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Market Intelligence

M&A 2023

Global interview panel led by Simpson Thacher & Bartlett LLP

Lexology GTDT Market Intelligence provides a unique perspective on evolving legal and regulatory landscapes.

Led by Simpson Thacher & Bartlett LLP, this *M&A* volume features discussion and analysis of emerging trends and hot topics within key jurisdictions worldwide.

- Keynote Deals
- Sector Focus
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- 2024 Outlook

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Japan

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INSIDE TRACK



1 What trends are you seeing in overall activity levels for mergers and acquisitions in your jurisdiction during the past year or so?

The overall Japanese M&A market saw the highest level of activity in 2022. According to RECOF DATA, which is one of the most reliable statistical data sources for M&A transactions in Japan, the number of announced deals that were completed by Japanese companies in 2022 was more than 4,300, slightly higher than that of the previous year (2021), which had marked the largest number of deals at the time. Since the number of M&A deals closed by Japanese companies in 2019 had been slightly more than 4,000, which in 2020 dropped sharply to approximately 3,700, at least from a numerical perspective, the activity levels in 2022 can be said to have returned to, and even exceeded, the levels prior to the covid-19 pandemic.

In terms of deal size, however, the total amount paid by buyers in all the announced deals in 2022, which was around US\$78 billion, dropped by 31.6 per cent in comparison to the previous year. Since the amount in 2019 was around US\$124 billion, the average size of each transaction in 2022 is much smaller compared to that of the pre-pandemic era.

Cross-border deals in 2022 were particularly characterised by their small size. The total amount paid by Japanese buyers in all outbound deals was approximately US\$23 billion, which had dropped by 51.7 per cent in comparison to the previous year. This scale down may have been affected by the travel restrictions imposed in the previous years as infection prevention measures. Moreover, the heightening international tensions may also have been another factor for this downward trend.

In a similar manner, the total amount paid by foreign buyers in all inbound deals in 2022 was approximately US\$27 billion, which was lower by 37.5 per cent in comparison to the previous year. Private



Jason Jiao



Kochi Hashimoto



Takuya Uehara

“Cross-border deals in 2022 were characterised by their small size.”



equity (PE) firms were the main buyers in such inbound deals, with the amount paid by PE firms constituting 76.4 per cent of the total amount paid.

This trend of shrinking deal sizes is not expected to last long. In fact, in the domestic and outbound deals completed from January to August this year, the total amount paid by buyers has already amounted to approximately US\$56 billion, which has exceeded the amount for the same segment for the whole of 2022. Although the size of inbound deals which were completed from January to August in 2023 remains relatively small, M&A transactions including cross-border ones closed by Japanese companies are expected to keep a stable level of activity in the near future.

2 Which sectors have been particularly active or stagnant? What are the underlying reasons for these activity levels? What size are typical transactions?

M&A transactions in the IT and system development industries have continued to show an increase in activities in recent years. According to RECOF DATA, the number of deals in 2022 where the targets were software or IT companies was more than 1,600, which increased from the 1,525 deals in the previous year (2021). This may partly be attributable to the recent trend of digital transformation in Japan.

For example, in 2022, Sony Group, an electronics manufacturer in Japan, acquired or made additional investments through its US subsidiaries in two gaming companies, Bungie and Epic Games. Sony acquired Bungie for a total consideration of US\$3.7 billion, while Sony invested US\$1 billion in capital in Epic Games. These deals have been perceived as illustrating Sony's strategy of focusing on the metaverse market.

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Another example is DeNA's US\$200 million acquisition of Allm, a Japanese medical ICT developer. DeNA is a major Japanese IT company and develops Big Data strategy for healthcare. DeNA announced that the acquisition of Allm will create synergies with DeNA's business. This deal illustrates the recent increase in investments in start-ups in Japan. Omron, a Japanese healthcare manufacturer, also develops healthcare Big Data strategy and has recently announced its approximately US\$580 million acquisition of JMDC, a Japanese healthcare Big Data company.

Another trend in Japan, which has been spanning multiple sectors, is carve-out deals. Major Japanese manufacturing or IT companies, such as Hitachi and Fujitsu, have sold their businesses or subsidiaries in recent years to various buyers, including to global-based PE firms such as KKR, Bain Capital and Apollo Global Management. For instance, Hitachi sold its shares in its logistics subsidiary, Hitachi Transport System, to KKR for a consideration of US\$4.5 billion, which was the highest price paid in M&A transactions closed by Japanese companies in 2022. Fujitsu also sold its shares for a consideration



of US\$573 million in its scanner manufacturing subsidiary, PFU, to Ricoh, a major Japanese electronics manufacturer. One of the driving forces behind this trend of carve-out deals might be the Practical Guidelines for Business Restructuring issued by the Ministry of Economy, Trade and Industry of Japan (METI) in July 2020, which strongly encouraged listed companies to review their business portfolios.

3 What were the recent keynote deals? What made them so significant?

The deals mentioned in question 2 above (the Sony Group transactions, DeNA's acquisition of Allm, Omron's acquisition of JMDC, etc) were significant not only because of their deal sizes, but also because they clearly illustrate the recent trend in the Japanese M&A market of an increased activity in the IT and system development industries.

Another recent keynote deal in Japan is the acquisition of the Japanese mega-manufacturer, Toshiba, by a Japanese PE firm, Japan Industrial Partners (JIP). The US\$14 billion tender offer launched in August 2023 is currently the highest among the amounts paid in all M&A transactions closed by Japanese companies in 2023. It is more than twice the second highest price paid in the acquisition of a Japanese semiconductor material company, JSR, by a public-private investment fund, Japan Investment Corporation (JIC). But the deal size was not the only factor that made the Toshiba deal so significant. It is also attracting attention because it will be a major turning point in the recent restructuring history of Toshiba, which has been negatively impacted by an accounting scandal revealed in 2015 and the confusion in its governance that followed.

“A recent keynote deal in Japan is the acquisition of the Japanese mega-manufacturer, Toshiba, by a Japanese PE firm, Japan Industrial Partners.”



Another deal that can be considered significant, although from a different point of view, is Nidec's US\$110 million tender offer proposal to TAKISAWA, a Japanese machine manufacturer. This deal was proposed and announced by Nidec without the consent of TAKISAWA's management. Since the issuance of such an acquisitional proposal without the consent of the target's management is rare in Japan, the progress of the deal, including the communications between Nidec and TAKISAWA, is garnering a lot of attention from stakeholders and M&A specialists alike. In addition, since METI just published its new Guidelines for Corporate Takeovers in August 2023, which discourage Japanese companies from rejecting buyout offers without reasonable cause, Nidec's proposal has been deemed a good case study to illustrate how the reasonableness of corporate takeovers in Japan will be assessed under the new guidelines. This deal may also have some impact on the corporate value of machine manufacturers evaluated under the Japanese M&A market, and accelerate the transactions they are involved in.

4 In your experience, what consideration do shareholders in a target tend to prefer? Are mergers and acquisitions in your jurisdiction primarily cash or share transactions? Are shareholders generally willing to accept shares issued by a foreign acquirer?

In Japan, M&A transactions can be broadly classified as either (1) statutory corporate reorganisations, which are specified in the Companies Act of Japan, such as mergers and stock exchanges; or (2) other transactions such as share transfer deals and business transfer deals. While shares are generally used as consideration in the former cases (ie, item (1)), partly because there are tax benefits under such transactions, cash is more frequently used in the latter cases (ie, item (2)). Since the number of the latter transactions are greater than

that of the former due to the simplicity of the process, cash deals are generally more common.

There are most likely multiple factors that make Japanese companies choose cash transactions in the latter cases (ie, item (2)). As one of these factors, it is often said that the sellers of target companies tend to steer clear of the downward risks associated with the buyers' shares. In addition, from the buyers' perspective, if they choose a share transaction, they must comply with the disclosure requirements under the securities regulations, which can be a significant burden for them. The burden of undergoing complex procedures to receive the other companies' shares, such as the opening of brokerage accounts, can also discourage sellers from choosing a share transaction. Such burden will be greater if the shares in question are issued by foreign buyers, which might be one of the reasons why the shareholders of Japanese target companies tend to prefer cash deals in cross-border transactions.

Recently, the Companies Act of Japan was amended and a Japanese company is now able to acquire a part of the target company's shares by delivering its shares to the target company's shareholders in order to make such target company its subsidiary. This is another option for statutory corporate reorganisations (ie, cases under item (1) above), but this can only be used in transactions between Japanese companies.

5 How has the legal and regulatory landscape for mergers and acquisitions changed during the past few years in your jurisdiction?

While the introduction of the new type of corporate reorganisations mentioned under question 4 above was a big change, there was another and more significant change in 2020 that affects



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QUESTIONS



foreign investors in the context of economic security, which is described below.

Under the Foreign Exchange and Foreign Trade Act of Japan (FEFTA), if a foreign investor carries out a foreign direct investment (FDI) in a Japanese target company that is conducting certain businesses that may have an impact on the national security of Japan, the foreign investor must file a prior notification with the Japanese government via the Bank of Japan. The FDI will then be examined after the notification during a statutory waiting period of 30 days, which can be extended for up to five months if the FDI elicits strong national security concerns.

The FEFTA was amended in 2020 and the businesses that are subject to the prior notification requirement are classified into two categories, namely, 'core industries' and 'other industries' (ie, non-core industries). The conditions for exemption from the requirement of prior notification are stricter if the target company is involved in a core industry. Core industries include semiconductor manufacturers,

certain cybersecurity service providers, etc. An FDI in an unlisted Japanese company, which is involved in a core industry, will always require a prior notification with no exceptions. In addition, the appointment of directors in the target companies was added to the list of FDIs subject to notification; thus, foreign investors may need to continuously comply with the notification requirements even after the closing of the M&A transaction.

6 Describe recent developments in the commercial landscape. Are buyers from outside your jurisdiction common?

In 2020, as the covid-19 pandemic spread, the number of M&As in the country decreased. However, in the subsequent years of 2021 and 2022, M&A activity surpassed previous records, with approximately 4,300 deals reported in 2022. This increase can be attributed to the increased acquisitions of Japanese companies by domestic and international investment firms, as well as an increase in business succession cases. In addition, while the number of M&A deals for the first half of 2023 decreased slightly compared with the same period last year, the monetary value of these deals has grown.

A notable trend in recent M&A deals in Japan is the focus on start-ups, which account for approximately 40 per cent of all deals. In particular, there has been a growing trend of M&A activity and investment in startups by corporations and corporate venture capital. Traditionally, initial public offerings have been the primary exit strategy for startups in Japan, but in recent years, M&A exits have also been on the rise.

In addition, M&A transactions by investment firms that target Japanese companies have increased. As mentioned above, in the first half of 2023, while the number of transactions decreased compared to the previous year, the total transaction value increased. The largest



transaction in terms of value in the first half of this year was the acquisition of Toshiba by a consortium, which included JIP, valued at approximately US\$14 billion. The second largest transaction was the purchase of JSR Corporation by JIC, valued at approximately US\$6.2 billion. Although acquisitions by investment firms stood out in terms of monetary value, there was also an increase in M&A activity relating to business successions and 'carve-out' transactions, in which listed companies divested their subsidiaries or business units.

M&A activity by non-Japanese buyers targeting Japanese companies has been increasing every year, although it still accounts for less than 10 per cent of the total number of annual deals. In 2022, the number of M&A activities conducted by non-Japanese buyers reached its highest level, surpassing the previous year's high level.

7 Are shareholder activists part of the corporate scene? How have they influenced M&A?

In recent years, the presence and influence of shareholder activists have grown rapidly in Japan. These shareholder activists acquire shares in publicly traded Japanese companies and use their position as shareholders to advocate for changes in corporate strategy and governance. Generally, they would demand governance reforms through the exercise of their right to make shareholder proposals, but in recent years, their demands have become more aggressive, for example, by pushing for business reforms through takeover bids and other methods. In fact, there have been cases of public companies being sold off as a result of shareholder activist proposals.

Several factors have contributed to the surge in shareholder activism. Domestically, one major factor is considered to be the introduction of the Corporate Governance Code by the Tokyo Stock Exchange in 2015. This code was formulated against the backdrop that Return On

“In recent years, the presence and influence of shareholder activists have grown rapidly in Japan.”

Equity and stock prices of Japanese companies were low compared to international standards, so it aimed to improve these ratios and make Japanese companies more attractive to investors in Japan and abroad. Since the establishment of the Code, dialogue with shareholders of Japanese companies has become more active.

Increased investments in Japanese companies by foreign shareholder activist funds and the increased activity of activists worldwide have also contributed to this trend of shareholder activism in Japan. The low price-to-book value ratios and low total shareholder returns of Japanese companies compared to their US and European counterparts, as well as the small average market capitalisation of listed companies, have also created an environment conducive to investments by shareholder activists.

Traditionally, Japanese society has tended to dislike these activists, but in recent years, this view has gradually changed and there are more and more cases where the actions of activists are favourably received. The increase in the number of shareholder activists is



expected to continue for some time, and this may bring about changes in the M&A activities of Japanese companies.

8 Take us through the typical stages of a transaction in your jurisdiction.

The typical M&A process in Japan is as follows: first, when a decision to conduct a sale or acquisition is made, preliminary preparations are made as necessary, and a potential counterparty is selected. Generally, the potential counterparty is selected through an M&A broker (often an M&A specialist or the M&A department of a bank or securities company), but it is also possible for the CEO or management of the company to contact their acquaintances or business partners. If a brokerage firm is used, an agreement is made with the brokerage firm in the initial stage before the selection of the counterparty. Seller due diligence may also be conducted around the time of selecting the counterparty, but this is not necessarily common in Japanese practice.

Once a potential counterparty is selected, a meeting with the potential counterparty is held and a confidentiality agreement is concluded. Alternatively, once a counterparty company contacts the seller expressing interest in the M&A based on a no-name sheet and company profile, the next step is to have a meeting between the top management of the two companies. After the top management meeting, the general terms of the M&A are negotiated, and the terms of the sale, such as the sale price and scheduled sale date, are agreed.

In recent years, it appears that sellers are increasingly conducting M&A using a bidding format to improve the terms of the sale as much as possible. In the case of a bidding process, a process letter describing the bidding procedure is distributed to potential

buyers, who have signed confidentiality agreements, along with an information memorandum containing basic information about the target company. From this group of bidders, one potential buyer is selected to proceed with the M&A transaction and negotiations.

When both the seller and the counterparty agree to proceed with the M&A after the top management interviews and negotiations are conducted, a basic agreement, such as a letter of intent, is signed. The letter of intent is not a final agreement, but rather a provisional agreement that confirms both parties' intentions regarding the M&A. The letter of intent is an instrument that is generally used to ensure the parties' compliance with the initial M&A agreement.

The letter of intent normally includes an outline or scheme of the transaction, the expected sale price, the expected sale date, the method of conducting the due diligence, the treatment of directors and officers, and whether exclusive negotiating rights will be granted.

Once this basic agreement is executed, due diligence is conducted, final terms are negotiated considering the results of the due diligence, and a definitive contract is signed before closing.

9 Are there any legal or commercial changes anticipated in the near future that will materially affect practice or activity in your jurisdiction?

In March 2023, for the first time in 17 years since the 2006 amendment of the law, the Financial Services Agency initiated a review of the takeover bid system, large shareholding reporting system, and other systems for corporate acquisitions. In recent years, various issues have been raised on the transparency of the tender offer systems, large shareholding reporting systems, and substantial shareholders, due to changes in the capital market environment, such as an increase in cases of unfriendly takeovers through intra-market



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transactions, etc, diversification of M&A, and the growing importance of constructive dialogue between companies and investors. In light of these, it was decided that it would be necessary to examine the current takeover bid system, large shareholding reporting system, etc. from the perspective of ensuring transparency and fairness in the market and promoting constructive dialogue between companies and investors.

Under Japan's current tender offer system: (1) a takeover bid is mandatory for any purchase of shares off-market from a large number of persons (more than 10 persons in 60 days), which would result in a shareholding ratio of more than 5 per cent; (2) a takeover bid is mandatory for any purchase of shares off-market, which would result in a shareholding ratio of more than one-third; and (3) in the case of a takeover bid that would result in a shareholding ratio of shares, etc, exceeding two-thirds, it is prohibited to set a maximum limit on the shares to be purchased during a tender offer. Despite these rules, recently, there have been cases where hostile takeover bids were launched using intra-market transactions to avoid violating

the takeover bid regulations, and there have been concerns that the minority shareholders may not be getting sufficient information and time to make appropriate investment decisions. Therefore, the possibility of requiring takeover bids even in the case of intra-market transactions, and even in new share issuances, is being discussed. There are also discussions on whether the current thresholds of one-third and two-thirds, referred to above, should be lowered. There is also a debate as to whether the Japanese takeover bid system, which requires that purchases that would result in the acquisition of voting rights in excess of the threshold be made through a tender offer, should be changed to an ex post facto regulation like the takeover bid systems in the UK and other European countries.

The large shareholding reporting system in Japan is a system that requires reporting when a person becomes a large shareholder (shareholding ratio of more than 5 per cent) or there is a material change, such as an increase or decrease of more than 1 per cent, in the shareholding ratio. Problems have been pointed out regarding the clarity of the scope and effectiveness of this system, and a review of this system is also currently being considered.

10 What does the future hold? What activity levels do you expect for the next year? Which sectors will be the most active? Do you foresee any particular geopolitical or macroeconomic developments that will affect deal sizes and activity?

In Japan, many companies, especially small and medium-sized enterprises, are suffering from a lack of successors and human resources. According to the Small and Medium Enterprise Agency's 'Current Status and Issues of M&A in Small and Medium Enterprises and Small Businesses,' the number of business owners aged 70 or older is expected to reach 2.45 million by 2025, of which about half will have no successors. As a result of this, the number of business



succession M&As has been increasing in recent years, and this trend is expected to continue.

As mentioned above, M&As involving startup companies have also been a trend in recent years. According to an announcement by the Japan Venture Capital Association, the amount of funding raised by start-ups was about ¥80 billion in 2013, but in 2021, it reached around ¥800 billion, a tenfold increase. It is expected that more and more start-ups that have received investments will choose M&A as their exit strategy, and, in fact, they have already been making their presence felt in the area of M&A transactions as of last year as well as this year. In Japan, as in the US, it is expected that the number of start-ups choosing M&A for further growth will increase.

One industry that has been particularly active in M&A activities recently is the dispensing pharmacy business. Dispensing pharmacies are stores that dispense and provide pharmaceuticals to fill the prescriptions issued by doctors. There are more than 60,000 dispensing pharmacies throughout Japan, and the market size is estimated to be around ¥8 trillion. M&As are increasing against the backdrop of the growing number of dispensing pharmacies, declining revenues due to the recent revision of dispensing fees, and a shortage of pharmacists. In addition to this, M&As in the medical and nursing care industry are increasing due to the aging population in the country. Moreover, as the covid-19 pandemic is finally coming to an end, the hotel industry, which saw a dramatic increase in the number of hotels before the pandemic, and which was severely affected by the pandemic, is also attracting attention. Against the backdrop of an increase in the number of foreign visitors to Japan post-pandemic, M&As in the tourism industry are gradually increasing and are expected to expand in the future.

Another recent trend gaining attention is M&A activities that are promoting SDGs and ESG initiatives to achieve sustainability management. M&As undertaken for the purpose of sustainability

management, such as 'carbon neutrality,' are becoming more and more popular, especially among large companies. According to some statistics, the total number of these M&As is close to 10 per cent of overall M&A activities in Japan. This trend is particularly prevalent in the electric and gas industries, where companies are enhancing and expanding their renewable energy businesses, and reconfiguring their asset portfolios for decarbonisation.

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The Inside Track

What factors make mergers and acquisitions practice in your jurisdiction unique?

If a buyer is intending to acquire a controlling stake in a public company in Japan, it will be required to commence a tender offer procedure that is peculiar to the Japanese legal system. Acquiring more than one-third of the total voting rights of a listed company would be sufficient to trigger the tender offer requirement. However, the current tender offer system is expected to be fundamentally amended in the coming years. From a cultural perspective, a seller in Japan often strongly desires to maintain all of its current employees in the target company even after the sale. As such, in the definitive agreement, it is common for the seller to require as one of the buyer's post-closing covenants that, for several years after closing, the target company's workers should continue to be employed by the company and their working conditions should remain unchanged.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

Since a complicated deal often requires expertise in various legal fields, it is advisable for a client to seek the assistance of a law firm that can provide a one-stop service covering all such various legal fields. Experience in these kinds of transactions is also desirable. To control costs, it is also a good idea to consider law firm options other than large or international law firms.

What is the most interesting or unusual matter you have recently worked on, and why?

In a diligence process of a family-owned business, a substantial amount of off-the-books inventory was found, for which the relevant tax risk turned out to be significant. In our jurisdiction, this kind of risk would usually be dealt with through special indemnity clauses in the definitive agreement. However, in this transaction, because of the magnitude of the risk, the parties agreed that the target company should file an amended tax return before the signing of the definitive agreement. Despite this, and even after such filing, another off-the-books inventory risk was discovered, so the buyer proposed a substantial discount on the purchase price. This eventually resulted in the seller abandoning the deal.





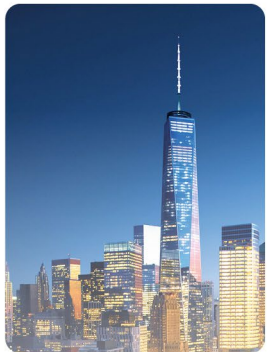
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