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M&A Japanese Style

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On October 24, 2007 this headline appeared in the Nikkei, Japan's equivalent of the Wall Street Journal: "Midsize Drugmakers Stay Independent Via Takeovers By Nondrug Firms" The article analyzed the Kyowa Hakko/Kirin deal.

Hard to find a businessman in the US or Europe who believes independence can be achieved by a takeover.

A generalized M&A scenario in Japan's pharma industry goes like this:

Company A, a conglomerate, merges its pharmaceutical assets into Company B, a listed, pure play pharma firm. In return, Company A acquires a majority (50.1%) interest in Company B. Company B remains listed and its president and his key associates run the combined business.

A foreign businessman could legitimately ask the question, "Who acquired whom?"

But there is more to this story that adds to the confusion. A headline in an October 20 article stated, "Kyowa Hakko Would Tap Kirin's Funds To Replenish Drug Pipeline." The article went on to say Kyowa will receive much needed financial and technology assistance from Kirin while it controls the pharma operations of the Kirin group. Furthermore, Kirin agreed not to change its 50.1% stake in the combined firm for a decade after October 2008.

The timing of this deal is also of interest. Kirin Pharma President Katsuhiko Asano said, "I've been talking with Matsuda (Kyowa Hakko President) for five or six years with the conviction that combining our technologies' will be effective going forward." The first step toward full integration takes place through a takeover bid whereby Kirin will acquire 27.95% of Kyowa Hakko. In April 2008, Kyowa Hakko will take over Kirin's subsidiary Kirin Pharma through a stock swap. With this, Kirin will hold 50.1% of Kyowa Hakko and turn it into a consolidated subsidiary. Kyowa Hakko and Kirin Pharma will merge in October 2008.

The lesson here is that you need to talk about a deal for five years, take one year to execute the merger, stand still on any further equity interest for 10 years, and in the meantime provide the acquired firm with "much needed" financial assistance. Depending on your point of view you could congratulate Kirin for their patience, or criticize them for getting sucked into a time consuming, expensive rescue operation. All the press reports I read took the former view.

Another example is Dainippon Sumitomo Pharma Co. Press reports said Dainippon strengthened its financial and managerial base by "affiliating" with Sumitomo Chemical Co. Although Sumitomo owns 50.1% of the combined company, Mr K. Miyatake, previously president of Dainippon, said, "We have been entrusted with leading the group's medical operations by Sumitomo Chemical.

Yet another example is the merger of Mitsubishi Pharma Corp. and Tanabe Seiyaku Co. The new company name is Mitsubishi Tanabe Pharma. Mitsubishi Chemical Holdings Corp. merged its pharma operations into Tanabe and took a majority interest in the newly named firm. And yes, Mr N. Hayama of Tanabe is the president.

Given the herd mentality among Japanese decision makers, observers expect this M&A model will be embraced by Asahi Kasei Corp., Ajinomoto Co., Teijin Ltd., Japan Tobacco Inc., Meiji Seika Kaisha Ltd., and Yakult Honsha Co. It is a safe bet to assume investment bankers are hot on the trail of midsized drugmakers who wish to stay "independent" through a takeover by one of these firms.

Married but Separated

Foreign executives can be excused for scratching their heads over a model that appears to be akin to getting married but living separately. Can this limited togetherness lead to marital bliss and avoid a nasty divorce?

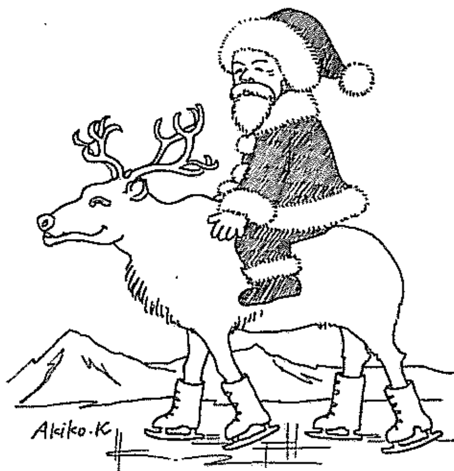
No doubt separation minimizes friction between two parties, but at the same time limits the desired synergies one should expect from an acquisition/merger. The so-called freedom factor certainly enhances the morale of executives and employees of the acquired firm. But who is looking out for the morale of Kirin, Mitsubishi and Sumitomo employees and executives?

Another serious issue relates to the governance of parent-subsidiary listings. For example, Tanabe remains a listed company in which the parent company, Mitsubishi Chemical Holdings, holds a majority of voting rights. Thus, other shareholders, even if they acted collectively, could not elect a board member of their choice unless they obtained the parent company's agreement.

I suspect this issue caused Merck to convert Banyu into a wholly owned subsidiary rather than a majority owned listed subsidiary. Will Roche eventually feel the same way about Chugai? Or both Mitsubishi and Sumitomo about their majority owned subsidiaries?

The acquisition game in Japan is all about a balance between friction and synergy. In the case of Yamanouchi and Fujisawa merging to become Astellas, they clearly eschewed the holding company structure for a complete merger and new image. They opted for the benefits of synergy and worked to reduce friction.

I have no doubt the preferred route for a foreign company to acquire a Japanese firm must start with a relatively small equity investment ratio to keep friction between the two firms to a minimum. At the same time I agree with the president of Nidec Corp, a precision motor maker, which controls listed subsidiaries under its wing, who said, "Eventually, if not in the near future, parent-subsidiary listings will disappear in Japan as well as elsewhere."



The bottom line may be that in Japan the key to a successful M&A strategy is to implement a step by step process. A pledge to ensure the acquired firms' independence gets you in the door. Then you learn to live together and focus on the obvious areas that yield synergistic, positive results. Over time, hopefully predetermined, the equity ratio is increased as friction is eliminated and the benefits of synergy are understood to be in the best interest of all stakeholders.

But there are always exceptions. In our experience there are two, e.g.

A case where a significant percentage of ownership is vested in a limited number of shareholders who want to cash out.

A case where a diversified company wants to exit the pharma business.

However, in both of the above cases the initial discussions did not involve a buy-out. Therefore, we come full circle back to the need for patience, a key virtue for success in Japan. This concept is understood by many foreigners but practiced by few.

P. Reed Maurer is still learning how to repress the desire for instant gratification.