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Balance Sheet Cash:

Unlocking Value in Japan

October 2006

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Abstract

This paper explores the concept of "cash-rich" firms and takes aim at uncovering those companies with excess cash on their balance sheets among the stock markets of Europe, Japan, and the United States. Through detailed analysis, we review aggregate cash levels within these markets and examine the existence of cash-rich companies across a 16-year period and a range of statistical measures. Digging deeper, our research focuses specifically on Japanese cash-rich companies and reviews disparities between these firms and their western counterparts. Within this study, we review capital management theory, taking a close look at dividend and share buyback policies. Our research uncovers differences in the payout practices of companies domiciled in Europe and the United States in comparison to Japan. We investigate our findings on cash-rich firms further by narrowing our focus and conducting a concentrated case study, contrasting the leading pharmaceutical companies across these three regions. We conclude our research by touching on various macroeconomic trends, regulatory imbalances, and cultural disparities that may have contributed to corporate Japan's historical "cash hoard" mentality. We also explore the potential for individual companies to engage in capital restructuring to help unlock cash-heavy balances by redeploying excess capital into value-constructive initiatives. At an aggregate level, the results presented in this paper reveal a recent rise in the number of cash-rich firms globally and largely confirm the existence of disproportionately high cash positions on the balance sheets of Japanese companies.

Introduction

Over the past five years, economic recovery and corporate cost cutting has contributed to the reduction of corporate debt and a significant growth of cash on corporate balance sheets. Cash-heavy positions among a number of U.S. public companies largely have been favorable for shareholders, as increases in cash flows have come back in various permutations of returned value. During 2005 alone, 300 companies within the S&P 500 Index raised their dividend payout rate, issuing a record total $202 billion in dividends.[1] At year-end, after-tax dividend yields for more than 60 companies in the S&P 500 were higher than the 10-year U.S. Treasury.[2]

In addition, 2005 saw U.S. companies spend a total of $315 billion on share buybacks, a 60% increase from 2004.[3] The prevalence of excess corporate cash also was a catalyst for a flurry of merger and acquisition (M&A) activity in 2005, as preliminary data from Thomson Financial indicated global M&As hit a 5-year high, exceeding $2.7 trillion, up 38% from 2004.[4] Investors in U.S. equity markets seemingly have endorsed the majority of these endeavors and perceived increases in dividends, stock buybacks, and M&A activity largely as value-constructive utilizations of excess capital. The effects of increases in shareholder activism also may be prodding companies sitting on stockpiles of cash to redeploy these assets more effectively.

Given the broad-based rise in profitability among U.S. companies, leading to heavier balances of corporate cash, we questioned whether similar cash accumulation was occurring within non-U.S. markets. Specifically, we sought to identify "cash-rich" firms that were lax in value-creative pursuits and then question how various valuation

[1] McDonald, Ian. "New Cash Cows: Biggest Stocks." *The Wall Street Journal*. January 6, 2006.
[2] McDonald, Ian. "New Cash Cows: Biggest Stocks." *The Wall Street Journal*. January 6, 2006.
[3] Barnett, Megan. "These 5 Companies Show Us the Money." *The Wall Street Journal*. February 19, 2006.
[4] Berman, Dennis K. "Fistfuls of Dollars Fuel The M&A Engine." *The Wall Street Journal*. January 3, 2006.

measures may have been affected by excess cash on the balance sheets of these firms. To investigate, we analyzed developed markets in the United States, Europe, and Japan. Interestingly, our research confirmed that not all three areas viewed excess cash the same, and over time, certain markets were prone to companies tending to hold greater proportions of cash on their balance sheets, particularly firms in Japan.

Given the number of cash-rich firms uncovered in the Japanese universe, our research focuses primarily on these companies and seeks to determine the central factors that have led to their cash buildup. In this study, we review a variety of statistical measures determining whether cash-rich firms are particular to certain sectors, industries, or capitalization ranges within their respective geographic areas. We also review the optimal structure for capital management, offering insight on the value of various cash management techniques. A concentrated case study of all three areas' largest pharmaceutical companies is also conducted to review cash-rich and non-cash rich firms on a company-by-company basis, noting any specific features that may promote a "cash hoard" mentality. Finally, we take a look at macroeconomic factors within Japanese markets that may have contributed to the current corporate cash glut and review regulatory revisions that may serve to influence change within corporate Japan.

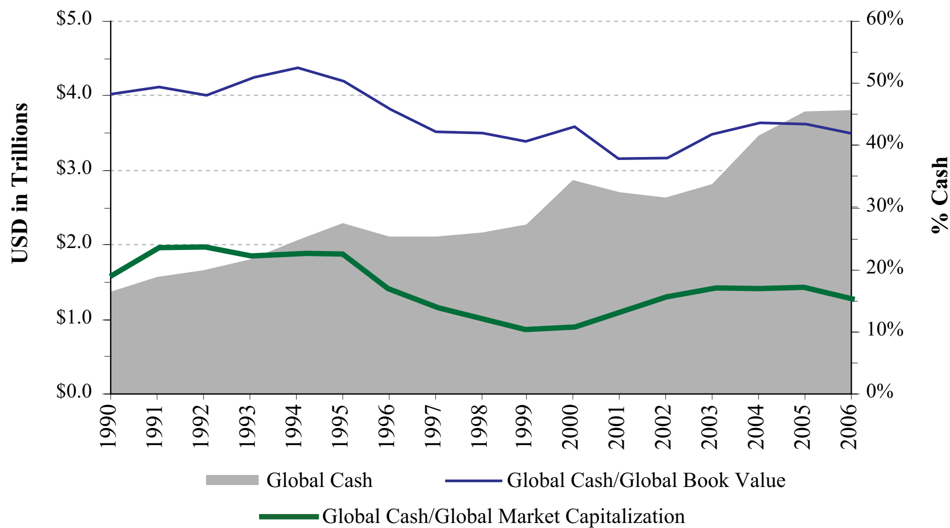
Measuring the Existence of Cash

Section Summary: *Using a variety of valuation measures, research results point to the existence of a significant number of cash-rich firms worldwide. However, when we narrowed our focus to screen only for those companies with extraordinarily high measures of cash on their balance sheets, companies in Japan were most prominent.*

Initial research aimed to evaluate the aggregate cash balances in global markets and answer whether global cash levels have been rising.[5] While we acknowledge the limitations of research conducted over shorter time spans, we believe the 16-year period selected for this study offers a robust data sample and yields evidence regarding the existence of cash on corporate balance sheets in global markets. Exhibit 1 reveals three figures reviewed to gauge cash balances during the past 16 years. The first of these measurements, global cash as a total dollar figure, demonstrated a modest upward trend during the period reviewed. Conversely, cash as a percentage of global market capitalization and cash as a percentage of global book value both exhibited slight downward trends after experiencing peak levels during the mid-1990s. However, all three sets of figures confirm a noteworthy increase in global cash levels since the early 2000s. Results from these three preliminary measures suggest that while global cash levels may have fallen from highs experienced during the early 1990s, corporate cash levels have remained high, and have risen significantly since 2001.

[5] All research conducted in this study was done via FactSet, limited to primary shares only (of any company), no ADRs, and no financial companies as defined by the Global Industry Classification Standards (GICS). Companies within the financial sector, as defined by GICS, were removed from our cash-rich samples to avoid bias toward this sector's business of cash management. Companies with market capitalization less than $100 million were removed to yield a universe representative of that available to an institutional investor.

Exhibit 1: Global Cash Levels



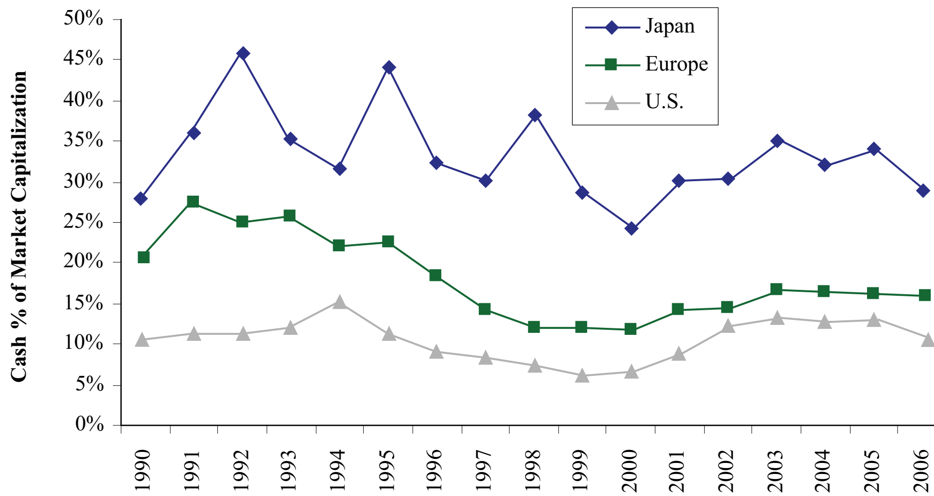
Source: The Brandes Institute via FactSet as of 6/30/06

The chart above, illustrating corporate cash levels on a global basis, has followed a broad economic trend of increased profitability and enhanced corporate efficiency. To confirm these results reflected aggregate cash levels, and were not overtly influenced by the impact of foreign currency appreciation relative to the U.S. dollar and the gradual rise in the number of companies entering the universe over the period of the study, these factors were investigated. Both issues were found to be relatively insignificant. The influence of currency was minimized by the 16-year period of our study, and reviewing the average and median cash levels on an individual company basis pointed to fairly uniform averages, suggestive of alternative explanations to recent increases in corporate cash balances. Based on these findings, it was of interest to apply these same statistics specifically to the markets of Europe, Japan, and the United States.

We first applied the earlier statistic used, cash as a percentage of total market capitalization, over the same 16-year period used for the global review. The results in Exhibit 2 indicate Japan's cash level is presently in-line with its historic average, but notably lower than mid-1990s' peaks. However, Japan's cash as a percentage of market capitalization still significantly exceeds the United States and European markets[6] on an aggregate basis. In fact, Japan's average cash as a percentage of total market capitalization was nearly twice as high as Europe's over the 16-year period of the study, and triple the U.S. average during the same timeframe.

[6] For our study, "Europe" is comprised of companies within the MSCI Europe Index, consisting of the following 16 developed market countries: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

Exhibit 2: Total Cash/Total Market Capitalization

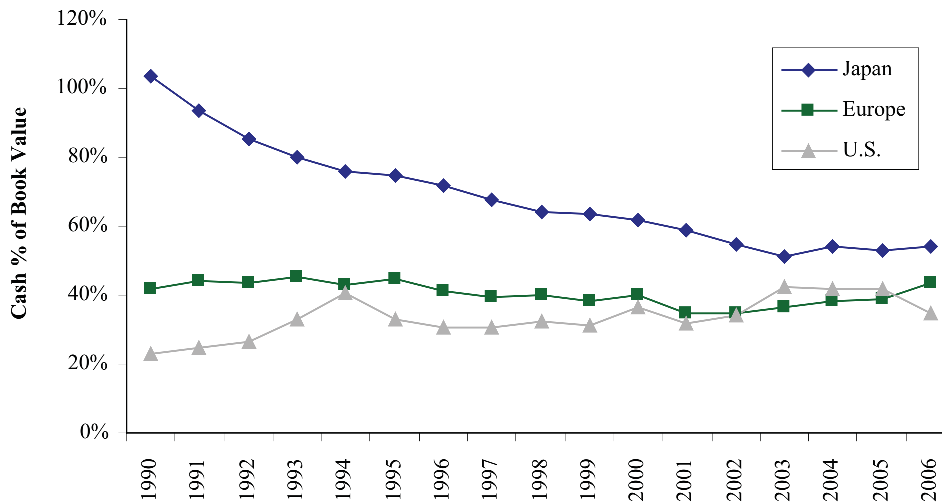


Source: The Brandes Institute via FactSet as of 6/30/06

It should be noted that certain regional differences, such as the U.S.'s cash level increase, Japan's fairly stagnant market capitalization level, or Europe's rise in market capitalization over the period of our study do have an effect on these ratios. However, we believe the overall impact of these factors to be negligible. Regional economic variances aside, the findings presented above emphasize prominent cash balances within all three markets under review. Specifically, we note a rise in cash balances since the late 1990s and early 2000s across all three universes.

To take another look at aggregate cash levels across these markets, Exhibit 3 displays cash as a percentage of total book value. This comparison illustrates that Japan's aggregate cash has declined steadily over the past 16 years. A quick glance at Exhibit 3 might temporarily mislead readers by suggesting Japan's corporate cash balance has deteriorated more significantly than the earlier measurement of cash as a percentage of market capitalization demonstrated. This decline can be attributed to two primary factors' influence upon the cash as a percentage of book value measurement. The first factor, most applicable to the recent 5-year period, has been corporate Japan's increasing compliance with international accounting standards. Beginning April 1, 2001, Japanese companies introduced fair value accounting for financial instruments, recording securities at market prices. The second factor impacting this measure is the greater increase in overall market book value Japanese companies experienced in comparison to capitalization during the period of our study. This rapid increase in book value does, to some degree, influence the cash as a percentage of total book value figure for Japan. The inverse holds true for Europe, where capitalization outpaced book value. However, in the United States, both market capitalization growth and book value growth remained even during the 16-year period, with both measures reflecting the recent rise in excess corporate cash among U.S. firms. Most interesting in both exhibits, however, is the fairly meaningful percentages of cash-rich companies for both measures, and particularly in Exhibit 3, the recent convergence of Europe and the United States at roughly 40% and Japan at 50%, suggestive of significant numbers of "cash-rich" companies in all three markets.

Exhibit 3: Total Cash/Total Book Value



Source: The Brandes Institute via FactSet as of 6/30/06

After reviewing these figures and determining that there were indications that companies experiencing heavy cash balances were prevalent across all three regions, it was of interest to uncover within which market capitalization ranges the cash-rich companies resided. Were the companies uncovered on an aggregate level an anomaly occurring only within a certain market capitalization segment, or was this occurrence a market-wide event?

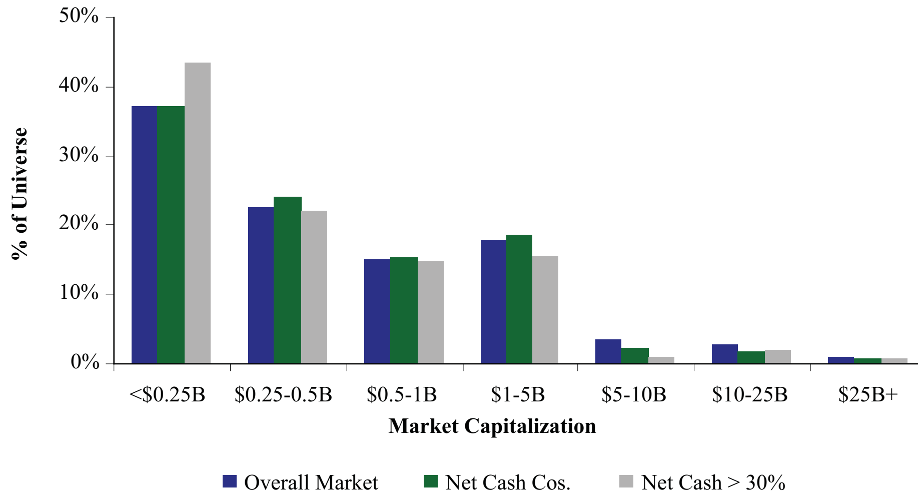
As illustrated in Exhibits 4, 5, and 6 (where each data series represents 100% of the companies within the respective universe, e.g. universes of companies with net cash on their balance sheets), very small, or micro-cap companies tended to exhibit the highest percentage of excess cash on their balance sheets (this result was anticipated as smaller capitalization companies typically seek to maintain a greater amount of financial independence and flexibility, whereas mid- and large-cap companies typically can afford to be more reliant on creditors and capital markets). However, it also was apparent that a significant percentage of cash-rich companies resided within the mid-cap ($1B – $5B) range[7] , and that within each area's mid-cap sample, a number of these firms were positive "net cash," defined as those companies whose cash balances exceed that of their total debt (balance sheet cash[8] minus both short- and long-term debt). More meaningful and of additional interest was that a significant portion of these companies maintained 30%+ net cash positions.[9]

[7] All capitalization ranges reflected in U.S. dollars.

[8] Cash is defined as cash, cash equivalents, short-term investments, and other investments via Worldscope.

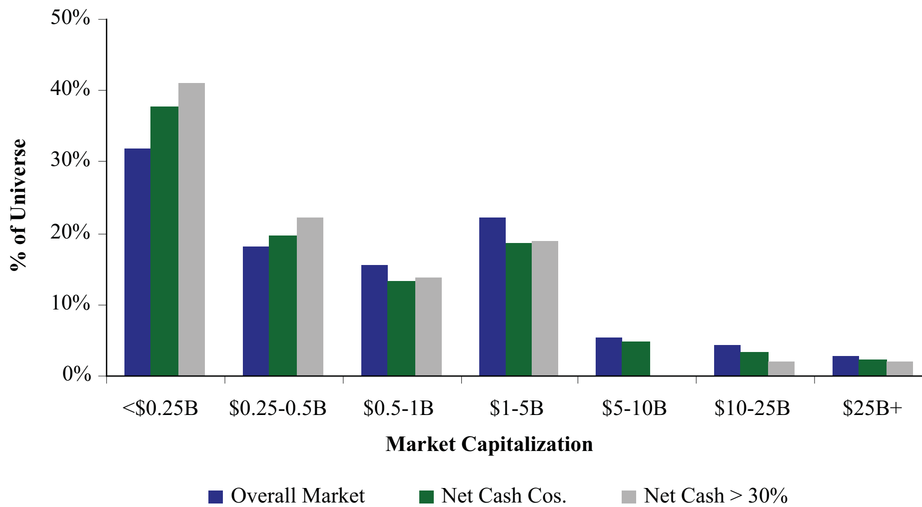
[9] The number of total companies in the universe, the number of net cash companies, and the number of net cash companies greater than 30% within this group for the United States were 3,060, 1,465, and 228; for Europe 2,458, 933, and 95; and for Japan 2,032, 1,220, and 389, respectively.

Exhibit 4: Companies with Cash by Market Cap Range – Japan



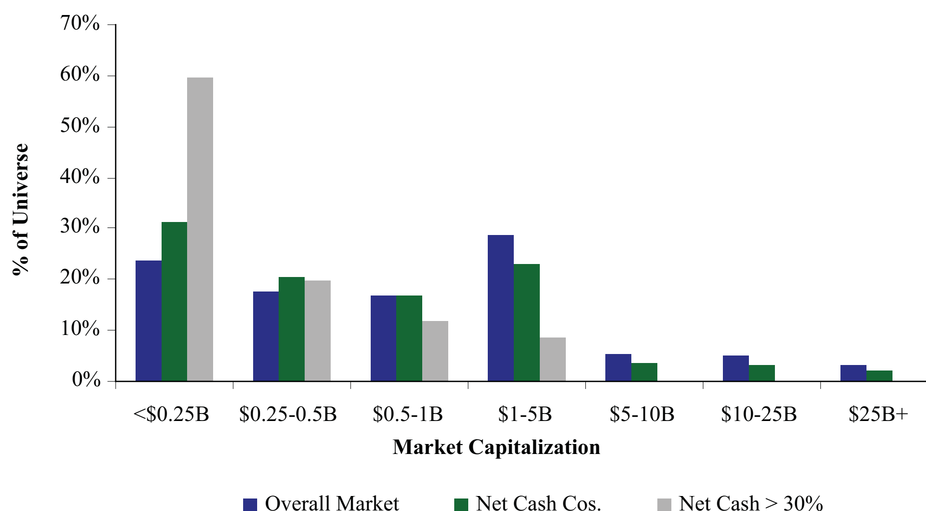
Source: The Brandes Institute via FactSet as of 6/30/06

Exhibit 5: Companies with Cash by Market Cap Range – Europe



Source: The Brandes Institute via FactSet as of 6/30/06

Exhibit 6: Companies with Cash by Market Cap Range – United States



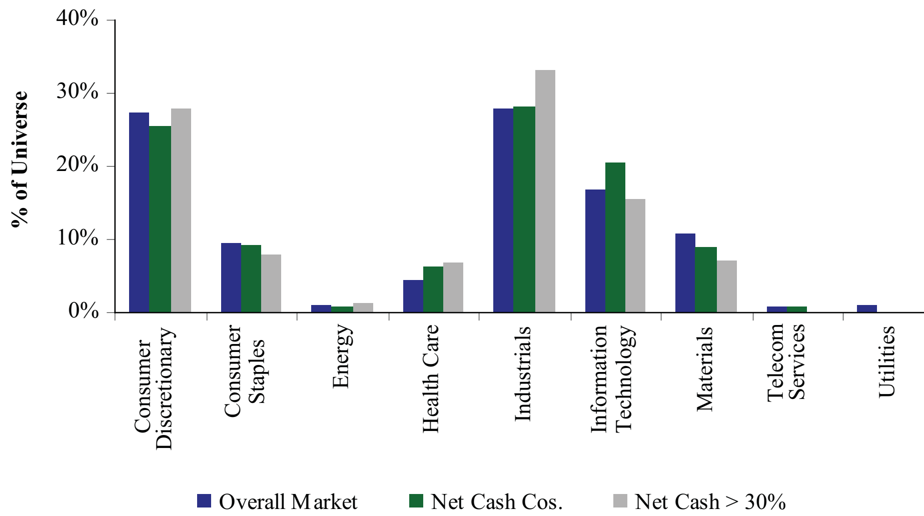
Source: The Brandes Institute via FactSet as of 6/30/06

At this point, we have established that companies in all three regions under investigation displayed noteworthy aggregate measures of cash as a percentage of both market capitalization and book value. Additionally, we have looked broadly at various market capitalization breakdowns to determine where firms displaying cash heavy balance sheets resided within each area. Furthermore, it was discovered that a number of these firms were net cash, and in some cases, maintained persistently high (30%+ net cash) cash levels. To look at these net cash companies in greater detail, we next analyzed where net-cash firms fell on a sector basis (again, excluding the financial sector to avoid bias toward this sector's business of cash management) and created cash-rich thresholds to determine which regions and sectors contained companies with the most significant cash on their balance sheets.

Sector concentrations of net cash companies tended to vary broadly within each market. Exhibits 7, 8, and 9 show each regional breakout and the sectors with the greatest percentage of net cash firms as of June 30, 2006. Although the results across regions are mostly mixed, some crossover of net cash sectors in differing regions is apparent. For instance, across all three regions, both the consumer discretionary and industrials sectors had significant weightings of net-cash companies. The information technology sector also proved home to a substantial portion of these firms, especially in Europe and the United States. The information technology industry's heavy cash balances may reflect management concerns over the volatility of cash flows, lingering caution in the wake of the burst tech bubble, and fears of no longer being perceived as a "growth" company if cash is paid out, implying the firm can not reinvest it sufficiently.[10]

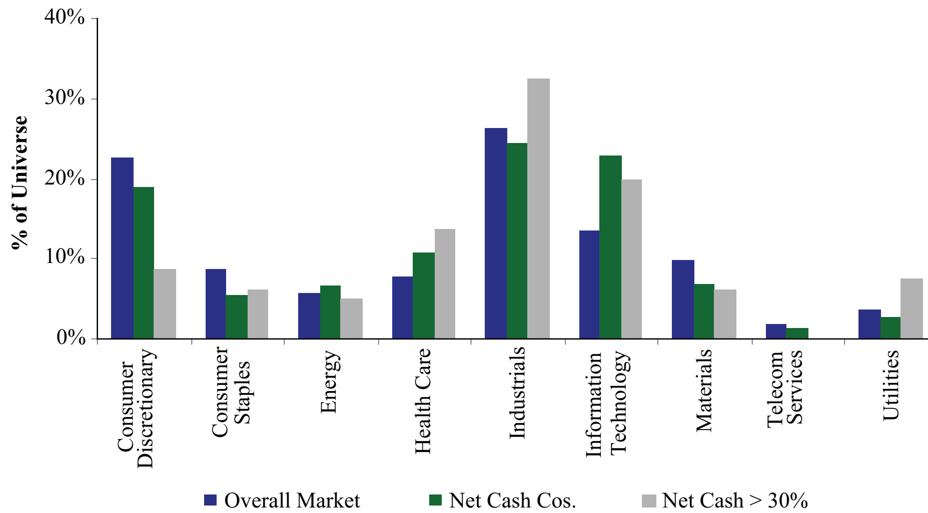
[10] Eisinger, Jesse. "The Tech Sector is Hogging the Green Blanket." *The Wall Street Journal*. April 5, 2006.

Exhibit 7: Companies with Cash by Sector – Japan



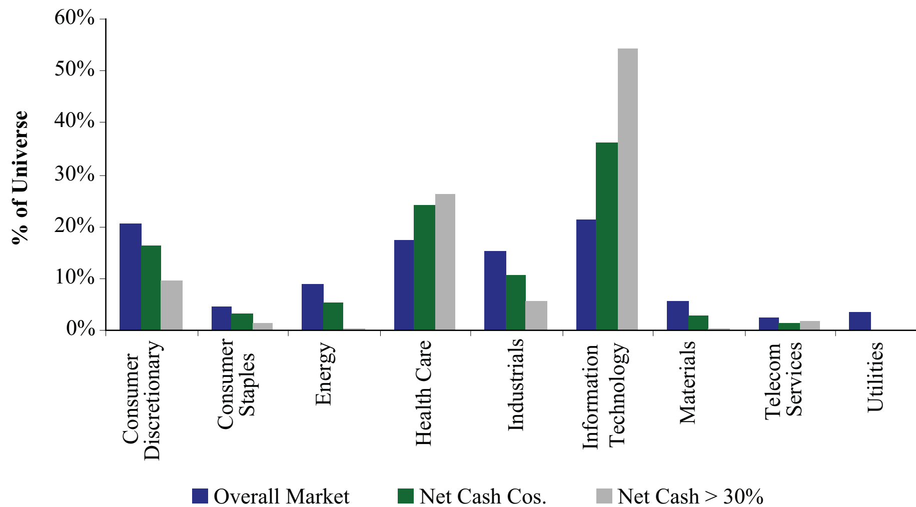
Source: The Brandes Institute via FactSet as of 6/30/06

Exhibit 8: Companies with Cash by Sector – Europe



Source: The Brandes Institute via FactSet as of 6/30/06

Exhibit 9: Companies with Cash by Sector – United States

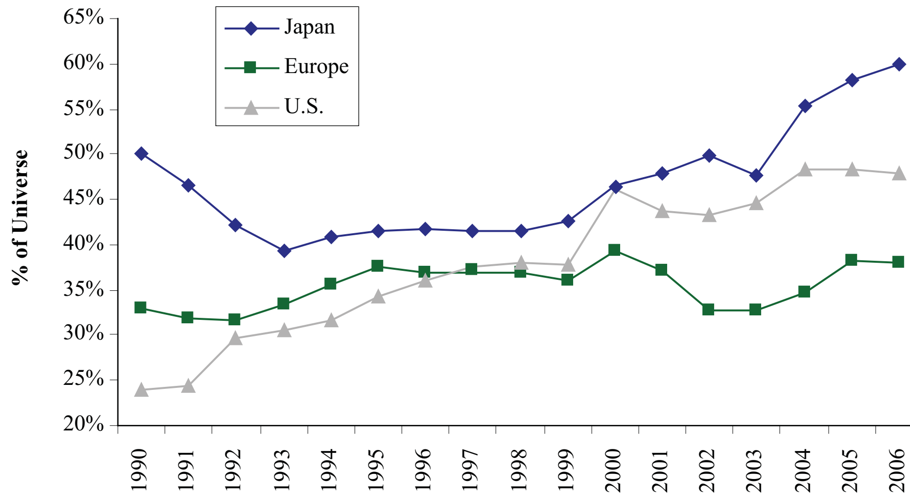


Source: The Brandes Institute via FactSet as of 6/30/06

Exploring the results of a net cash screen for companies across all three regions shows interesting results relative to each market's total universe. For example, in Japan, net cash companies comprised an average of 47% of the total universe during the entire length of the study, while in the United States, net cash companies comprised an average of 38% of the universe. In Europe, the net cash constituent group was slightly less, with net cash companies comprising 35% of the region's universe during the 16-year period. This statistic became even more pronounced during the past year as both the United States and Japan hit 16-year net cash highs with 48% and 60% of their markets being comprised of net cash companies, respectively, while Europe's net cash group remained closer to its historic average at 38%.

Looking on an aggregate basis across regions over time, as shown in Exhibit 10, it was apparent that net cash percentages were on a steady rise in both Japan and the United States over the most recent 5-year period, while the European market lagged since a peak in mid-2000.

Exhibit 10: Percent of Regional Market Net Cash



Source: The Brandes Institute via FactSet as of 6/30/06

To identify concentrations of companies with even more considerable net cash balances, a higher net cash hurdle rate was introduced. The hurdle rate introduced to each region was gradually increased during the entire period under review from 0% to 30% or greater. Results showed that while net cash companies represented an increasingly smaller percentage of each regional universe as the hurdle rate was increased, several distinctions presented themselves particular to each market. While net cash results showed that the United States and Japan were comprised of 38% and 47% net cash companies, respectively, over the 16-year period of the study, once a 10% net cash hurdle rate was introduced, Japan's universe showed an average 32% cash-rich statistic, while the U.S. and European figures dropped to 19% and 17%, respectively. This data substantiated that while all three regions had seemingly similar percentages of net cash companies initially, the Japanese universe had significantly higher cash levels within its cash-rich group. To further refine our results, the hurdle rate was raised to a 20% net cash position within each market across the 16-year time period. At a 20% net cash level, the percentage of the U.S. and European universes that represented cash-rich companies dropped to a single-digit figure, while Japan maintained a 20% average for the entire 16-year period. And, when the final hurdle rate was introduced to screen for those companies that exhibited 30% or greater level of net cash, Japan continued to demonstrate a persistently higher proportion of companies with larger net cash balances than its western counterparts. See Exhibit 11.

Exhibit 11: Percentages of Net Cash Companies Within Each Region (1990 – 2006)

	U.S.	Europe	Japan
Net Cash	38.0%	35.4%	46.7%
10%+ Net Cash	18.9%	16.9%	31.7%
20%+ Net Cash	9.5%	9.1%	19.8%
30%+ Net Cash	5.2%	5.5%	11.9%

Source: The Brandes Institute via FactSet as of 6/30/06

Looking back at sector level data with the newly introduced hurdle rates, it was possible to pinpoint the highest cash percentages within various sectors and industries within each universe. In Japan, at the 30% net cash hurdle rate, there was nearly an even split of cash-rich companies concentrated within the consumer discretionary and industrials sectors. Taking a closer look within these sectors, Japan's heaviest cash-rich concentrations were located in the textiles, apparel, and luxury goods and construction and engineering industries, respectively. In the United States, cash-rich firms tended to reside most prominently within the information technology sector, specifically in the software and semiconductor & semiconductor equipment industries. And in Europe, cash-rich firms had their heaviest weighting in the information technology sector, specifically among the software industry. However, overall sector and industry results tended to be mixed, and the existence of cash-rich companies across a broad cross-section of sectors and industries suggested companies that exhibit high levels of cash may be more reflective of certain company-specific fundamentals, rather than a broad sector or industry influence.

Of additional interest was to find out details regarding the year-to-year turnover during the 16-year period of the study in each of these universes. By turnover, we mean what percentage of cash-rich companies in one year were not cash rich the previous year. Were there significant deviations of cash-rich companies year over year, or were cash-rich companies maintaining significant cash balances over extended periods? The United States had the highest average year-to-year turnover of net cash companies at 31%. Turnover in Europe averaged 30%. In Japan, turnover was 18%. These results suggested that while the United States and Europe saw more companies become cash-rich and then deploy the cash build-up, leading to companies falling in and out of the net cash sample, the market of Japan contained more companies that consistently held on to cash over longer periods.

In summary, preliminary research results supported the notion that a significant increase in global cash levels recently has taken place. To refine this hypothesis, cash measurement statistics were used on a global basis and then applied to the markets of Europe, Japan, and the United States, which revealed significant amounts of cash being held by companies within these regions. More detailed results gave mixed perspectives on net cash as a percentage of market capitalization and book value, as well as the sectors and industries in which these companies resided. Supplementary research done to include net cash hurdle rates then illustrated how Japan persistently had demonstrated higher cash levels within its universe, in contrast to the cash-rich companies of Europe and the United States. Final analysis conducted on the turnover rate of each region illustrated Japan's low year-over-year turnover in contrast to the markets of the United States and Europe.

Research compiled at this stage suggested that the Japan universe had an abundance of cash-rich companies, and that within this cash-rich group, their cash balances were significantly higher than the cash-rich firms of the United States and Europe. We recognize that economic factors during the period of the study, such as real interest rates, may have influenced results. While not discounting these influences, the remainder of this paper focuses on commonly held views on cash management, and analyzes the drivers within Japanese markets outside of governmental policy that may prompt Japanese companies to maintain relatively high cash balances.

Optimal Cash Structure and Payout Policy

Section Summary: *We believe implementing a cash management policy that serves to maximize firm and shareholder value simultaneously should be a primary focus for corporate executives. Being cognizant of the best means for excess cash deployment can dramatically influence profitability and efficiency measures, and may contribute to enhanced shareholder value.*

Striking the correct balance between a mix of debt and equity financing along with an optimal cash management approach can prove difficult, no matter where a company is domiciled. An optimal cash structure is a constantly moving target that is influenced by a long list of financial criteria in addition to more abstract measures such as management's perceptions of business risk, the current market environment, as well as daily company operations. Much debate remains regarding appropriate capital structures as businesses attempt to perfect the balance between risk and return, with no one capital management structure having universal application. Apparent from our earlier research results, evidence points to a growing number of net cash companies, some with exceedingly high net cash levels, within developed markets, thus begging the question, "Are management teams at these companies doing shareholders a disservice by maintaining persistently high levels of cash?"

Using return on equity (ROE) as a measure of management effectiveness, we find the historical median ROE hovered in the 4% range for Japanese firms during the 16-year period ending June 30, 2006. Conversely, companies in both the European and U.S. universes sustained an average 11% median ROE level during the same timeframe. During the 1990s, U.S. ROE levels were driven to significant highs. However, during this same period, Japanese companies lagged, as they perceived ROE improvement to be of limited importance. Their heavy reliance upon traditional banking relationships for financing, coupled with Japan's traditional business focus on top-line growth, as opposed to bottom-line profitability, proved detrimental, perpetuating low efficiency measures. However, during the late '90s, after the collapse of Japan's banking industry, ROE quickly became a primary emphasis for Japanese businesses. Increasing dependence on capital markets for fundraising meant Japanese companies needed to appease investors' growing appetite for higher returns and their focus on companies with high profitability measures, such as ROE.

Equipped with this knowledge, Japanese companies recently have made significant strides in improving ROE figures. But it has been argued that more improvement could still be accomplished through continued capital restructuring, and by maintaining more efficient cash management structures. Goldman Sachs Global Strategy Research Group studied hypothetical examples of how ROE could be doubled and WACC (weighted average cost of capital) could be lowered through the restructuring of Japanese firm balance sheets.[11] The premise of its studies focuses on the increase of leverage by conducting increased share buybacks and raising dividend payments. Its research argued that a sample of 15 Tokyo Stock Exchange (TSE) blue-chip companies with below-average leverage ratios potentially could double their ROE through the increase of dividend payouts and share buybacks. Additionally, after a separate U.S. study[12] verified that increases in dividends per share proved to bolster share price performance, parallel analysis conducted specifically on the markets of Japan suggested that dividend increases would have similar effects as in the United States, serving to increase relative share prices.

In addition to contributing to enhancing share value, dividend payouts and share buyback programs can benefit firms by limiting the discretionary cash available to management, potentially spent on value-*destructive* investments or in the pursuit of low-risk/low-profit ventures.

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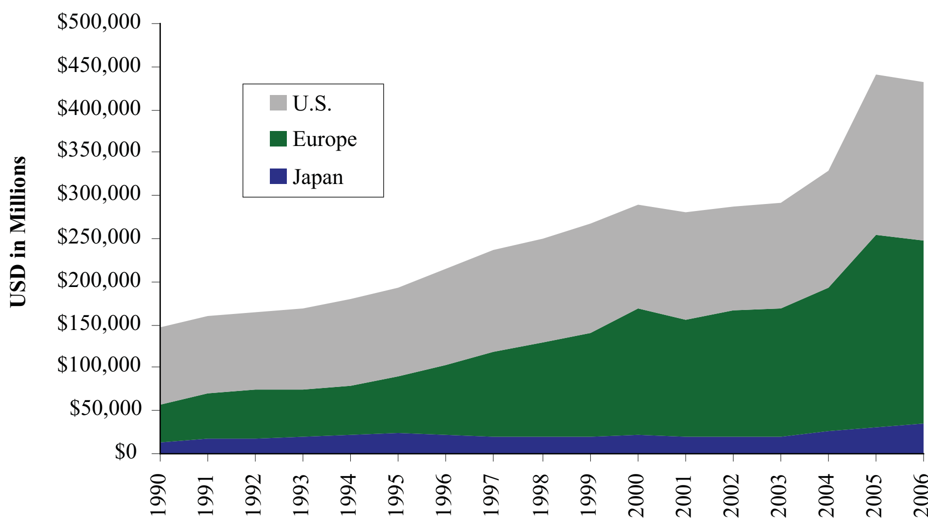
[11] Goldman Sachs Global Strategy Research. *"Dividend Demand Balance Sheet Restructuring – II.I"* July 8, 2004.
[12] Clement, Michael and Abby J. Cohen. *"Dividend-Based Investment Strategies: Dividend Yields vs. Dividend Increases."* December 16, 2003.

While not guaranteed to prevent such ventures, a regimented payout policy, in our opinion, offers a form of self-governing financial discipline; guiding excess capital primarily toward value-enhancing initiatives for shareholders. In particular, we believe the excess capital available in our sample of net cash companies, at net cash levels exceeding 10%, 20%, and even 30%, may hold the potential to substantially enhance overall firm value if these cash reserves were deployed in the form of a payout. We believe companies with limited uses for their cash buildup may in fact be adversely affecting share price by simply sitting on excess cash.

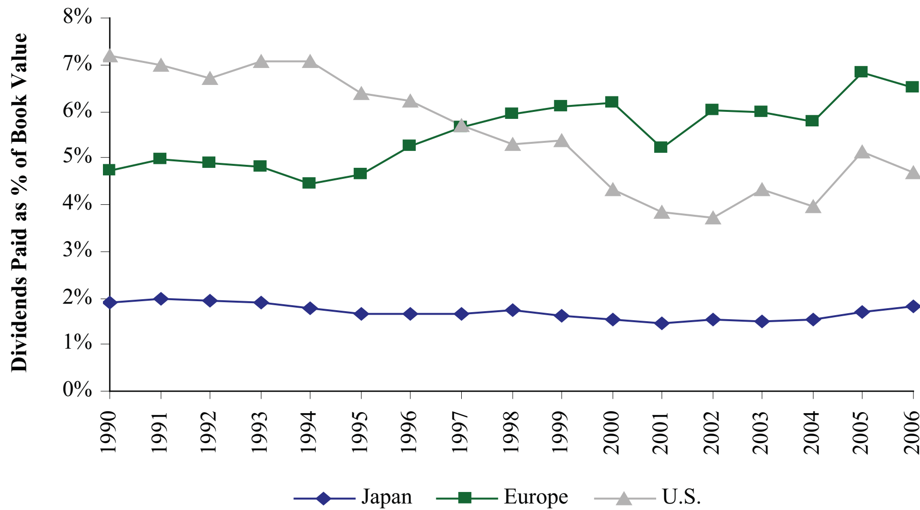
To investigate the potential for improving efficiency measures by enhancing cash payout, we first sought to identify historical dividend trends across the three regions studied. On an aggregate level, Exhibit 12 highlights Japan's significant difference from the U.S. and European markets by contrasting total dividends paid.



Source: The Brandes Institute via FactSet as of 6/30/06

Because we recognize the size differences in a comparison of these three universes, we account for this in Exhibit 13, using dividends paid relative to total book value to compensate for different sized markets. However, results again show Japan trailing in cash deployment relative to the European and U.S. markets.

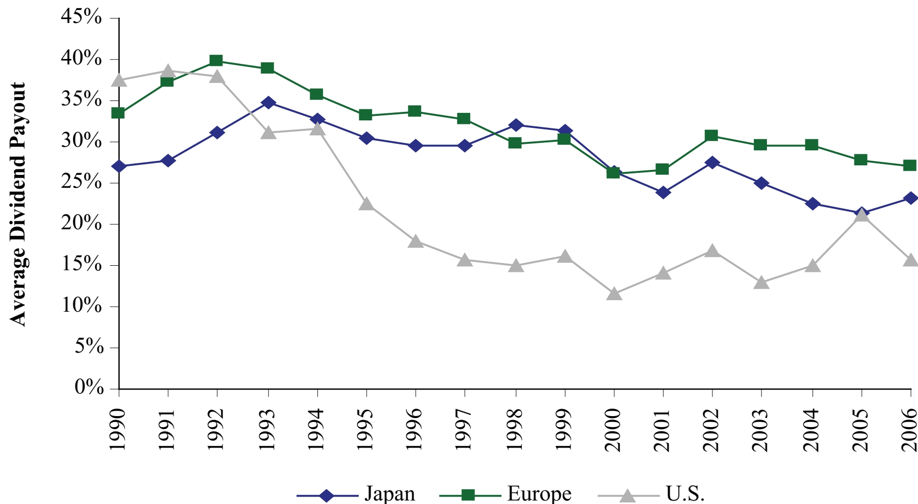
Exhibit 13: Total Dividends Paid/Total Book Value



Source: The Brandes Institute via FactSet as of 6/30/06

Finally, to identify company-level distinctions, we analyzed data by the average company for each universe, as illustrated in Exhibit 14. Our findings on an average company basis were notably dissimilar from those uncovered on an aggregate regional level. Japan's average company payout ratio conspicuously rose to levels above both the markets of Europe and the United States by mid-June 1998. However, we believe this rise can be primarily attributed to Japan's typically fixed dividend policy, coupled with depressed earnings, serving to drive the average company payout ratio to relatively high levels in contrast to the markets of Europe and the United States. Conversely, the United States average dividend payout ratio fell during the majority of the period, as earnings soared during the late '90s and dividends were disproportionate relative to earnings. Additionally, U.S. companies maintained a significant focus on reinvestment during much of the study, depressing average dividend payout. Since 1998, Japanese companies have experienced significant increases in earnings, in line with the country's economic rally, but dividends have not increased anywhere near a commensurate rate. This has caused the dividend payout ratio in Japan to decline through 2006.

Exhibit 14: Average Dividend Payout Ratio



Source: The Brandes Institute via FactSet as of 6/30/06

Exhibits 12, 13, and 14 show a disparity between the dividend payout policy of Japanese companies, versus the markets of Europe and the United States. All three measures confirm that Japan underutilizes cash available, based on the existence of excess cash uncovered in the first section of this paper. Furthermore, as suggested by Goldman Sachs Global Strategy Research, "Theoretically, in a low interest-rate environment like Japan's where the cost of equity is well above the cost of debt, companies that have limited uses for their cash should be raising their leverage in order to reduce the WACC and boost ROE."[13] Compounding the problem of excess cash on balance sheets has been corporate Japan's historical tendency to finance extensively through banks and retain significant portions of earnings. Each approach has garnered management with greater opportunity to fund low-risk projects that have tended to perpetuate reduced firm profitability and, we believe, share value.

However, a recent study[14] by the Bank of Japan seems to provide hope that Japan's corporate environment is increasing its focus on capital restructuring. The study suggests that Japanese companies may be headed toward "more active payout policies commensurate with their financial capacities."[15] Of particular note, the study shows that since 1994, Japanese firms' dependence on bank loans has been on a steady decline, while fundraising through equities has been on a modest uptrend.[16] It should be noted however, that these findings apply generally to larger firms on solid financial footing. The Bank of Japan research found that smaller firms with lower credit ratings typically continue to experience more dependence on the traditional banking system.

While academics have long argued for and against the value of dividend policy and its effects on share value, it remains an attractive quality for many investors and an effective means for building shareholder wealth. From 1926 to 2003, U.S. equity investors have earned 63% of their total returns from dividends.[17] In addition, a generous divided policy may not only be a reflection of competent management, but a catalyst for its continuation. Clifford S. Asness and Robert Arnott recently evaluated S&P 500 dividend payout ratios and resultant earnings growth over a 55-year period.[18] The results of their study concluded that companies which pay out dividends experience increases in earnings growth over the ensuing 10-year period. Also, as noted earlier, their findings can support the notion that companies paying dividends need to be more careful in selecting higher value-creative projects with the smaller allotment of excess capital, whereas those companies with excess capital and paying smaller dividends may make poorer deployment decisions.

Furthermore, Asness concluded that "dividends are not simply an important part of total stock returns; they are an important aspect of corporate governance."[19] An article in *The Wall Street Journal* lends support to their hypothesis, suggesting that a stable dividend payout ratio "instill[s] fiscal discipline in corporate managers."[20] Research also suggests that there remains significant opportunity for companies to pay out larger amounts of earnings through dividends. Currently, the S&P average for dividend payouts is roughly one-third of profits, compared to a historical average of over half.[21] Goldman Sachs Global Strategy Research group goes a bit further in its study,

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[13] Goldman Sachs Global Strategy Research

[14] Shimatani, Takeshi, Motoharu Nakashima, Yoichi Ueno, & Naohiko Baba. "Reduction of Interest-bearing Liabilities and Payout Policy by Japanese Companies." *Bank of Japan Review*. March 2006.

[15] Shimatani, Takeshi, Motoharu Nakashima, Yoichi Ueno, & Naohiko Baba, p. 5.

[16] Shimatani, Takeshi, Motoharu Nakashima, Yoichi Ueno, & Naohiko Baba, p. 1.

[17] Brandes Institute. "Income Component of Returns" http://www.brandes.com/insititute/biresearch. July 2004

[18] Asness, Clifford S. "Rubble Logic: What Did We Learn from the Great Stock Market Bubble." *Financial Analysts Journal*. November/December 2005, Volume 61 pp.42-43.

[19] Asness, pp.42-43.

[20] Mcdonald, Ian. "When Markets Turn Dark, Dividends Shine." *The Wall Street Journal*. January 22, 2006.

[21] Mcdonald, Ian. "When Markets Turn Dark, Dividends Shine." *The Wall Street Journal*. January 22, 2006.

stating not only could dividends be increased, but that "higher dividends seem to exert a positive signaling effect regarding future cash flows, and analysis shows that dividend increases seem to have a significant and positive effect on relative share price performance."[22]

Goldman's research focusing on cash levels in corporate Japan suggests that an increase in share buybacks or dividends in many of Japan's cash-rich companies could potentially raise leverage ratios and increase ROE. Additionally, its U.S. study[23] conducted in 2003 illustrated that dividend increases generated enhanced total returns. Applying its U.S. research to Japan, the group determined it would yield comparable results. The analysis demonstrated that increases in dividend payout per share led to positive relative share price performance.[24] One of the key findings was the perceived signaling effect upon the market by these companies once a dividend increase was announced, and that cash flows had positive future implications, suggesting that a stable dividend payout policy would be maintained going forward.

Investors emphasize that companies must efficiently manage cash in seeking to provide superior returns. This not only creates greater profits for investors, but also helps ensure companies are operating at efficient levels in which to increase debt leverage and decrease their cost of capital. We believe one of the most promising ways to achieve these benefits of dividend policies is by paying an increasing amount of after-tax earnings to shareholders by way of dividends or conducting stock buybacks. While recent research supports this notion, to better understand the practical applications of these theoretical approaches, we offer a case study.

A Case Study: The Pharmaceutical Industry

Section Summary: *Detailed analysis of companies within one industry provides insight to company-specific rationales for maintaining disproportionately high cash balances. Understanding these select pharmaceutical firms' propensity to hold significant cash balances may assist in grasping a broader range of firms' tendencies to do the same.*

To get a closer look at aspects of cash-rich firms, we sought to conduct a case study within an industry containing enough similarities across countries that it was conducive to comparing firms on a global basis. We also sought to study an industry in which companies had fallen in and out of our net cash sample over time, across all three regions studied, the United States, Europe, and Japan. Based on these criteria, the pharmaceutical industry represented a suitable industry for comparison, offering a global sample with robust data. Additionally, the pharmaceutical industry represented a good mix of cash-rich and non-cash-rich firms across regions, with each area experiencing select pharmaceutical constituents entering our net cash sample.

We selected the top five companies from each region based on market capitalization as of year-end 1990 to narrow the broader pharmaceutical industry. This criteria left us with a 15-company sample to analyze the disparities between various capital structures, valuation measures, and value-creative or value-destructive initiatives that took place during the period of our study. Exhibit 15 lists the 15 pharmaceutical companies used in our study.

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[22] Goldman Sachs Global Strategy Research
[23] Clement, Michael and Abby J. Cohen. "*Dividend-Based Investment Strategies: Dividend Yields vs. Dividend Increases.*" December 16, 2003.
[24] Goldman Sachs Global Strategy Research

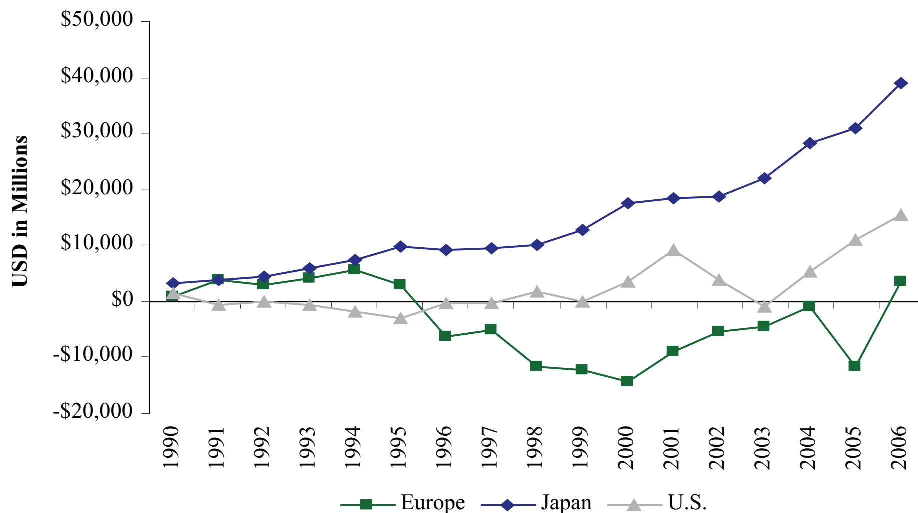
Exhibit 15: Pharmaceutical Sample Group by Region as of 6/30/1990

Europe	Japan	United States
Astra	Yamanouchi*	Abbott Laboratories
Hoechst*	Sankyo Co. Ltd.*	Bristol-Myers Squibb Co.
Roche	Ono Pharmaceutical Co. Ltd.	Eli Lilly & Co.
Smithkline Beecham*	Taisho Pharmaceutical Co. Ltd.	Johnson & Johnson
Wellcome*	Takeda Pharmaceutical Co. Ltd.	Merck & Co. Inc.

Source: The Brandes Institute via FactSet as of June 30, 2006
*All pharmaceutical company names are as of June 30, 1990. Mergers may have caused some company specific restructurings in which the merged company was then included in our sample for analysis.

Initial observations of the 15 pharmaceutical companies selected yielded distinguishing results for the firms in Japan. For example, on a year-by-year basis and on a three-year basis, all five Japanese pharmaceutical companies were net cash through the entire period of our study. Taking a closer look at the levels of net cash, it was apparent both on an average and total sum basis that the Japanese pharmaceutical companies had higher levels of cash versus their European and U.S. counterparts as illustrated in Exhibit 16.

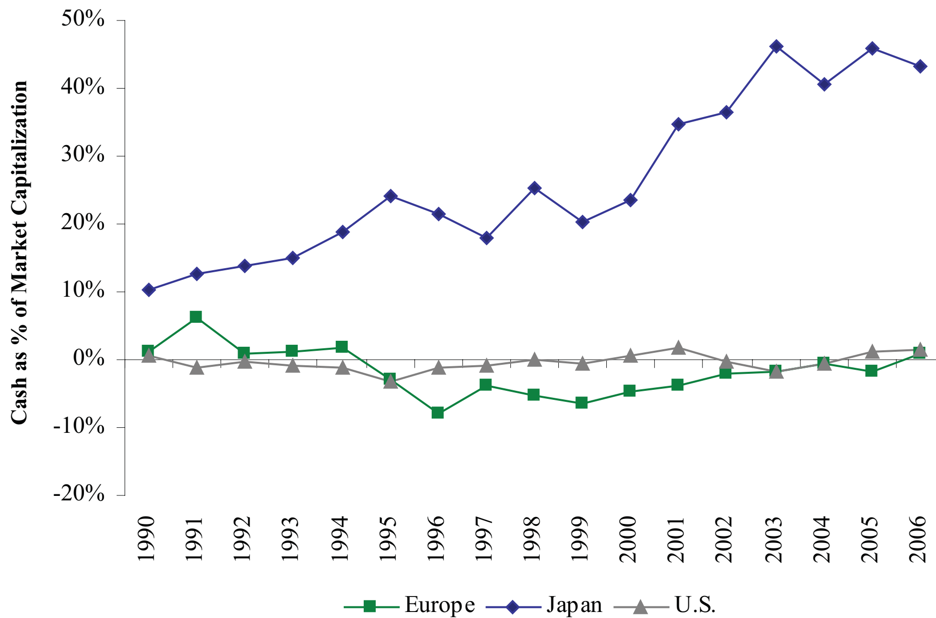
Exhibit 16: Pharmaceutical Sample – Total Net Cash



Source: The Brandes Institute via FactSet as of 6/30/06

Next, we contrasted net cash as a percentage of market capitalization across the sample. Again, results showed that net cash levels in Japan's pharmaceutical companies far exceeded those pharmaceutical firms in Europe and the United States. See Exhibit 17.

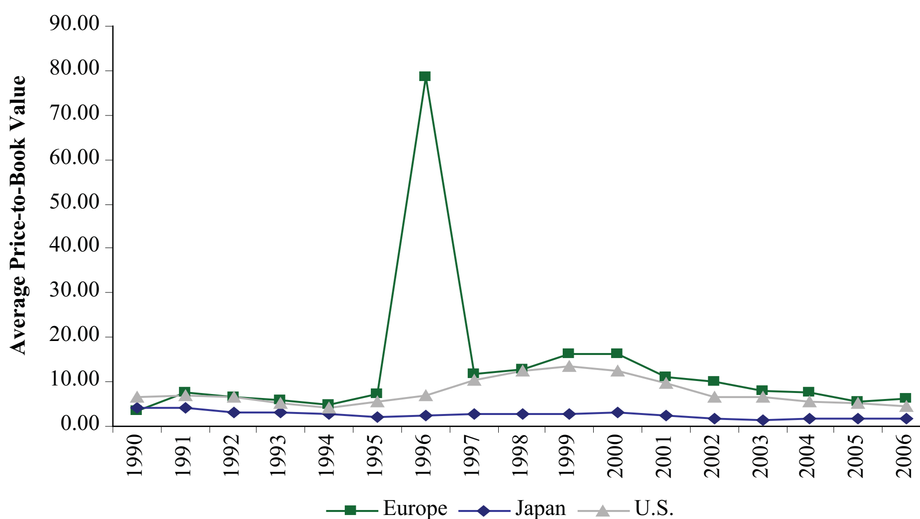
Exhibit 17: Pharmaceutical Sample – Average Net Cash/Market Capitalization



Source: The Brandes Institute via FactSet as of 6/30/06

Investigating deeper, we focused on fundamentals, such as price-to-book (P/B) and enterprise multiple (EV/EBITDA[25]). These figures further pointed to evidence of the existence of an overabundance of cash within the representatives of Japan's pharmaceutical industry, versus similar companies in Europe and the United States. Furthermore, as Exhibits 18 and 19 demonstrate, these Japanese companies tended to trade at consistently lower P/B and EV/EBITDA multiples, perhaps suggestive of their unconstructive use of available cash.

Exhibit 18: Pharmaceutical Sample – Price-to-Book[26]



Source: The Brandes Institute via FactSet as of 6/30/06

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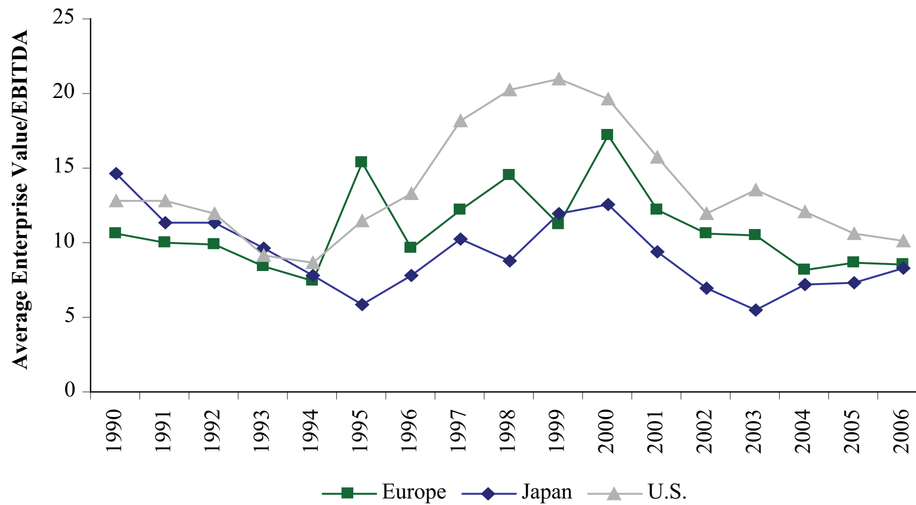
[25] EV/ EBITDA is a figure adjusted for the presence of cash, and is a frequently relied upon measure to assess the attractiveness of takeover candidates. EBITDA was adjusted for goodwill and write-offs.

[26] The reason for the exceptionally high price-to-book value in Europe is due to a large reduction in the book value of Glaxo Wellcome in 1996.

Exhibit 19: Pharmaceutical Sample – Average Enterprise Value/EBITDA

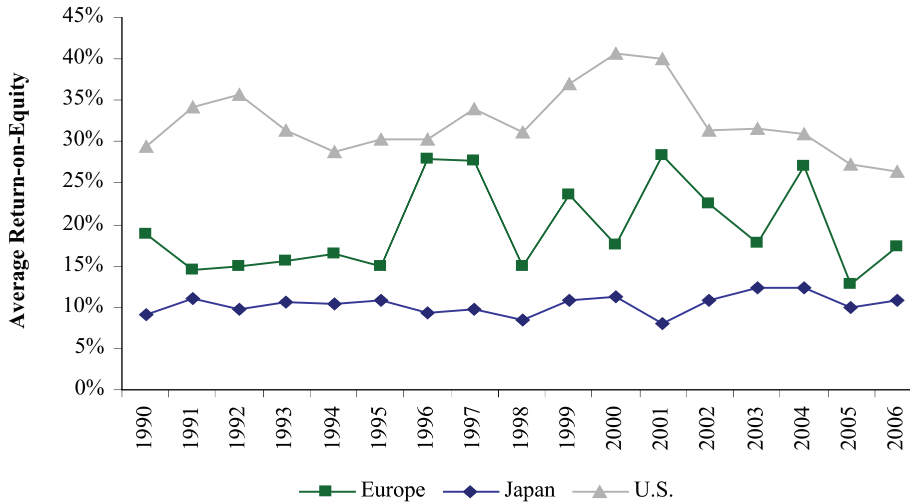


Source: The Brandes Institute via FactSet as of 6/30/06

We also explored whether our small pharmaceutical group sample would yield similar ROE characteristics as we uncovered at the broad regional levels noted earlier. Interestingly, the case study sample provided parallel ROE results to the larger universes – Japan's pharmaceutical companies had significantly lower ROE measures than their western pharmaceutical peers. See Exhibit 20. In the U.S. pharmaceutical sample, companies averaged a 32.4% ROE for the 16-year period, while companies in the European pharmaceuticals sample averaged 19.5%. In stark contrast, Japanese pharmaceutical companies yielded a 10.4% ROE, higher than the median broad universe average, but considerably weak for the pharmaceutical industry and particularly weak relative to similar companies in other regions. To investigate what may have accounted for the lower efficiency measures in Japan, we used DuPont analysis[27], which uncovered three primary factors driving these statistics: lower leverage ratios (less debt relative to other regions), lower asset turnover, and lower profit margins.

[27] DuPont analysis is a means of breaking down the components of return on equity.

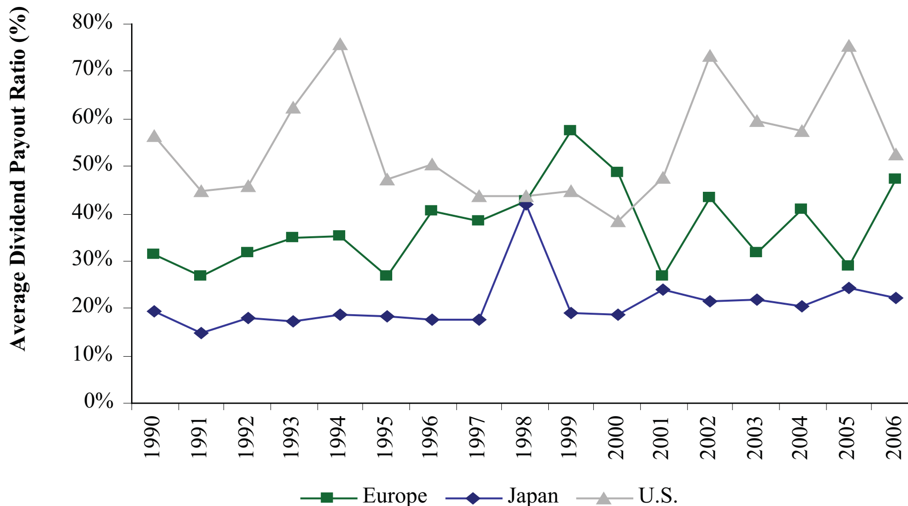
Exhibit 20: Pharmaceutical Sample – Average Return-on-Equity



Source: The Brandes Institute via FactSet as of 6/30/06

Next, we examined the historical trend of cash deployment by these companies, electing to review dividend payout ratios, share buybacks, and acquisition spending. Dividend levels measured during the period confirmed that as profits increased for pharmaceutical firms in the United States and Europe, dividends generally were commensurately increased. Conversely, dividends paid in Japan remained near a constant payout level.[28] Illustrated in Exhibit 21, this analysis demonstrates a clear trend of lower dividend payouts for the sample of Japanese pharmaceutical companies, averaging 21% for the period of the study. This paled in comparison to the payout ratios from our 10-company sample from Europe and the United States, which averaged 37% and 54%, respectively, during the same period.

Exhibit 21: Pharmaceutical Sample – Average Dividend Payout Ratio



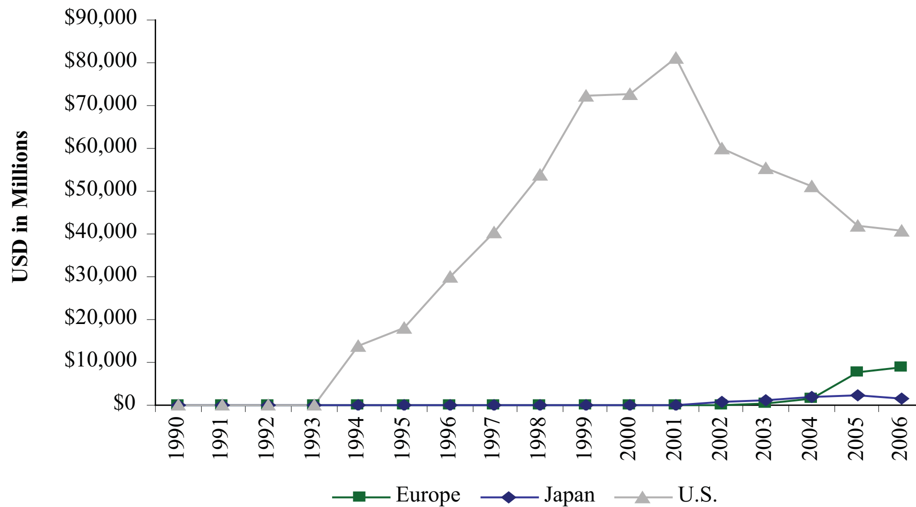
Source: The Brandes Institute via FactSet as of 6/30/06

[28] Japanese companies have historically set a fixed payout for dividends typically around ¥5 per share, but this is slowly changing.

It should be noted that within the past five years a modest upward trend of rising dividend payouts has been apparent in Japan. This may be due to increased investor demand, or perhaps a signal that awareness in the areas of better use of excess capital is taking root. Recently, revisions to Japan's Commercial Code also have allowed companies greater flexibility over dividend payouts, a topic that will be addressed later in this paper.

To further review the potential cash deployment strategies among our sample of companies, we sought to identify any share buybacks that were conducted during the course of our study. We note the significance of these results are muted due to the long-time ban of share repurchases in Japan until 1994, as well as in Germany (a major contributor to the European market) until 1998. However, we believe the results of retirement of shares over the 16-year period still offers a compelling perspective on the differences between U.S. companies' cash deployment versus European and Japanese firms. As illustrated in Exhibit 22, Japanese and European pharmaceutical companies significantly trailed the United States in percentage of market cap value repurchased, even after long-time bans on share repurchases were lifted.

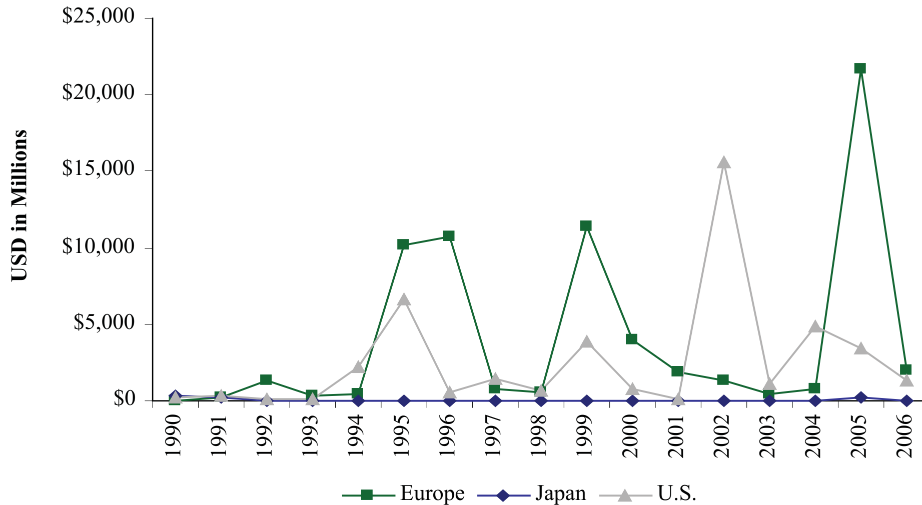
Exhibit 22: Pharmaceutical Sample – Average Market Value Repurchased



Source: The Brandes Institute via FactSet as of 6/30/06

Results indicated that excess cash among our Japanese pharmaceutical sample was not being returned through dividend payouts or share buybacks. Because the global pharmaceutical industry has been under a trend of consolidation, research sought to identify if cash deployment was perhaps taking place in the form of acquisition spending. However, anecdotal evidence suggested that Japanese pharmaceuticals had done little in the way of acquisition spending, in contrast to pharmaceutical firms within Europe and the United States. Although two out of the five companies in our Japanese pharmaceutical sample did engage in merger activity during the course of the study, comparing the results from all three regional samples in Exhibit 23 confirmed substantial deviations between Europe, the United States, and Japan.

Exhibit 23: Pharmaceutical Sample – Average Acquisition Activity



Source: The Brandes Institute via FactSet as of 6/30/06

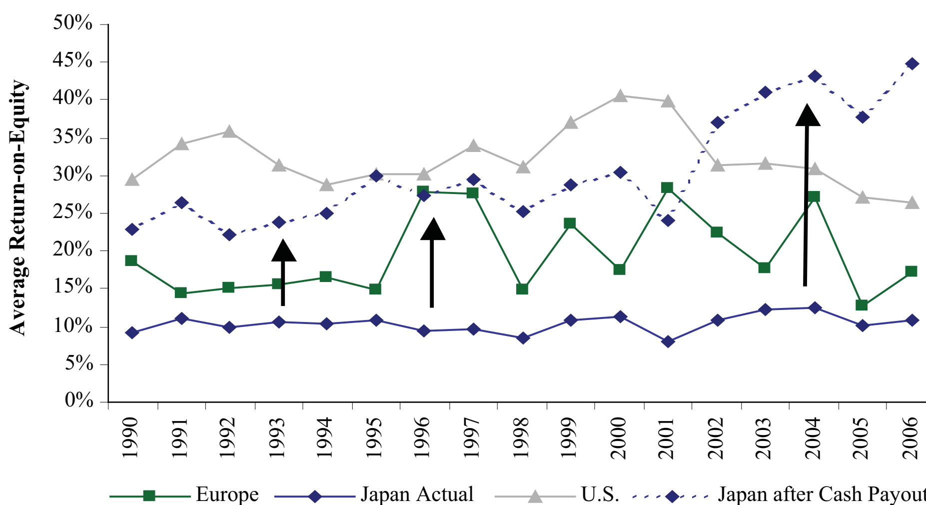
The pharmaceutical industry's aggressive consolidation efforts in both the United States and Europe have been driven largely by firms seeking to enhance R&D efforts and increase the number of pipeline drugs available. Simultaneously, these firms have been strategically increasing company size to remain competitive in a progressively globally focused industry. In our study group alone, four out of the five companies within our European sample merged with or were acquired by another pharmaceutical company during the period of our study. While our data shows less merger and acquisition activity taking place in our Japanese sample, relative to U.S. and European companies, recent evidence suggests Japan's pharmaceutical firms are gaining confidence to join the industry trend of consolidation. During 2005, the number of Japanese mergers and acquisitions jumped 22% from the year prior, driven primarily by what analysts believe to be efforts to enhance strategic focus.[29] To compete on a global scale, Japanese firms perhaps are realizing that avoidance of these activities may serve to weaken their market positions and potentially reduce competitiveness. While the limited success of select Japanese pharmaceutical companies' acquisition of foreign firms in the past has heightened perceived risks regarding acquisitions, we believe this trend may be changing.

Given the potential for change among Japan's cash-rich firms, we evaluate how value could be derived from putting excess cash on balance sheets to better use. We investigated effects of a hypothetical one-time, all-cash dividend payout for our 15-company pharmaceutical case study group. The results showed a noteworthy jump in ROE for all of the companies in our case study. While both the U.S. and European companies experienced moderate increases in ROE, Japanese companies were able to double and in some cases triple their average ROE, as illustrated in Exhibit 24. This hypothetical distribution also served to increase leverage and bolster asset turnover across Japanese firms. While a full cash payout may be unrealistic in practice, this hypothetical example sheds light on the significant shareholder gains Japanese pharmaceutical companies may realize by more

[29] Morse, Andrew. "Increase in Japanese M&A activity Boosts Tokyo Stocks." *The Wall Street Journal*. March 31, 2006.

efficiently managing current cash balances. Residual differences still apparent between ROE levels of Japanese and U.S. pharmaceutical companies after the payout we attributed largely to the combined effects of lower tax rates in the United States[30] and higher margins for U.S. firms, due primarily to a higher-priced U.S. drug market.

Exhibit 24: Pharmaceutical Sample – Hypothetical All Cash Payout Increase to Average Japan Return-on-Equity



Source: The Brandes Institute via FactSet as of 6/30/06

While heavier cash weightings on balance sheets and lower trading multiples appear to weigh on current stock prices among cash-rich Japanese firms, an argument could be made that a universal capital management standard is not applicable for all markets. As a whole, perhaps Japanese companies are exposed to a unique corporate environment that demands a heavier cash balance. Is it possible that our research results have overlooked a significant difference between today's developed markets which could tilt the scales of "suggested" and "adequate" levels of working capital for Japanese, U.S., and European companies toward different amounts?

Because our research found no common thread which clearly explains Japanese cash-rich companies' propensity to maintain heavy cash balances, we sought to pursue other rationales. Could behavioral elements within Japan explain aversion to the typical capital management techniques employed in Europe and the United States? Are stronger net cash positions justified within Japan? More importantly, could Japanese companies do more to increase capital efficiency? Is it advantageous for these companies to increase leverage ratios and decrease the excess capital on their balance sheets with the expectation of increasing share value? The remainder of this paper will tackle a variety of these questions by taking a closer look at the economic environment and culture of corporate Japan that may have influence over a corporate "cash-hoard" mentality. Additionally, research will show initiatives that are currently underway which may serve to unlock cash going forward, and outline what paths investors may follow to unlock more value within these cash-rich firms in the future.

[30] In addition to lower statutory tax rates in the United States and Europe versus Japan, U.S., and European firms may have managed taxes better than Japanese firms. For example, U.S. and European firms have built factories in Puerto Rico and Ireland to take advantage of special tax benefits.

Structural Factors in Corporate Japan

Section Summary: *Although Japan may have turned the corner economically, its corporate structure still differs from other developed markets. Elements of traditional Japanese culture are apparent within its corporate environment, which has proven to be both beneficial and detrimental to creating shareholder value. It remains to be seen what styles Japan will adopt from more aggressive western capitalism within its financial markets, and what will remain uniquely Japanese.*

During 2005, Japan proved its capability to move forward economically, after suffering through a prolonged recession primarily driven by the combination of the bursting of the 1980s bubble economy and then further punished during the late 1990s under the collapse of Japan's banking industry. Since the early 2000s, Japan seemingly has emerged from the lingering burdens of the "three excesses" accumulated during the 1980s: excess debt, investment, and employees.[31] After a long period of directing after-tax earnings toward paying down debt obligations, and overcoming the demands of legacies passed down over more than a decade of stagnation, many Japanese firms entered the 21st century cautiously restraining capital expenditures, selling off unprofitable business segments, and exhibiting greater efforts to control costs.

Meanwhile, enhanced corporate earnings, driven by increases in exports and improved domestic demand, were gradually amassing among risk-averse management teams, hesitant to redeploy increases in cash flow into new ventures. Surges in profitability led to significant cash hoards among a sizeable percentage of Japanese companies. Shaky confidence in former lenders after the collapse of Japan's banking industry also has underpinned firms maintaining larger cash surpluses. However, a rapid influx of foreign investors during the late 1990s and early 2000s eyeing good opportunities within Japanese markets increasingly demanded greater returns, requiring corporate Japan to address a combination of forces unique within Japan's capital markets. Specifically, how Japanese companies can maintain their ongoing financial stability, increase their global competitiveness, and provide greater value for their shareholders, while preserving the unique benefits of Japanese culture.

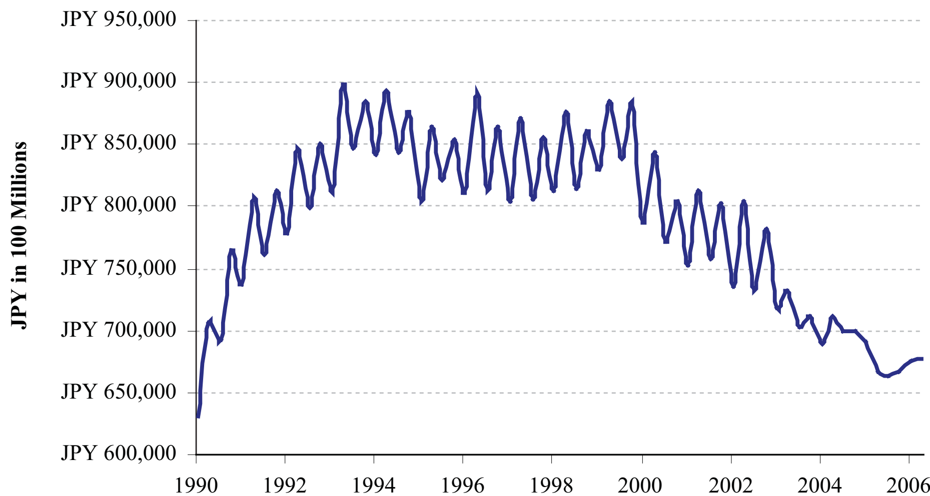
Japan's historically conservative customs, its heavy reliance on its long-standing banking relationships for debt financing, and restrictive government regulations all have potentially contributed to a perceived need by Japanese companies to maintain a fairly independent stance, possibly encouraging disproportionately high cash balances. One example of a long-standing market structure that has served as an impediment to value-creative initiatives for shareholders in Japan has been the presence of *keiretsu* relationships, a Japanese term describing a set of companies maintaining cross-shareholding relationships with one another, typically centered on a bank. Originally conceived after World War II, *keiretsu* groups were encouraged to replace the pre-war *zaibatsu* family monopolies that had since been dismantled. While the *keiretsu* groups were tremendously successful at promoting mutual success through organizational alliances between companies across a variety of industries, the presence of *keiretsu* groups as stakeholders often diluted outside shareholder interests. The *keiretsu* structure historically has allowed a degree of indifference to external shareholders and put heavy emphasis on Japanese banks for debt financing of the *keiretsu* group.

[31] Gittler, Marshall. "Joy Ride for Japanese Stocks." *BusinessWeek Online*. March 29, 2006.

However, the collapse of the Japanese banking industry during the 1990s forced many banks to sell off their cross-holdings, diminishing the influence of the *keiretsu* groups. According to a recent article in the *Far Eastern Economic Review*, *keiretsu* group holdings "have dropped to around 22% of market capitalization from a peak of 53% in 1987."[32] Foreign investors flocking to the stock markets of Japan have further contributed to the erosion of the influence of the *keiretsu* groups. With this significant drop in cross-shareholdings, Japanese corporations have been allowed greater freedom to select more profitable projects and shed many of the extraneous demands placed upon them by weak or unprofitable *keiretsu* group members.

Banks' large role in the financing of Japanese corporations potentially served as one of the largest, if not the largest, impediments to value creation within the markets of Japan. A 1999 Harvard Institute of Economic Research Study concluded that bank involvement as a shareholder of Japanese companies has been purely on the basis of self-serving interests, using their control rights upon management only as it pertains to increasing debt, and enhancing debt repayment.[33] This tactic of "creditor-controlled" governance unwittingly has guided Japanese businesses to "excessively direct their capital investment toward the expansion of existing facilities, increased market shares in existing products, minor variations in product design, and other low risk, low return ventures."[34] This research illustrates that the traditional Japanese banking system has been a significant deterrent to Japanese firms' ability to increase both firm and shareholder value. However, a positive indicator that the traditional role of banks is slowly reforming is the reduction in bank borrowing and increasing reliance on capital markets for fundraising. As shown in Exhibit 25, Japanese companies have become less reliant on long-term loans as a primary source of funding. Long-term lending has dropped 23% from the highs reached in 1993, and recently has dropped to levels not seen for 15 years.

Exhibit 25: Long-Term Bank Borrowing Among Japanese Companies Greater Than ¥1 Billion (JPY) in Market Cap, 12/31/89 – 6/30/06



Source: Japan Ministry of Finance as of 6/30/06

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[32] Koll, Jesper. "Japan is Back, For Real This Time." *Far Eastern Economic Review*. October 2005.

[33] Morck, Randall and Masao Nakamura. "Japanese Corporate Governance and Macroeconomic Problems." *Harvard Institute of Economic Research*. February 1999: 11.

[34] Morck, Randall and Masao Nakamura, p. 13.

In addition, a strong deterrent to value creation for management has long been the Japanese government's slow reaction to introduce laws and governance which would serve to keep the financial markets of Japan on an equal level with other major economic powers around the globe. For example, the Commercial Code of Japan enforced restrictions on share repurchases until 1994 out of fear of stock price manipulation. More recently, accounting scandals that have taken place within U.S. markets have encouraged corporate Japan to question the ethics and effectiveness of the U.S. financial practices, and has lent increased credence to maintaining a conservative "Japanese standard" in financial markets.

However, Japan's Commercial Code has undergone over a dozen revisions since the early 1990s, aimed at improving Japan's corporate governance tenets and moving financial regulations more in line with global standards. These revisions have allowed greater flexibility to appease shareholder demand and enhance value-creative initiatives in Japan's markets. Past revisions have focused on measures including the ability for Japanese firms to repurchase shares, the allowance of stock swap mergers, and increased focus on expanding authority of statutory auditors.[35] One of the most promising revisions for enhanced shareholder value was introduced on May 1, 2006, when Japanese companies were permitted to issue dividends on a quarterly basis, as opposed to the bi-annual rigidity of the past, thus aligning Japanese firms' dividend policies more closely with the markets of Europe and the United States. The promise of continued shareholder-friendly policies provides encouraging support of Japan's continued focus of increasing shareholder value.

On a structural basis, Japan's financial agencies suffer from similar needs for revision as its legislative body. For example, in the United States, rules and enforcement within securities markets are largely under the control of the Securities and Exchange Commission (SEC). In Japan, however, the current structure has the Financial Services Agency (FSA) in charge of creating regulations while the Securities Exchange and Surveillance Commission (SESC) is responsible for their execution.[36] Critics argue that Japan's regulation of its security markets continues to remain vastly understaffed and under funded. However, increased cooperation and collaboration efforts between the SEC and Japan's FSA and the increased prevalence of investors voicing their concerns for enhanced corporate governance and governance rating systems in Japan, such as the Kabunushi Ombudsman (KO), Institutional Shareholder Services (ISS), Governance Visions, and Standard & Poor's, provide hope for structural reform, as well.

On the political front, Japan's Prime Minister Junichiro Koizumi has directed much of his term in office pushing for reforms that he has envisioned necessary for the advancement of Japan's economy. A recent economic resurgence in Japan perhaps has served to indicate that his aim at pushing the country in a new direction is beginning to pay off. Chief among his implementations has been to eliminate the Japanese banking industry's bad loan status, the privatization of the postal savings system, and the reorganization of the factional structure of Japan's Liberal Democratic Party (LDP). However, Koizumi's efforts have generated controversy in Japan where, in many ways, the country remains steeped in long-preserved cultural nuances focusing on maintaining the status quo.

One of the largest impediments to Koizumi's push for reform has been the role of traditional corporate Japan, which has been slow to adapt to change. Managers and CEOs remain apprehensive to deploy cash due to the past 15 years of stagnation, and remain largely paralyzed by risk-averse behavior. Enhancing the broader aversion to

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[35] Nomura Research Institute. "Commercial Code Revisions: Promoting the Evolution of Japanese Companies." May 1 2002, p. 3.
[36] Hayashi, Yuka and Andrew Morse. "Livedoor Crisis Prompts Calls for More Oversight." *Wall Street Journal*. January 25, 2006.

perceived risky endeavors has been Japan's long-time tradition of lifetime employment. This long-standing employment structure has promoted corporate leaders that remain focused on maintaining the status quo and reaching group consensus, as opposed to ushering in change.

However, the recent emergence of a different type of corporate leader in Japan has attempted to challenge the "old guard" of corporate Japan. Young entrepreneurs, most notably, the founders of Internet-related firms such as Softbank, Rakuten, Inc., and Livedoor, have seemingly attempted to turn traditional corporate Japan on its ear. Their founders, Masayoshi Son at Softbank, Hiroshi Mikitani at Rakuten, and Takafumi Horie of Livedoor, have adopted aggressive westernized takeover methods aimed at rapidly growing their firms into large companies. While these companies have boosted stock price through smaller acquisitions, their attempts to place hostile bids for large companies within Japan's market have been met with limited success. However, their actions have prompted corporate leaders of Japan to take notice of the potential the future may hold for domestic takeover bids, something quite rare in Japanese markets.

Son has been perhaps the most successful of the three. Founder, President and Chief Executive Officer at Softbank, Son invested aggressively, yet selectively during the early years of the Internet boom. His investment successes paved the way for his more recent purchase of Vodafone KK, the Japanese unit of Vodafone Group PLC that serves approximately 15 million customers.[37] Son helped his firm secure nearly 1.3 trillion yen (about $11 billion U.S. dollars) in financing for that acquisition.

While accounting scandals and the subsequent imprisonment of Takafumi Horie, founder of Livedoor, earlier this year have largely tainted these new leaders' efforts, it is noteworthy what their actions signal for future generations of management. The emergence of these new types of leaders may illustrate the likelihood of increased focus on implementing westernized methods in Japan's capital markets to create firm and potentially, shareholder wealth in Japan. Additionally, academic studies point to incremental increases in the penetration of western business culture within Japanese companies, suggesting that a growing number of those receiving graduate school training in the United States are moving into middle management positions within Japanese companies and are adopting an ideological influence from the United States.[38] The true question for Japanese companies will come in the form of what aspects of western capitalism Japan will adopt, and how they will weave western society's capitalism-intensive business strategies into Japan's future without compromising traditional Japanese values. Koizumi has said, "In Japan there is the word wakon-yosai, which means to maintain the spirit of Japanese people while embracing Western thinking and learning" which is ultimately the transition that Koizumi and others hope to usher in.[39]

Conclusion

In closing, our research confirmed that during the period of our study global cash levels have reached historic highs, and within these results, companies in Japan have maintained large cash positions influenced by a pervasive net savings corporate and cultural philosophy. We also note that a cash hoard mentality may have unwittingly served as a value-destructive catalyst for cash-rich firms, through their unconstructive use of available capital. While adequate capital structures may differ by region, optimal cash management and increasing value creation

[37] According to information available at Vodafone's website: http://www.vodafone.jp.
[38] Dore, Ronald. "Japanese Style Management. Has It Survived? Will It Survive?" September 8, 2004.
[39] Koizumi Cabinet E-mail Magazine No. 223. February 23, 2006.

for shareholders increasingly will be expected from firms exhibiting cash-hoarding tendencies. We believe increases in share buybacks, higher dividends, and astute acquisitions are suitable means to achieving these ends. Although the past decade has been witness to numerous structural changes within Japan that point to attempts to more efficiently raise capital and reward shareholders with value-creative initiatives, we argue still more could be done in this area through changes in corporate cash management, changes in Japan's corporate environment, and changes in legislation.

Going forward, we believe the increase in equity-oriented investment culture within Japan's markets will serve to strengthen shareholder voices, which will seek enhanced share price, increased corporate efficiency, and heightened corporate governance standards within Japanese firms. Companies in Japan seeking to reduce their reliance upon the traditional banking system and increasingly raise capital within financial markets ultimately need to collaborate with shareholders and work toward progressive and value enhancing changes in the corporate arena in seeking to remain competitive and profitable in an increasingly global market. While traditional business culture in Japan is expected to gradually adapt to management styles that may have a greater focus on creating firm and shareholder value, shareholders in Japan will likely face their greatest battle in convincing Japanese executives that they are not trying to implement western culture, but instead introduce advancements in western governance that also maintain the distinct advantages inherent in Japanese companies.

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