan has special Bilateral Tax Treaties (BTT) for avoidance of double taxation with 49 countries, for which the Japanese M&A purchases comprise 98.3% of total M&A purchase value, BTT variable is insignificant in all specifications. EXR variable is also not significant in all cases, and mostly was excluded from the specifications. GDP growth has a negative sign, which also confirms that Japanese cross-border M&A outflows are greater in the countries with stable and relatively small growth rates.

As the majority of the Japanese outward M&As are concentrated in developed countries (90.2% of the total M&A value), in the next step of our analysis we excluded developing countries from our sample (as shown in Table 10).

Trade and market capitalization variables become more significant in the above developed countries sample. This implies that Japanese companies in M&A purchases in developed countries are influenced by bilateral trade flows and market liquidity at a higher degree than in the original sample.

5. Conclusion

In summary, this paper examines the trends in the Japanese cross-border M&A transactions during 1988-2004, their motives and the factors influencing them. In contrast to the Japanese cross-border M&A sales serving as a corporate restructuring vehicle, the main motives of the Japanese cross-border M&A purchases were international diversification and the expansion of sales in the developed markets.

In this paper we made an attempt to determine the effect of factors influencing the Japanese cross-border outward M&A transactions. The results show that besides the importance of the market size in a target country, the main factor affecting the location of the Japanese M&A purchases is bilateral trade flows between Japan and a target country. According to our analysis, Japanese companies tend to have more M&A purchases in existing developed markets with which Japan has a large trade turnover, mainly in export. Moreover, the liquidity of capital markets and the degree of investor's protection in a target country have significant correlation with the volume of the Japanese outward M&As. The negative sign of the labor cost coefficient suggests that Japanese companies are not using M&As mainly for reduction of production costs, in contrast to Japanese FDI in general, as they tend to involve in M&A purchases more in the countries with larger and developed markets. Bank lending growth rate is significant in the developed countries sample and is positively correlated with the M&A volume that supports the hypothesis on the importance of the sources of financing for the Japanese outward M&A transactions.

The trends in Japanese cross-border M&A sales are determined by the institutional factors because the Japanese corporate governance and financial systems are very unique. The domination of financial institutions in corporate shareholdings, long-term shareholding and credit-based system of financing with underdeveloped stock markets were the major obstacles for the M&A

market development. Our findings show that the major factors influencing the Japanese M&A sales in 1988-2004 were economic depression and changes in the legislative and corporate environment. Accumulated bad loans in banking system significantly reduced the amount of available credit funds and created pressure for restructuring in corporate sectors. The recent institutional reform towards liberalization of corporate market facilitated the sharp increase in the Japanese M&A sales, especially in banking and finance.

In closing, the recent changes in the legislation and corporate structure in Japan have created a more favorable environment for M&A activity and demonstrate that Japan is keeping pace with the worldwide tendencies towards globalization and internationalization. Major Japanese banks have essentially completed their bad-loan disposals and have available funds for financing M&A transactions abroad. Moreover, new methods of financing, such as stock swaps and convertible bonds are developing, following the changes in corporate legislation. The latest changes in accounting systems increased transparency in financial reporting which can facilitate calculating real value of a company and unify the approach to determine a deal price. Despite the still existing institutional and cultural constraints, the Japanese M&A market is gradually developing and according to foreign analysts' forecasts, over the next 6-7 years might reach the current level of modern European M&A activity.

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