

## A SPECIALIST OFFERS ADVICE

### A Japan Acquisition That (Luckily) Never Closed (Part One)

By Tom Nevins, Founder and President of TMT Inc.

Thirty months ago, I met at my office with the head of a non-Japanese, well-known electronics manufacturing client with tens of thousands of employees. My human resource consultancy had set up its Rules of Employment (ROE), salary and retirement system, and had gotten rid of a few poor performers including its former top Japan representative. At that time we also found it a new Japan president.

But on this chilly December morning my client was excited about the prospect of buying a factory, land, and about 550 people from one of those giant Japanese electronic firms that makes everything from chips and PCs to telecommunications equipment. That Japanese giant had acquired this smaller Japanese company about twenty years earlier. Only recently had its 'very strong' union finally agreed to fold into the giant parent firm's more moderate enterprise union. There were still sixty people on *shuko* (secondment, or loan) from the parent company to the subsidiary.

#### As Usual my Client was Out-numbered 5 to 1

I didn't hear much more about this over the long Japanese New Years holidays, but was asked to a meeting on January 11 at the giant Japanese firm's impressive head office. There were 21 people in the room. Since there were only four of us, the other 17 must have been from the other side, unless they were selling tickets. The oldest and grayest Japanese gentleman in the room was the main spokesman. Actually a number of his juniors spoke better English. His *meishi* (name card) said 'Vice President' (of parent's head office) in English, but *shihainan*, or 'Manager' on the Japanese side. Reportedly he had once been one of the parent com-

pany's *torishimariyaku*, or board members (one of probably about thirty top working executives). It looked to me like he was set up as a buffer or cushion, so that none of the company's key executives on the way up would 'slip off the ladder' over this one.

After all, we were being told this was the first time the huge parent had ever considered selling one of its Japanese affiliates lock-stock-and-barrel to a foreign company. We were also given the very clear ground rules for being able to participate in this opportunity: The Letter of Intent should be finalized in less than twenty days, by February 1, all the 550 staff and production workers must be taken over, there should be no negative change in their pay and benefits, and a voluntary retirement benefit should be offered to anyone who decided they didn't want to have a new foreign boss. (Being able to get a job with the giant Japanese parent never came up and was not a possibility.) They also said nothing about paying for the extra voluntary severance package that would be needed.

#### Seller Sees A Great Chances to Unload 550 Staff

My client didn't want to, and couldn't, absorb 550 employees in one pop, but we went ahead, and overcoming their great reluctance insisted on getting a copy of everything the Japanese company provided in terms of personnel policies, salary and benefits. The gray-haired parent company spokesman appeared to be baffled and surprised, because "if you want to make changes that negatively effect the employees acquired, you are free to do it after you own the company, and have a better knowledge of the people

and the way the company operates." (Has anyone who doesn't use TMT ever fallen for that one?)

We were going out to visit the factory the next day, January 12. We insisted that all ROE, salary and benefit policies be given to us before we left the factory site. The answer "But I'm sorry, everything is only in Japanese, are you sure it's OK?" was not enough to deter us. The elderly spokesman had a habit of laughing after key points or requests made by my gaijin client. It wasn't easy to get my client to understand that it wasn't intended to be insulting. It just represents a certain type of Japanese when that type has to interface with *gaijin*. But my client repeatedly asked: "Why would they do that? It's insulting."

There were about 25 people in the room this time. Again the vast majority came from the parent. The same senior spokesman made it clear again that he wanted everyone to "have same conditions from the start, then it is yours to do what you like." My client was getting a little annoyed and was ready to propose a few ground rules of his own. He said his firm would not need everyone, all acquired employees should start with zero service, all unused vacation should be paid off, and "we want to be union-free like all our other operations." And my client didn't say that he would probably expect the acquired staff to accept and be covered by his firm's own employment policies.

#### Laughter Doesn't Always Lubricate Negotiations

The senior spokesman from the Japanese parent laughed (again) and said Japan is very different. He added that "there is lifetime employment and we don't/can't fire people as in Western countries." Luckily time was up. I

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had homework to do -- analyze and report on about 1.5 inches of Japanese-language policies. It had to be written up in time for our next meeting scheduled eight days later on January 20.

Toward the end of our January 12 meeting at the factory sight we ruffled a few feathers when we maintained that we would need to communicate with the 550 employees explaining the acquiring foreign company's philosophy, mission, corporate culture, and salary and benefits. That was the real show-stopper. The Japanese parent company feigned surprise, or maybe actually was surprised. They had been indicating it would naturally only be their parent company executives in combination with the subsidiary executives who would explain about the takeover, until the ownership had changed hands.

#### Before the Deal is Sealed, Communication with Employee Groups is Critical and Revealing

In contrast, our position was that those 550 employees had better know what they will be facing under the new foreign ownership. Not to be honest up front would even be immoral and unfair. If those staff up-for-sale with their 'strong union' didn't like what they heard, and were not going to be willing to play a different game under different rules, they should not come over. My client was not going to let his acquiring company misrepresent the truth and the situation. The Japanese parent company was happy to let that happen. My client also was not going to be stuck with all the problems, dissatisfaction, potential Labor Relations Commission (LRC) hearings, or litigation which would probably accompany such misrepresentation.

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In this, I often run up against clients (and their legal counsel) who fail to see that the 'no contact until the sale is complete' is totally dwarfed at the practical, and even legal level, with the misrepresentation or bungled communication issue, along with issues of employee rights to get the truth. And it is those employees and their attitudes and behavior after the acquisition that will give you the biggest headaches, and make or break success.

At the factory meeting it became clear that the executives among the 550 staff on the block had been clearly told by their masters that they had no futures with the giant Japanese parent. They knew that if my client would not go ahead with the acquisition they would be sold to a tougher local buyer, face bankruptcy, closure, retrenchment, or massive benefit and pay cuts at best. We were beginning to show that we were not quite as naive as the other side had hoped. Up until my involvement the day before on January 11, it really seemed as though my client was moving lickety-split to a February 1 letter of intent (LOI) that would have shifted tremendous financial and human problems and burdens to the acquiring firm.

#### **The White-Haired Spokesman was Replaced with Others Less Patronizing - Too Late**

But the Japanese giant, and at least the leaders of the 550 person subsidiary really needed this deal to happen. (One never would have guessed based on the several weeks of good acting at the end of the prior year.) So guess what happened at the next meeting?

There was no trace of the white-haired spokesman and his name was never even whispered. Some of the other actors also changed, or at least changed their

lines. Unfortunately, based on my report distributed to our side two days before the meeting, my client decided the corporate cultures, practices, benefits, and reward systems were too far out of line. Before the meeting my client basically decided that they would be buying something that would be too hard to turn around, and would require too much sacrifice, from too many people who had been treated and rewarded too well for too long.

It's a shame. I feel sorry for those 550 men and women and their families. Even if a more gullible foreign buyer (and there appear to be many and also those who fail to do their due diligence homework) did arise, I'll bet it would have faced serious turmoil later on -- mainly because it wouldn't be aware of what it was getting into, and probably wouldn't have the tools or know-how to decisively resolve problems later on.

#### **Offer Salaries and Benefits on Your Terms, and Work with a Few Core People Who Will Select Only Strong Colleagues**

Working with my client on a one-day program of communications and education addressed to all employees together in one room, implementing different salary and personnel systems, hiring selectively the 250 people or so that my client really needed, strategically rationalizing those not needed, all in a background of frank, honest, non-condescending, and synergistic cooperation with that giant Japanese parent, we could have helped the foreign buyer, the Japanese parent, and the 550 poor families out at the factory site.

And one of the most dumfounding, yet so typical high-

lights to this 'lack of success', or 'nothingness' story, is that about three weeks after the February 1 LOI was supposed to have been finalized, the same Japanese giant had to announce that (after all!) 'lifetime employment' isn't possible. It announced that ten percent of the giant's workforce would be reduced within three years, including 9000 in Japan and 6000 abroad.

My client reflected on the process he had been exposed to between November and the 'throw-in-the-towel' date of January 20. "Tom, you've gotten to know me pretty well over the last four or five years," he said, "and we've done some good things and some bad things together. I don't know if you've noticed. I like to be touched, and sometimes don't mind being kissed. But people have to be real careful when they mess around with each other." (Less polite words can replace 'mess'.)

Beyond this display of an arrogance that is fading away these days, but still lingers all too much in Japan, those interested in the details of why my client realized it had better not acquire this struggling Japanese entity should not miss the final part of this article next issue.

And a final word: If you believe you know what you're doing, talk turkey from the beginning, cut through the smoke and mirrors, and ensure Japanese sellers know they're dealing with a savvy counterpart. The streets of Japan today are exciting, and worthy of close but careful exploration.

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## A SPECIALIST OFFERS ADVICE

### A Japan Acquisition That (Luckily) Never Closed...And Here's Why Part Two of a Two-Part Article By Tom Nevins, Founder and President of TMT Inc.

*Editor's Note: This second part of Tom Nevins' article about an acquisition abandoned because of employee compensation and benefit issues offers a rare, inside look at some of the 'brass tacks' issues that companies often consider during such a process. Readers who have not participated in such a process may find some of Tom's notes to his client, included in this article, rather harsh in their tone and intent. Nevertheless, the notes demonstrate the complexity of the many issues acquiring executives face in evaluating a potential acquisition, and should not be construed as anything but a competent professional's best advice to an important client.*

Last issue, I described the acquisition process, meetings, typical Japanese sellers' pitch and position, as well as the cultural and communications climate you are likely to encounter when negotiating with Japan Inc. However, reading Part One [SSJ, June 2001 issue] is not required to gain insight from this piece.

Part One recapped how my client, a non-Japanese major electronics firm with tens of thousands of employees, rapidly moved from being pushed (and pushing itself) to complete what seemed like a major deal opportunity, to calling off the deal once it realized that the Japanese seller was attempting to dump its problematic subsidiary company on it. The seller was hoping and had largely succeeded in completing the acquisition by not making my client aware of the many questions my client needed to ask. The acquiring foreign-capitalized firm was, in fact, inclined to feel that people's pay and benefits should be protected, so it was not so unreasonable for the Japanese seller to take the position that any changes in these areas could take place only after the acquisition closed. The Japanese parent selling the subsidiary was hoping

that there would be no presentations, or contact directly between the buyer and the acquired employees, until after the ownership had changed.

This may not seem to be such an unusual or unreasonable way to do things. But in Japan, with the difficulties that angry staff and unions can create if they feel they have been ignored and by-passed, such execution gets the acquisition off to the wrong start. Acquisitions and even joint ventures in Japan are difficult, and only recommended if the foreign buyer knows how to restructure and change personnel and pay systems, corporate culture, and the environment. Foreign acquirers must also have the tools to frankly communicate this directly to all employees. You also need to understand the liabilities and burden of past benefits practices, and honestly let the employees know and see the changes you are going to make before your company completes the transaction.

Naturally the Japanese selling party wanted to keep it much simpler than that, quickly unload its subsidiary's 550 people, and transfer the burden and responsibility to clean-up the company's operations to the acquiring foreign capitalized firm. In reality, the long-term welfare and well-being of the subsidiary's staff being sold was of distant secondary importance to their supposedly fraternal parent company. Of course, as do many Japanese companies, the seller gave 'lip service' to keeping the employees pay and benefits the same, and maintaining job security. But the seller wants your company to do that, because it knows it no longer can. And it also knows how difficult it can be not to maintain

the same employment policies. Any seller (in any country) can look good and try to play the role of the 'good guy' if the buyer allows it.

So buyer be aware in any country, but in Japan, keep in mind that there seems to be more than the usual level of 'smoke and mirrors' that can keep you from understanding a company's true situation. A perceived need to be culturally sensitive, and an awareness of cultural differences, can numb our instincts and common sense. Sometimes that process even feels good. However, even today in Japan, if a company or one of its units is up for sale, and available to you, there are usually bad reasons, not good, why that is so. It doesn't mean you should not consider buying. It simply means that you must buy on your own terms, which are also the only terms that will provide for the long-term success of the operation. This of course ends up being best in the long run for all the hardworking individuals, both average and above-average, who come along as part of an acquisition.

#### WHAT KILLED THE DEAL FOR US

A Letter of Intent (LOI) was supposed to be completed and signed by February 1. Based on my written analysis between January 13 and 17, what were some of the things we discovered that persuaded my client to decide not to move ahead at the January 20 meeting with the seller?

In the order that I reviewed the Japanese-language documents provided, and in the order of my write-up for the client, here are some specific examples of what we discovered when considering buying the electronics subsidiary from that giant Japanese electronics firm. In my experience,

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similar situations and practices are common when dealing with many of Japan's largest conglomerates. Perhaps this is why the Japanese economy continues to limp along. Perhaps this is also why so few joint ventures are successful, and why there is quite a lot of dissatisfaction with, and regret over acquisitions, that have been made. Most of us 'in the know', who have years of 'hands-on' experience in Japan, encourage clients to start from scratch when and if they possibly can.

But the good news is that a foreign buyer can have control over the terms of acquisition, and can make the necessary changes in benefits, pay levels, and practices, and can and should make things clear upfront and in advance. If it sounds repetitive in this article, it's because the point is important and shouldn't be under-emphasized. Unfortunately most of the advice you will get from your legal counsel, paid professionals, and working executives will focus on how difficult or even 'legally' impossible this is. But in fact, the law rarely comes into play. Rather, the key factors are the dynamics of fundamental power relationships, and the quality and credibility of the communications directly given to all of the employees involved in the change.

In a Japan acquisition, the foreign buyer often finds itself saving and rescuing a crippled organization. The Golden Rule probably can and should apply: 'The Man Who has the Gold Makes the Rules'. But depending on how the rule is applied and communicated, it is possible at the same time to win the respect, gratitude and loyalty of the employees acquired.

The report I prepared for my client on the details of the compa-

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ny's policies included some of my comments as follows, which conclude this article:

#### Collective Bargaining

(1) Articles 3 & 5 state that everything and all changes must be negotiated only with the union.

(2) Article 16. The Union must be informed seven days in advance of any job change, transfer, or secondment of union members.

(3) Article 36. May 1, Labor Day, Saturdays, May 4, and two more days are all extra holidays. One of the nineteen public holidays falling on a Saturday, (or more commonly Sunday) makes for other holidays. These could be cut back. (The holiday occurring on the anniversary of the company's establishment had recently been cut back, and the two extra holidays had once been four days.)

(4) Article 45. With Japan's nineteen public holidays, and all extras (including 21 days of paid vacation fully carried over etc.), I do not believe you need to give 5, 7, 10 days of 'refresh leave' for respectively hitting 10, 20 and 30 years of service.

(5) Article 46. Funeral leave of up to ten and seven days is not necessary. Five days is more common. It becomes a fairness issue as many people will show restraint and think of their peers' workload. Only some people take full advantage of these entitlements.

(6) Article 48. Company must discuss with the union the union members' salary and retirement benefits.

(7) Article 50 states the company will, in principle, 'increase' wages

once every year. The word 'review' should be adequate.

(8) Article 51. These overtime rates should all be cut back to the legal minimum (which is very common). The normal rate of 135 percent should become 125 percent, holiday rate of 140 percent should be 135 percent, and midnight overlapped with over 8 hours, to 150 percent from 160 percent.

(9) Article 53. Why should the company have to pay the difference between normal wages and the pay a union member gets while in a public/government job?

(10) Article 74. The company must explain to the union and get the union's opinion on virtually every management prerogative conceivable -- management policy and situations, production planning, factory closings, work suspensions, productivity improvement, anything affecting working conditions or the company's assets.

(11) Article 85. The company cannot hire any strike replacement workers.

#### Rules of Employment

(12) Article 36. Here again is the extremely generous paid vacation. Whereas most companies start with ten or twelve days at the most for the first year of service, and an additional two days for each year after that, for some extremely unusual reason they start out with 21 days, or over four weeks vacation right from the start! Since vacation can be carried over to the next year, someone could have over 8 weeks vacation in only their second year of service!

(13) Before taking this operation over, I would cut vacation back to the Labor Standards Law (LSL) minimum of ten (or maybe twelve) days after six months, with two additional days per each year of service.

(14) Chapter 10. The whole emphasis of this chapter is on 'discipline' and 'punishment' rather than performance and contribution. The pay cut is limited to the maximum LSL pay cut of one-half a day's pay, or ten percent of the pay during the pay period. Our interpretation must be that this is for specific penalty, not for overpayment in relation to an employee's worth, contribution, or the job he is assigned to.

(15) Article 73. We should add to this transfer clause that such position changes may be accompanied by a commensurate pay cut.

(16) Article 78. To the contrary, should say that when leave of absence ends, it may not be possible to reassign the person to the same or equivalent job, at the same or equivalent pay level.

(17) Article 83. Since the legally mandated retirement age will be moving above sixty to 65 and above in the future and by 2013 at the latest, I recommend TMT style trade-off language that states that after perhaps age 58 or maybe sixty, years of service will no longer be calculated into the retirement benefit, and people will be placed on one year contracts with flexible pay adjustments. I am surprised they do not already have such approaches. The 'strong union' that people seem to defer to may be one of the reasons. (Such age discrimination is illegal in US, but common practice in Japan.)

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(18) Article 5 once again assumes an annual salary 'increase' here. 'Review', 'adjustment', or 'decision' are recommended.

(19) Article 22. I would recommend menstrual leave no longer be paid. They have been paying seventy percent the first day and sixty percent for the second and third day. The dedicated, hard-working women who never take advantage of this benefit resent it when a minority of the women take these days, thereby increasing the burden on colleagues.

(20) Article 23. It is unusual and legally unnecessary to pay wages during the time that an employee is appearing in court as a witness, serving as an elected or appointed public official, etc.

(21) Article 33. In cases of non-job related sickness, it is unusual for an employer to deduct only twenty percent of wages for as long as the first four days of the sickness. Usual Japanese practice is not to provide for such sick leave with pay.

#### Retirement Regulations

(22) Article 14. In addition to a retirement benefit that is already quite generous, they have extra retirement premiums should a person retire at the company's sixty year retirement age. Premiums are ¥500,000 for ten to twenty years of service, ¥800,000 for twenty to 25 years of service, ¥900,000 for 25 to thirty years, and ¥1,000,000 if over thirty years of service. An unusual and extra burden you could do without.

(23) The Tables. The discounts for when people quit the company are not very great. At five years of service the months of salary paid for each year of service are

2.050 and 3.625; ten years of service, 6.130 and 10.781; 15 years, 12.7 and 16.446; twenty years, 22.617 and 22.617. After just twenty years of service there is no discount. I would recommend much larger discounts.

(24) At 25 years of service you are committed to 30.817 months salary; thirty years, 38.717; 35 years, 44.867, forty years, 51.017, and 44 years, 55.937. If we compare this to your (my client's) current retirement benefit, and to your global philosophy concerning retirement benefits, I do not see a fit! (This private plan is in addition to a costly government-required pension plan.)

(25) I think these difficult issues should be responsibly faced now. Issues such as the union, this retirement liability, the only twelve percent of pay tied to performance, all these other areas of expensive, wasteful excess.

(26) In any case, on the retirement issue, it might be easier to get the seller to back us up in cutting it back if your condition for taking over is that the seller pay you in cash for all the accrued liability for all the employees.

(27) I could also picture a scenario in which we honestly present to employees the best terms that you will offer, and give them a choice if they want to join you or quit. Perhaps the larger of two severance packages should be offered to those not offered a job by you (the buyer). The seller should naturally be the one paying normal and extra severance.

(28) Of course the seller, in their

dreams, may be hoping that you will take over the operation before reality hits -- before you have had a taste of their corporate culture and reaction of the union. Then you alone will be stuck with all the problems.

(29) To me it still gets down to the question of who is doing who the big favor. From what I see, you will be taking on a burden that they cannot adequately handle now.

(30) We cannot expect them (the seller) to be confident to implement the kind of change, and give the kind of messages to employees and union that need to be given. They are probably not used to doing that, and do not have the tools to do that. Probably they also do not know what can and needs to be done.

(31) That is where we can help them and help you. The seller largely needs to drop back and look to us to define and implement the program.

(32) Some of the benefits and practices are creating their own administrative bureaucracy. Other seemingly harmless things such as cash service awards of ¥12,000 for ten years of service, ¥30,000 for twenty years of service, and ¥180,000 for thirty years of service are simply not necessary.

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