# Cases on International Business and Finance in Japanese Corporations

Mitsuru Misawa

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The University of Hong Kong

香港大學出版社
HONG KONG UNIVERSITY PRESS

**Hong Kong University Press**
14/F Hing Wai Centre
7 Tin Wan Praya Road
Aberdeen
Hong Kong



ISBN 978-962-209-891-6



British Library Cataloguing-in-Publication Data
A catalogue record for this book is available from the British Library.

Secure On-line Ordering
http://www.hkupress.org

Printed and bound by Pre-Press Limited in Hong Kong, China

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Ali Farhoomand is the Director of ACRC and a professor in the Faculty of Business and Economics at the University of Hong Kong.

# Cases on International Business and Finance in Japanese Corporations

To my two daughters,
Anne Megumi Misawa and Marie Lei Misawa

# Preface

> Now Japan continues to drive change. We've learned much over the past years from companies in Japan. The best practices that we've learned on how to develop new products or how to work better in teams, many of those have come from Japanese companies.[1]
>
> — Jeffrey R. Immelt, chairman and CEO, General Electric Company, US

Japan is a country that is extremely difficult for outsiders to understand. Language plays the most basic barrier to understanding the culture: the only language used to communicate among inhabitants is Japanese; English is used to a limited degree for education and in daily life. Moreover, Japanese people are extremely cautious in disclosing their thoughts to outsiders. The basis of this attitude lies in the traditional character of the Japanese people, which is expressed in various mottos and proverbs, such as, "Silence is golden" and "Speaking less makes one look more graceful." Corporations are no exception and are run essentially on the same principles.

Japan has the second largest gross national product in the world. It exports an enormous number of excellent quality products, such as automobiles, home appliances, and electronic components that are closely integrated into the daily lives of people the world over. Thus, corporations and consumers around the world are interested in better understanding Japan's economy, how its corporations are run, and how decisions about its products are made.

However, case studies of Japanese corporations written in English are not readily available. There are two reasons behind this:

1. It is partly due to the attitudes of Japanese corporations. They do not wish to have their case studies published unless authored by someone with whom they have a close relationship and whom they can trust.
2. While there are quite a few foreign scholars who claim to be well versed on Japanese matters, a very limited number are capable of communicating in Japanese, and so their information is limited to secondhand sources, i.e., articles and books already written in English. This language deficiency makes it difficult for foreign scholars to write about the Japanese economy and corporations and, similarly, difficult for Japanese scholars to write case studies in English because of their limited English language abilities.

Meanwhile, the demand for cases written about Japanese corporations as teaching materials is accelerating. This is due to the following factors:

1. The number of business schools in the US that focus on Asia-Pacific studies is increasing. The Schidler College of Business at the University of Hawai'i at Mānoa, where I am a professor, is one of those schools. A thorough education focusing on the Asia-Pacific region requires case studies of Japanese corporations.

2. The trend shows that an increasing number of universities in the US are teaching courses about Japanese corporations and their peculiarities. The re-emergence of Japanese corporations, after experiencing a period of negative growth for 15 years, known as the "lost age," is attracting worldwide attention. The number of US corporations and students who wish to study the revival process is increasing.
3. The internationalization of the Japanese economy prompted the internationalization of Japanese education as well. Most of the leading Japanese universities are now offering MBA courses in English. Side by side, Japanese and foreign students are studying to be future international business professionals.

The lack of case studies written in English and the growing demand for such case studies are the reasons I have written this casebook. After visiting a number of corporations and meeting with their top executives, I have developed field case studies from ten corporations that I believe will provide outsiders with an understanding of the Japanese economy and Japanese corporations. These case studies contain abundant information and data that could be collected only by a Japanese person and are quite unique in that they are written from an insider's perspective. It is my hope that this casebook will be used by universities in the US, as well as in Japan and other Asian countries.

Over the years I have gained much insight into both Japanese and American issues of finance, law, and international business. I have had first-hand involvement and extensive dealings with various projects for many companies. I have had considerable access to relevant information and also have a broad-based familiarity with the issues discussed in the cases. It is because of my own long experience in the fields of international finance and business that the top management of these corporations allowed me to write their case studies.

This casebook is meant for use as a textbook in business schools for their graduate or undergraduate International Business and International Finance courses. My students of International Finance, both graduate and undergraduate, at Shidler College of Business at the University of Hawai'i at Mānoa, have given me positive feedback about these cases.

This casebook may also be useful for business people interested in Japanese corporations and the Japanese economy. Foreign companies dealing with Japanese companies may achieve smoother business transactions with a better understanding of their counterparts, and those companies intending to do business with Japanese companies will be better prepared by reading this casebook.

The cases in this book deal with international business and finance. Each case presented is a real story. These cases were selected to depict, as accurately as possible, the issues that the Japanese economy and Japanese corporations are facing today. Each case contains a fair amount of previously undisclosed information used by the executive to make actual decisions. A case study relying solely on published information will limit the skills and the insights that the reader can obtain through analytical exercises. By including this previously undisclosed information, the reader will be able to realistically place himself/herself in the shoes of the executive who made the decision.

Each case presents multiple decisions that could be made, and all of those decisions might be correct. There is no way to ascertain which decision is best. Therefore, it is not a question of whether the actual decision made by the executive was correct. The reader is supposed to identify the issues first, then analyze the various problems that exist, and, finally, decide on the course of action. Necessary and sufficient information for this process is included in each case. The aim of these cases is to learn about the decision-making process and the techniques used in making an "intelligent" decision, based on the given information. It, therefore, is far more convincing, and the student can face the case more sincerely, if the case is based on an actual incident rather than a fictitious one.

Although it is not possible to completely understand the Japanese economy or Japanese corporations merely through these cases, the reader should be able to get a good grasp of them. I trust my selection will fulfill this purpose.

Mitsuru Misawa

1 Nikkei Global Management Forum (20 October 2003) "GE's Strategy for Building Corporate Value", http://www.nni.nikkei.co.jp/FR/NIKKEI/ngmf/ngmf2003/2003ngmf_sp_immelt.html.

# Acknowledgements

I am grateful to the following people who helped me publish this casebook.

First of all, I wish to thank the staff members of the Asia Case Research Centre (ACRC), particularly Jeroen van den Berg, for editing the draft version of each case and for bringing it to a publishable level.

Thanks are also due to Hong Kong University Press for taking up the idea of publishing the casebook. It is a tremendous benefit for students to be able to purchase one book containing all of the cases, rather than having to buy each case individually.

In my research for the ten cases, I had to visit companies, arrange interviews, and obtain reference materials. I am therefore indebted to the following executives (listed in alphabetical order) for their kind understanding and cooperation:

1. Mr. Hisashi Hieda, chairman, Fuji Television Network Inc. (Fuji TV)
2. Mr. Kozo Hiramatsu, president, Livedoor Co.
3. Mr. Toshio Kagami, chairman, Oriental Land Corp. (Tokyo Disneyland)
4. Mr. Teruhide Osawa, chairman, OSG Corp.
5. Mr. Hiroshi Tsukakoshi, chairman, Ina Food Co.
6. Mr. Hidemaru Yamada, president, Nireco Corp.

It was necessary for me to make several trips to Japan to complete my work. This would not have been possible without the research fund provided by the Center for Japanese Global Investment and Finance at the University of Hawai‘i at Mānoa, of which I am the director. I wish to sincerely thank all sponsors of the center.

Above all, I wish to express my love and gratitude to my family, especially my two daughters, Anne Megumi Misawa and Marie Lei Misawa, for their support of this book and their contribution to my research.

My hometown is in Nagano Prefecture, Japan, an area known for its beautiful mountains and rivers. My parents rest there. The University of Hawai‘i at Mānoa, where my office is located, is in Blue Hawai‘i, an island paradise full of beautiful hibiscus flowers in the southern Pacific. As I worked on this casebook, I thought of my hometown thousands of miles away, and admired the gentle undulation of Diamond Head through the window of my office.

Mitsuru Misawa

# About the Author

Dr. Mitsuru Misawa (三澤満) received his LLB from Tokyo University Law School in 1960, his LLM from Harvard Law School in 1964, his MBA from the University of Hawai'i as an East-West Center grantee in 1965, and his PhD in International Finance from the University of Michigan in 1967.

He is a professor of finance (International Finance and International Banking) and director of the Center for Japanese Global Investment and Finance at the University of Hawai'i, which was established in 1997 under the sponsorship of Japanese Keidanren (Japanese Federation of Economic Organizations). He was granted tenure at the University of Hawai'i in June 1998.

Before joining the University of Hawai'i in August 1996, he had been with the Industrial Bank of Japan (IBJ) for 30 years, the most prestigious investment bank in Japan. It is now known as Mizuho Financial Group and is one of the world's largest banks. His career has included assignments as an investment banker in New York and Tokyo, each for 15 years. During his time at IBJ, he served as executive vice-president of IBJ Trust Bank (NY); deputy general manager of the loan department, IBJ (Tokyo) in charge of large-scale companies such as Nissan, Sony, and Komatsu; general manager of the International Headquarter, IBJ (Tokyo); and president of IBJ Leasing (NY), as well as a member of the board of directors, IBJ Leasing (Tokyo). One of the financial arrangements he facilitated as an investment banker at IBJ was Nissan Motor's direct investment in the manufacture of trucks and cars in Smyrna, Tennessee, in 1983. For a total financing of US$400 million, he employed "global financial engineering" techniques. Since then, these techniques have been widely used by other Japanese investors in the US.

His research has been published in numerous academic and professional journals, including the *Sloan Management Review*, *Financial Management*, *The Columbia Journal of World Business*, *Vanderbilt Journal of Transnational Law*, *The Banking Law Journal*, *Temple International and Comparative Law Journal*, *Columbia Journal of Asian Law*, *Journal of International Law and Business* of Northwestern University School of Law, *Penn State International Law Review* (Dickinson School of Law), and many cases developed at the Asia Case Research Centre of the University of Hong Kong.

Dr. Misawa consulted for a number of international institutions such as IBJ (Japan) and OSG Corporation (Japan). From 1989 to 1996, he served as the US counselor on the Keidanren's Council for Better Corporate Citizenship. From 1993 to l996, he was a member of the visiting committee at the University of Michigan's business school, which was composed of global business executives. Dr. Misawa was appointed Colonel of the State of Kentucky in 1984 and Arkansas Traveler in 1985 by the respective states in recognition of his achievements in soliciting Japanese investments for these states.

Dr. Misawa's most recent book, *Current Business and Legal Issues in Japan's Banking and Finance Industry* was published in September 2006.

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1 **Tokyo Disneyland:** Licensing versus Joint Venture 11

Tokyo Disneyland was the result of a licensing agreement between Walt Disney (WD) of the US and Oriental Land Corporation (OL) of Japan. The agreement stated that WD would receive a licence fee of 7% of sales in exchange for WD providing OL its managerial and technological know-how, and assuming small risks in the venture. When WD proposed a second project with OL, OL's senior executives tried to find a way to make WD a risk-taking partner through investment in the business as a precondition to venturing into the project. To prepare for the negotiations, OL's management asked the finance team to calculate the project's net present value as seen from WD's standpoint using two methods, i.e, using the existing licensing method and using a joint venture method in which WD would share appropriate risks.

2 **Tokyo Disneyland and the DisneySea Park:** Corporate Governance and Differences in Capital Budgeting Concepts and Methods between American and Japanese Companies 29

In 1997, Japan's Oriental Land Corporation and the Walt Disney Company, its licenser for Tokyo Disneyland, had intense discussions about the possibility of building an additional theme park called Tokyo DisneySea Park. The difference in the economic and political assessment of the project between the American and Japanese firm was the root cause of disagreement. Japan and USA use significantly different capital budgeting techniques. The difference in decision making between Japanese and American firms also reflects the difference in corporate governance techniques between the two countries. For example, the principles of discounted cash flow, such as the new present value (NPV) and the internal rate of return (IRR), are widely used outside the realm of Japanese corporate finance. Although familiar with these tools, Japanese executives rarely use them and often consider them invalid tools for the decision-making process. Instead, Japanese corporations have come to rely on the average accounting return method for their financial analyses. The reason behind Japanese businesses rejecting NPV and IRR lies in Japan's socio-economic conventions and the nation's history.

3 **A Rogue Trader at Daiwa Bank (A):** Management Responsibility under Different Jurisprudential Systems, Practices, and Cultures 49

Sumio Abekawa, Daiwa bank's president, received a letter on July 18, 1995 from Toshihide Iguchi, vice-president of the bank's New York branch. In that letter, Iguchi confessed to losing about US$1.1 billion (approximately ¥123 billion) by selling the bank's securities in order to cover up the loss from his unauthorized trading of US Treasury Bonds over 11 years. The senior management at the bank reported the loss two months later on September 18 to the Federal Reserve Bank of New York and the New York State Banking Department. The bank directors faced a number of challenging questions: Had the bank complied with the reporting requirements? What would be the potential liability of the directors? Would the Japanese bank directors be held liable for violating the law of a foreign country? How could the Japanese Ministry of Finance help?

4 **A Rogue Trader at Daiwa Bank (B):** The Board Meeting on September 25, 1995, in Japan 61

This case raises many basic legal and economic issues regarding directors' responsibilities for the activities of their employees, which were not discussed in the main case, "A Rogue Trader at Daiwa Bank: Management Responsibility under Different Jurisprudential Systems, Practices and Cultures." According to an official at Japan's Ministry of Finance, the individuals involved in this case may not have directly contributed to the incident at hand as they were not only trustworthy but also very capable professionals. Could they be held responsible for responsibilities delegated to others? Irrespective of this fact, were they liable and responsible for this situation? What about the bank's responsibility as an institution? The additional questions were: (1) Was there any non-feasance regarding duties in establishing an internal control system? (2) Could the directors claim principle of trusting right? (3) Was Daiwa bank also responsible under the principle of *respondeat superior?*

5 **Hostile Takeover Battle in Japan:** Fuji TV versus Livedoor for NBS 65

In February 2005, the top management of Fuji Television Network, Inc. (Fuji TV), one of Japan's leading media conglomerates, was informed by its main brokerage that a small IT services firm, Livedoor Co. (Livedoor), had succeeded in buying 35% of the shares in Nippon Broadcasting System Inc. (NBS), of which Fuji TV owned 12.39% and which it was in the process of acquiring through a takeover bid, to make NBS its subsidiary. What made the issue even more complicated was that NBS's main asset was its 22.5% stake in Fuji TV. The news that a relatively unknown company had managed to buy 35% of NBS's shares thus came as a great shock to the top management of Fuji TV, which had to study and determine effective tactics to counter Livedoor's planned acquisition of NBS. They immediately instructed legal counselors to conduct a study on what would be the most effective and legal actions Fuji TV could undertake against Livedoor. At the same time, they asked the planning department to calculate the corporate value of NBS using both American and Japanese methods. This involved forming judgments about the price Fuji TV should be prepared to pay if it went through with acquiring NBS completely. The case addresses issues of strategic fit between the bidder and the target, target performance, valuation, financing decisions, and whether and how the target's anti-takeover moves might affect outcomes in the battle for corporate control.

6 **Livedoor:** The Rise and Fall of a Market Maverick 87

Internet service firm Livedoor allegedly took advantage of loopholes in the securities trading laws to swell the amount of assets held by the firm and its president, Takafumi Horie ("Horie"), who led the

Livedoor group. Livedoor was established in April 1996 with ¥6 million in capital. It made its stock market debut in April 2000, with a stock market value of ¥57.2 billion. Its market capitalisation surged to ¥830 billion in December 2005, a 15-fold spike, caused by a series of highly tactical moves intended to boost the stock prices of the parent and group firms. Livedoor's strategy essentially focused on how to attract speculative investments from individual investors, largely ignoring institutional players. A 100-for-1 stock split in December 2003 sent the price of Livedoor's shares soaring to the ¥18,000 mark at once, although the ex-split price should theoretically have been just ¥2,220. Livedoor's operations turned out to be a kind of "money game" under the guise of efforts to challenge the establishment. Where did Livedoor deviate from the path of fair business, and what kind of illegality was involved in its activities? Shedding light on these questions should help both companies and investors make more constructive use of the securities and capital markets.

7 **Nireco Japan:** Introduction of the Poison Pill 99

A big factor behind the looming threat of hostile takeovers in Japan was the rapid dissolution of cross-shareholdings, which began in the 1990s, between creditor banks and corporate borrowers in particular. At the same time, foreign ownership of Japanese companies, which used to account for only a small percent of all outstanding shares, had now risen to approximately 20%. The proportion of free-floating shares had thus risen significantly. This also meant that buying out a company through a takeover bid (TOB) in Japan had become far easier. Recognizing the trend, and driven by the fear of Japanese companies being swallowed up by foreign investors, Hidemaru Yamada, president of Nireco Corp. (Nireco) — a high-tech measuring-device manufacturer — thought that his company needed to introduce a "poison pill" defence to counter possible hostile TOBs. With this thought, Yamada diverged from Japan's traditional way of thinking, which assumed that hostile takeovers had little chance of success in Japan. Nireco assessed the situation, taking into account Japan's institutional infrastructure, its law and its economic conditions. In March 2005, Nireco announced what it called a "security plan," which included an issue of subscription warrants to existing shareholders in the event of an unfriendly takeover bid.

8 **Ina Food Industry:** A New Management Philosophy for Japanese Businesses 119

Ina Food Industry Co. Ltd (Ina Foods) was led by Hiroshi Tsukakoshi, Ina Food's 68-year-old chairman, who had been with the company through an incredible 48 years of continuous revenue and profit growth. The company was a leading manufacturer of powdered agar, a traditional gelatine product derived from seaweed. Tsukakoshi's cautionary attitude about quick growth was quite unique in current times when return on investment and total market value were considered key management indices. His belief was that if management were not preoccupied purely with revenue, and focused instead on establishing steady growth, the company would continue to exist for a long time. This would, in turn, make happier everybody who was directly or indirectly associated with the company. He believed that his role as president was to make employees happy at work. In the summer of 2006, he felt he had done a good job so far. The business had prospered and did not pose any urgent problems. But he also felt that he should not simply sit back and savor his success. There were tremendous growth opportunities and he knew operations had to be improved before those opportunities could be targeted. He had been thinking that real joy came from change and from going to the next level. His long-time belief had been that no company could get to the future by standing still.

9 **OSG Corporation:** Hedging Transaction Exposure 133

On Monday, April 24, 2006, the US dollar fell to a new three-month low against the yen to ¥114.30 = US$1, carrying over its weakness from Friday's trading in New York where it fell more than ¥2 (1.75%). Teruhide Osawa, president of OSG Corporation, Japan (OSG), a multinational cutting-tool producer, was following the foreign exchange market on his computer screen that Monday. Faced with big fluctuations in the yen–dollar exchange rate, he summoned the manager of the Support Centre Finance Group, Koji Sonobe. He asked Sonobe to analyze and report on how OSG's exposure to foreign currency transactions was currently being measured and how it could be managed in the future. He asked the manager specifically how the company was currently hedging its foreign currency exposures. The board's consensus was that the amount of currency risk exposure that should remain covered depended on the management's philosophy and decision. OSG's policy in the past did not intend to hedge transaction exposure perfectly and intended to leave it partially open to the market. The board would need to decide how much hedging was required as a policy.

**10 Bank of Japan's Meeting in March 2006:** An End to the Quantitative Easing Policy? **151**

The policy board of the Bank of Japan (BOJ) convened for a two-day meeting starting March 8, 2006. It was expected that the board would decide to end its five-year, extremely loose monetary policy, which was designed to combat persistent deflation, and to set forth the quantitative easing approach. A decision to end the policy meant Japan would return to a normal monetary stance, targeting interest rates after five years of pursuing an unorthodox policy. The BOJ's decision was not easy. Although the law established the BOJ's independence, there was considerable opposition from the government, including Prime Minister Koizumi, to an early end to the quantitative monetary easing approach. Politicians were concerned that a "premature" monetary policy change could hamper the economic recovery from deflation. Because no major central bank had ever had such a loose monetary policy, no one knew for sure how to end it smoothly. In the end, the BOJ did as expected and lifted its quantitative easing policy, replacing it with a more standard inflation targeting policy. The bank now had to avoid sending shock waves through the country's recovering economy and through world markets, to which end the BOJ drew up a set of measures aimed at averting possible market turmoil.

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# Introduction

The history of Japan's economy during the 60 years after the Second World War followed a trend of internationalization. Many corporations switched from doing business domestically to doing business internationally. Because Japan is geographically small with limited natural resources, economic growth and a higher per capita income became viable only through the export of products to overseas markets. As a result, every company concentrated on producing inexpensive goods of better quality in a cost-effective manner. Internationalization was the goal for every company.

While globalization of the Japanese economy has been advancing with astounding speed, significant differences remain between the management philosophy and techniques used within Japanese companies and those used in the West. These include the significant differences in the use of capital budgeting techniques, economic and political assessment of projects, decision-making styles, and techniques of corporate governance. Furthermore, Keiretsu (interlocking shareholdings) still plays an important role in the financing of companies in Japan. Such differences have a momentous impact on decision-making processes within companies, and this book illustrates many of the key differences that exist in the realm of corporate governance and finance.

September 1985 marked a change in the progression of the Japanese economy. Six industrialized countries of the world signed the Plaza Accord, increasing the value of the yen until it reached its peak in August 1995 of ¥79/$, more than four times stronger than it had been during the fixed exchange rate period, i.e., ¥360/$. Encouraged by the yen's appreciation and super fluidity of currency in the domestic market, many Japanese companies rushed to buy real estate overseas, including the famous Plaza Hotel where the abovementioned Plaza Accord was signed. However, contrary to the expectation of Japanese industries, this strong yen introduced a long-term economic downturn and a substantial deterioration of the economy.

The export industry, which was the foundation of the Japanese economy, was hit hard by the sharp yen appreciation. The Japanese economy went into the most serious recession in 70 years since the Great Depression in 1930, during the early Showa period. Financial uncertainty and plunging prices added to the recession, creating a severe deflation spiral. Industrial companies, tormented by excess product supplies due to the lack of demand for exports, sought relief through employment adjustments, which, in turn, caused further weakening of consumption and demand. The economic growth rate was –0.7% in 1997 and –2.8% in 1998 — an unbelievable downturn for the Japanese economy that had been growing continuously since the end of the Second World War. The Nikkei average, which reached its historical peak of ¥38,916 in December 1998, started to drop. The land price index, which is based on the price in 1983 as 100, reached its peak at 488 in 1990, but dropped sharply to 144 in 1995.

The Japanese economy suffered from the aftermath of this recession for a long time. Reduction of personal and business financial assets caused severe shrinkage in personal spending and business capital investments. Banks had to cope with huge bad debts and place borrowing companies under a credit crunch in order to reduce assets. Starting in 1995, the economy entered a period that is now referred to as "the lost age," a period of compound depression in which prices dropped and the net gross national product growth rate was negative. To combat the situation, the Bank of Japan introduced a zero interest policy, i.e., a super money-easing policy, which had not been seen in the world's economic history for many years. However, its effect was dubious, to say the least. It is a common belief that, although inflation can be cured by a mix of monetary and fiscal policies, there is no cure for deflation. Consumers are wise and will not spend money today if they know that prices will drop tomorrow. Moreover, the per capita income level of the Japanese was high, and they already owned everything they wanted. There was no reason for them to spend money hastily. Japanese companies' executives used various hard and soft policies in order to survive this "lost age."

Japan is currently in an up phase. In fact, the economy has continued expanding for 58 months since February 2002, beating the 57 months of the Izanagi boom, from November 1965 to July 1970. However, the Japanese economy has a basic structural problem — the domestic economy is shrinking, and competition is becoming harsher due to the reduction and aging of the total population. Essentially, the Japanese economy has no alternative but to pursue the world market by adapting itself to globalization. Restructuring of its industrial formation through corporate buyouts and reorganization is an unavoidable task for Japanese corporations.

With the backdrop of this brief recent history of the Japanese economy, these case studies were chosen from a broad range of Japanese corporations. The ten cases, briefly described, can be classified into the following categories:

1. Internationalization. Examples of internationalization of the Japanese economy are described in two cases: a successful foreign investment in Japan — Tokyo Disneyland — and a failed Japanese investment in New York — Daiwa Bank.
2. Mergers and Acquisitions. Japanese corporations are busy dealing with mergers and acquisitions (M&As). Fuji TV versus Livedoor and Nireco are two cases that have been included to discuss hostile takeovers and countermeasures against them.
3. Small companies. When discussing the Japanese economy, small companies cannot be disregarded. The case of Ina Food is an excellent example of a thriving small company.
4. Parts manufacturing. OSG is included as a case representing the parts manufacturing industry of Japan. This company, although not fashionable, is the world's leader in the industry and sustains the Japanese economy.
5. Macro economy. The decision-making process of the Bank of Japan that steers the macro economy is described in another case. A description is given of how the breadth and depth of the decision-making process of a governing body differs from that of an individual company.

### *Case 1 — Tokyo Disneyland: Licensing versus Joint Venture*

The biggest obstacle in establishing Tokyo Disneyland was the amount of risk that the US side (Walt Disney) was willing to take in the particular project. The issue hinged on the question of whether Walt Disney wanted to license the project or participate in a joint