The Present Status of Unwinding of Cross-Shareholding — The Fiscal 2000 Survey of Cross-Shareholding

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1. Introduction

As the Nikkei Average continues to plunge to new lows, raising concerns about the impact on the financial system, the structure shareholding is weakening centered around cross-shareholding. The causal relationship between the unwinding of cross-holdings and the weak stock market is not always clear. However, the initiation of mark-to-market accounting for cross-shareholdings (starting with September's interim results for most companies) is expected to stimulate unwinding, and the prospect of a massive flotation of stocks has understandably put market participants on edge.

The market environment is also important to companies seeking to unwind cross-holdings and concerned about whether stock prices will cause realized gains or losses, and to what extent the presence of buyers will alleviate the market impact at the time of sale. In fiscal 1999, unwinding occurred under a favorable environment due to the strong stock market and active inflow of funds from foreign and institutional investors.

Given the market's deterioration in fiscal 2000 (although less severe than in fiscal 2001), this paper examines how companies fared in their attempt to unwind cross-shareholdings. Below we analyze the results of the Fiscal 2001 Survey of Cross-Shareholding.

2. Survey Results

(1) Survey Method

The present survey marks the fifth annual survey since its initiation in fiscal 1996. The main characteristic of the survey is that the basic data is obtained from portfolio holdings data (*Yuka Shoken Meisaihyo*) attached to the *Yuka Shoken Hokokusho* (Company Securities Reports), and from *Major Shareholders Data* (published by Toyo Keiza Shinposha), from which ownership patterns are identified so that pure cross-shareholdings (wherein a mutual relationship exists between shareholders and companies being held) can be obtained.

The purpose of our survey is to ascertain the status of cross-shareholding in the overall stock market. For the present survey, we decided that the existing procedures would not adequately reveal the status of cross-shareholding due to new developments in fiscal 2000, and made several changes in the survey method (Figure 1). However, in the interest of continuity with previous survey results, all prior results have also been revised to reflect the new survey method.[1]

Figure 1 Changes to the Cross-Shareholding Survey

	Previous	New
Survey sample	All listed companies nationwide at fiscal yearend	Same, plus companies delisted at start of following year due to merger, etc.
Shareholders	Surveyed companies, plus unlisted insurance companies	Surveyed companies, plus unlisted banks and insurance companies
Cross-shareholding	Cases where mutual ownership has been confirmed between surveyed companies and shareholders	Same (including cross-shareholding through retirement benefit trusts and holding companies)

1. Change in Survey Sample

In previous surveys, the survey sample consisted of all companies listed on Japan's stock exchanges at the end of the fiscal year (March).[2] However, this definition has become inadequate due to the mounting wave of corporate restructuring in recent years. This is because reorganizations through mergers or the creation of holding companies are in many cases conducted at the beginning of the fiscal year, so that acquired companies are delisted at the end of the previous fiscal year. As Figure 2 shows, many major banks were simultaneously delisted at the end of fiscal 2000 for just this reason. Since banks form the core of the cross-holding structure, their exclusion from the sample was deemed to have a significant effect on the survey results.[3]

Thus we changed the sample definition to include not only listed companies as of the end of the fiscal year, but companies delisted due to mergers, etc. at the start of the following fiscal year.[4] As a result, the present survey sample contains 2,601 companies (2,587 listed companies, plus 14 delisted companies), with a total market valuation of 368 trillion yen.[5]

Figure 2 Major Companies Delisted Due to Mergers, Etc.

Company	Reason for delisting
Sakura Bank	Merger with Sumitomo Bank
Tokyo Mitsubishi Bank	Establishment of Mitsubishi Tokyo Financial Group
Mitsubishi Trust Bank	Same as above
Sanwa Bank	Establishment of UFJ Holdings
Tokai Bank	Same as above
Toyo Trust Bank	Same as above

2. Changes in Cross-Shareholding Definition

Shareholding trusts for retirement benefit plus

With the introduction of retirement benefits accounting in fiscal 2000, many companies cannot avoid reporting a shortfall in reserves for retirement benefit liabilities. To reduce the reserve shortfall (unrecognized net obligation at transition),[6] many companies are contributing their cross-shareholdings to pension trusts. According to the Trust Companies Association of Japan, retirement benefit trusts were valued at 5.7625 trillion yen (at market value) at the end of fiscal 2000, which is equivalent to 1.6 percent of the total market valuation.

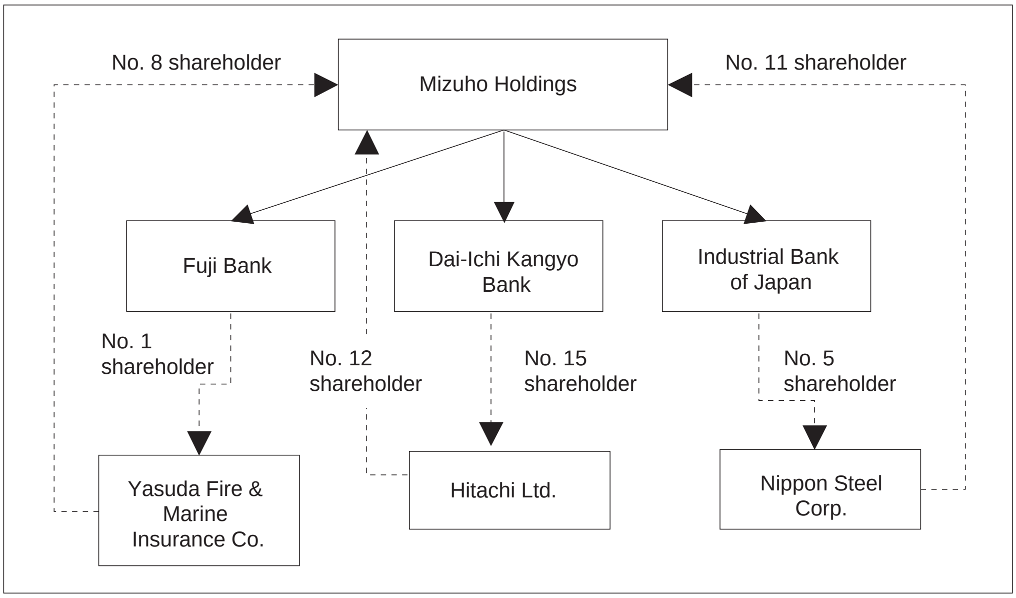
The majority of this amount comes from trusts established during fiscal 2000. Whether such corporate behavior constitutes the unwinding of cross-shareholdings is a matter of debate. However, in the present survey, we took two factors into consideration: that voting rights for the contributed shares still rested with the contributing company,[7] and that the shares were often those of closely allied companies. We decided that the shares held in trust should be treated the same as a directly held shares, and thus be counted as cross-shareholdings.

Cross-shareholding through holding companies

With the creation of holding companies, cross-shareholding inevitably changes from the conventional form. Mizuho Holdings, a pure holding company, was created in September 2000 with the transfer of shares of Dai-Ichi Kangyo Bank, Fuji Bank, and the Industrial Bank of Japan. Thus, for example, Dai-Ichi Bank, who has a cross-shareholding relationship with Hitachi Ltd., still owns Hitachi shares, but Hitachi now owns shares of Mizuho Holdings (Figure 3).

In this way, although corporate relationships have not changed, the conversion to a holding company can create the illusion of change. Thus the present survey counts cross-shareholdings held through holding companies.

Figure 3 Cross-Shareholding Patterns and the Establishment of Mizuho Holdings



Source: Toyo Keizai Shinposha

Continuity of time series data

In the interest of continuity in the times series data, last year's survey included revised values[8] that reflected a change in the disclosure rules for one of the basic data sources, the *Yuka Shoken Meisaihyo* (securities holdings with a balance sheet value of 1 percent of capital or less can be omitted, up from 1/500 of capital). The data in the present survey also follows this procedure of retroactively revising past results.

However, due partly to the need to improve accounting transparency, many listed companies have already implemented mark-to-market accounting for cross-shareholdings, which will become mandatory from the April 2001 period. Since the scope of disclosure in the *Yuka Shoken Meisaihyo* is based on both the balance sheet value of each security (market value under mark-to-market rules) and shareholders' equity, it should be noted that some continuity in the observed results may be lost. [9]

(2) Survey Results

Below we discuss the survey results obtained using the survey method described above. Unless otherwise noted, all ratios are based on value.

1. Survey of the Overall Market (Figure 4)

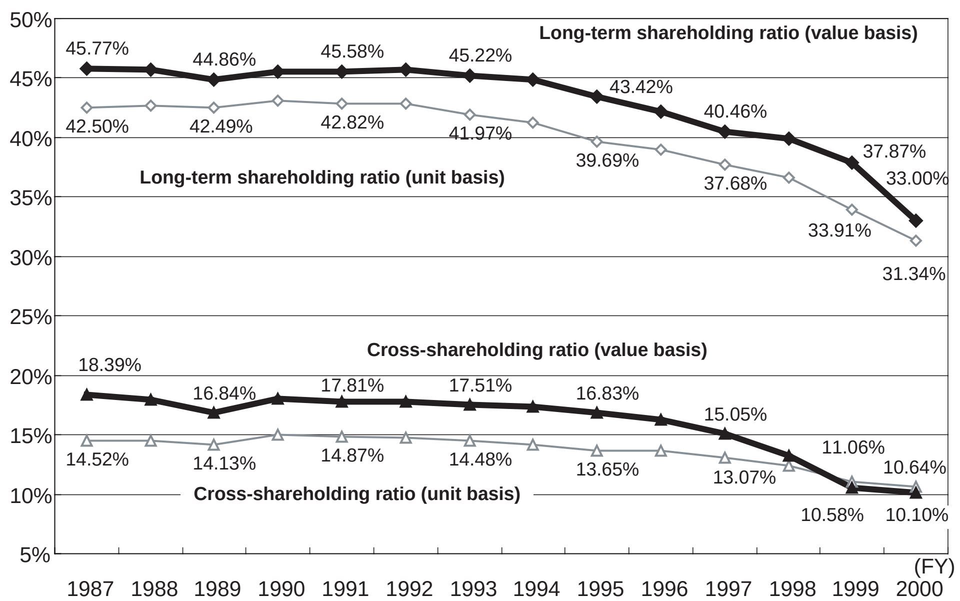
As of the end of fiscal 2000, cross-shareholdings observed among listed companies in the overall market totaled 37.2 trillion yen. This amounts to 10.10 percent of the total market capitalization, or a -0.47 percentage point decline from the previous year and the tenth consecutive decline since 1990. Compared to the peak level, this represents a decline of two-thirds in value terms, and approximately 50 percent in the ratio. The strong presence of cross-shareholdings in the past has thus faded significantly.

In terms of share unit volume (number of shares divided by the trading unit of shares), the cross-shareholding ratio stands at 10.64 percent (a decline of 0.42 percentage point from the previous year). Thus both the level of cross-shareholdings and magnitude of change are consistent with the value based figures.

The proportion of cross-shareholdings in the overall market is much lower than the holding ratios of foreigners (18.77 percent) and individuals (19.43 percent), which we obtained from the TSE's *Shareownership Survey* (market value based). However, since cross-shareholding still comprises over 10 percent of the overall market, it remains an important characteristic of Japan’s stock market.

On the other hand, the long-term holding ratio,[10] which also includes one-sided holdings of financial institutions[11] and holdings of listed parent companies, is 33 percent on a value basis (4.87 percentage-point decline from the previous year), and 31.34 percent on a unit basis (2.57 percentage-point decline). The sharp decline of this ratio is attributed to the active efforts of financial institutions to reduce shareholdings, and to the significant decline in value-based market weighting of listed subsidiaries following the collapse of the IT bubble (the market weight of NTT owned NTT Docomo alone dropped by approximately 2 percent).

Figure 4 Cross-Shareholding and Long-term Shareholding Ratios of the Overall Market



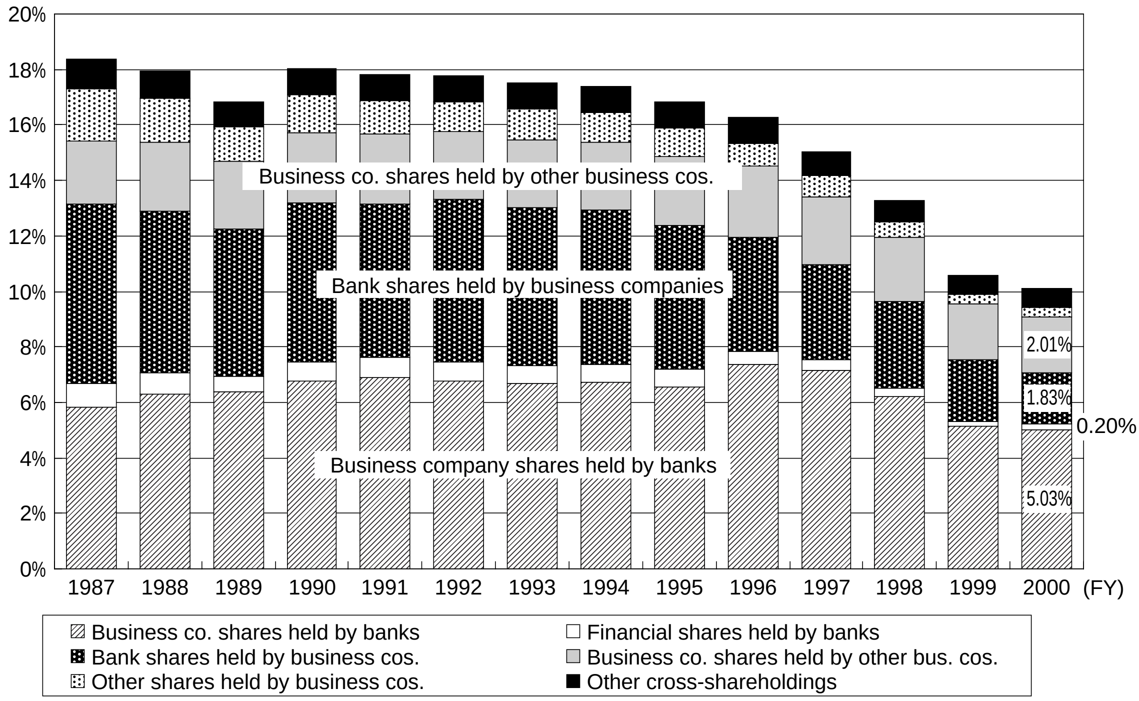
Source: NLI Research Institute

2. Composition of Cross-Shareholdings (Figure 5)

In the composition of the cross-shareholding ratio, banks account for half (5.23 percent) of the total. The majority of this amount (5.03 percent) consists of bank cross-holdings in business companies. Thus banks continue to form the core of the structure of cross-shareholdings.

Because of the reciprocal nature of cross-holdings, there must exist cross-holdings by business companies in bank shares. However, the cross-shareholding ratio of this category is only 1.83 percent, or 0.36 times the size of the cross-shareholding ratio of banks in business companies. Although the balance of cross-holdings had been fairly even until the early 1990s, it subsequently changed due to the decline in bank stock prices and the one-sided sale of bank shares by business companies. Despite the mutual nature of cross-holdings, this imbalance could not easily be corrected.

Figure 5 Composition of the Cross-Shareholding Ratio (value basis)



Source: NLI Research Institute

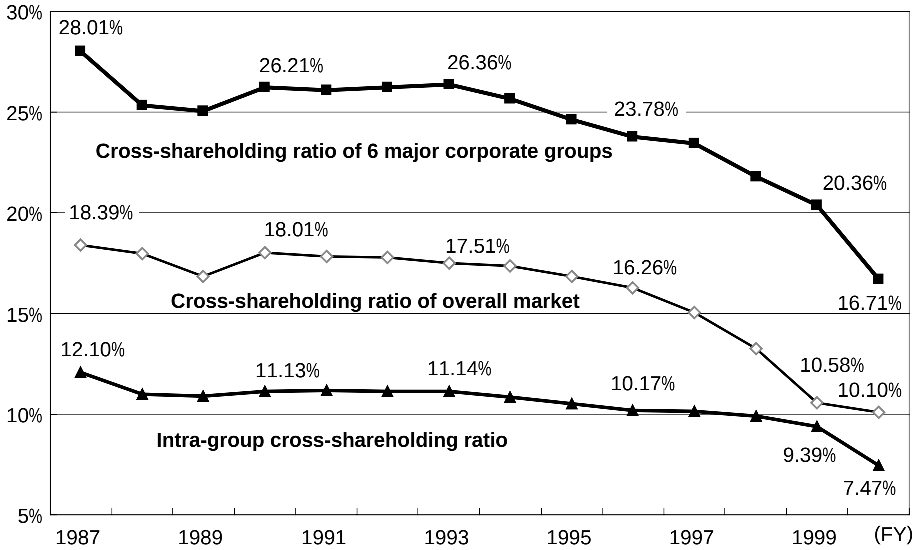
3. Trends Among the Six Major Corporate Groups

According to the Fair Trade Commission’s *State of Corporate Groups in Japan — The 7th Survey Report* (released May 18, 2001), the economic positions of the six major corporate groups as well as their internal ties have declined.

On the other hand, with regard to their priority in reducing cross-shareholdings, they cited non-member companies (64.4 percent among business companies, and 46.0 percent among financial companies) overwhelmingly over member companies (13.8 percent among business companies, and 18.4 percent among financial companies). This suggests that group loyalty remains strong.

Nonetheless, since the banks, who form the core of corporate groups, have become consolidated, corporate group loyalty may be on the verge of change.[13] Thus we examined the cross-shareholding status of the corporate groups, who form the bulwark of the cross-shareholding structure (Figure 6).

Figure 6 Cross-Shareholding Ratios of the Six Corporate Groups (value basis)



Source: NLI Research Institute

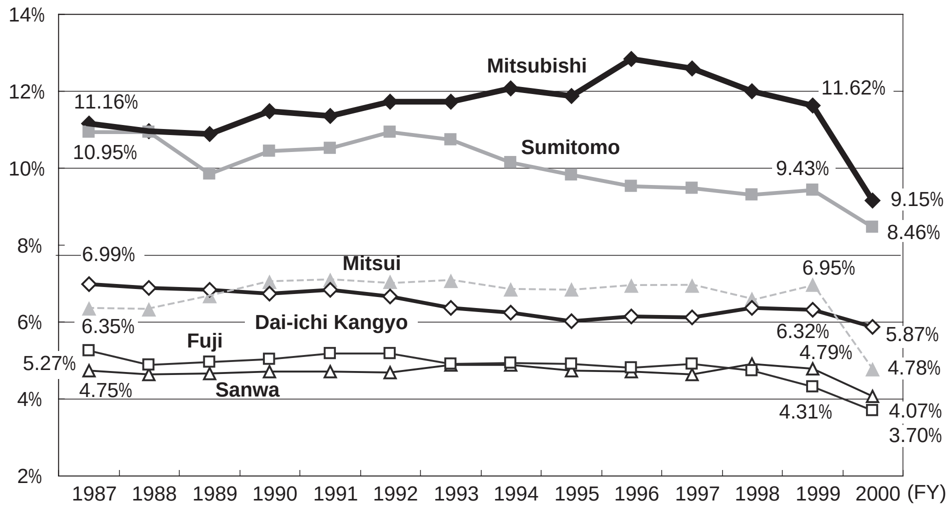
At the end of fiscal 2000, the overall cross-shareholding ratio of the six corporate groups (16.71 percent) was significantly higher than that of the overall market (10.10 percent) as well as of non-group companies (7.03 percent). Furthermore, the intra-group cross-shareholding ratio of 7.47 percent, when compared to the rapidly shrinking overall cross-shareholding ratio of the corporate groups, confirms that group solidarity remains steadfast.

Focusing next on business companies, we looked at the cross-shareholding ratio of each corporate group on a unit volume basis to eliminate the effect of stock price movements. Regardless of whether they are zaibatsu-centered or bank-centered, or have consolidated banks or not, all corporate groups saw a significant decline in their ratio (Figure 7).

While unique factors at individual companies account for part of the decline, the decline itself is broadly based. For example, Sumitomo Bank, which owns shares in the 18 other listed companies belonging to its president's club, has reduced its holding ratio in 11 of the companies in the past year.

With corporate groups rethinking their core cross-holding structure in this way, there no longer appears to be any sacred ground left for cross-shareholdings.

Figure 7 Intra-Group Cross-Shareholding Ratios (unit basis)



Source: NLI Research Institute

4. Retirement Benefit Trusts

Turning next to the shares contributed to retirement benefit trusts, of the 238 identified cases (1.5 trillion yen in market value), 20 were made by the top shareholders. In particular, since the contributed shares were often those of affiliated companies (21 cases, totaling 0.5 trillion yen), we surmise that the shares being contributed to trusts are those which companies have no intention to sell (Figure 8).

Figure 8 Retirement Benefit Trusts Formed by Major Shareholders

Contributor	Contributed shareholding	Holding ratio (%)	Share-holder rank
Nippon Valqua Industries	Goh Iron Works Co.	49.3	1
Kinki Nippon Railway Co.	Kin-Ei Corp.	45.0	1
Kinki Nippon Railway Co.	Kinki Sharyo Co.	35.2	1
Tanabe Seiyaku Co.	Eiken Chemical Co.	34.7	1
Mitsui & Co.	Moshi Moshi Hotline	34.1	1
Intec Inc.	Intec Communications	25.8	1
NEC	NEC Soft	25.0	2
Brother Industries	Nissei Corp.	20.6	1
NEC	Nippon Electric Glass Co.	20.0	1
NEC	Tokin Corp.	19.9	2
Kinki Nippon Railway Co.	Kinki Nippon Tourist Co.	16.2	1
Fujitsu	Advantest Corp.	16.1	1

Source: Toyo Keizai Shinposha

Among the contributed shares, we confirmed 123 cases involving cross-shareholdings that amounted to 0.7 trillion yen.[14] Thus half of the holdings were identified as cross-shareholdings. Among them, we confirmed cases such as Shionogi and Co. and Suzuken in which both parties contributed to retirement benefit trusts.

Contributions to retirement benefit trusts appear to be the result of two forces: the reluctance of companies to sell off shares involving important corporate relationships, and their desire to effectively use cross-held assets. However, since this simply represents cross-shareholding in a different form, we must keenly watch further developments in this area to stay abreast of the condition of companies and the stock market.

3. The Status of Unwinding of Cross-Shareholding

While our annual surveys track the cross-shareholding ratio of the overall market at the end of each fiscal year, the fact is that comparing ratios at fiscal yearend does not reveal the changes taking place. However, in view of the strong interest in the progress of unwinding, below we focus on the status of unwinding rather than on the cross-shareholding ratio itself.

In calculating the cross-holding ratio of the overall market, a standard of some kind is needed to aggregate the shares of different companies. In our survey, standardization is performed using both a value and unit volume basis. However, since fluctuations in the standard weighting (weight in total market capitalization for the value basis) affect the aggregate results, caution is needed when looking at fluctuations in the ratio. For example, on a values basis, declining share prices of companies with high cross-shareholding ratios (or on a unit basis, changes in trading unit size for companies with a low cross-shareholding ratio) make the market's cross-shareholding ratio appear to decline.

We performed a factor analysis of the fluctuation in the cross-shareholding ratio of the overall market, and extracted the factors contributing to the actual unwinding of cross-shareholding. Fluctuations in the cross-shareholding ratio are the sum of five factors:

① Fluctuation in each company's weight
② Fluctuation in each company's cross-shareholding ratio
③ Overlapping between ① and ②
④ New listings
⑤ Delistings

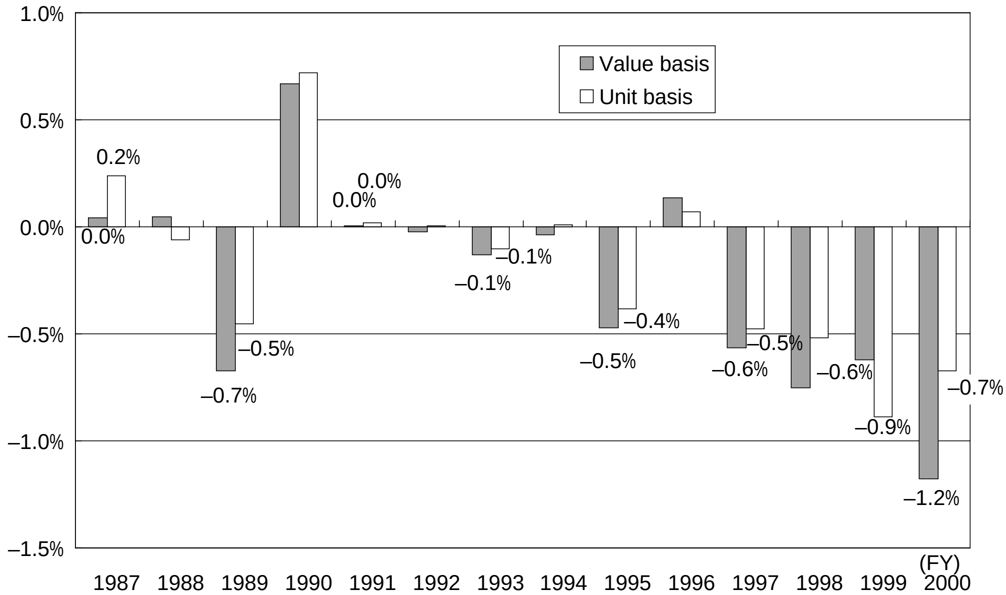
The actual unwinding of cross-shareholding was measured using (②+③).

As Figure 9 shows, the unwinding of cross-shareholding proceeded moderately through fiscal 1996, but began to speed up significantly from fiscal 1997. In particular, even as the cross-shareholding ratio was declining, the pace of unwinding remained strong, and peaked on a value basis in fiscal 2000.

4. Forecast for the Unwinding of Cross-Shareholdings

In the present survey, we were able to reconfirm the unwinding trend of cross-shareholding. In particular, since significant unwinding occurred during the stock market's rise in fiscal 1999 as well as its decline in fiscal 2000, unwinding is not likely to be a transitory phenomenon.

Figure 9 Actual Fluctuations in the Cross-Shareholding Ratio of the Overall Market



Source: NLI Research Institute

(1) Limit on the Shareholdings of Banks

A number of factors are contributing to unwinding, including recognition of shareholding risk due to introduction of mark-to-market accounting, review of non-operating assets to improve capital efficiency, and the declining importance placed on shareholding due to the changing nature of corporate relationships.

Another factor that will significantly affect the progress of unwinding is a measure currently being debated to restrict the shareholdings of banks (gross restriction on the amount of shareholdings of banks, so as not to exceed shareholders' equity). Under pressure from the disposal of bad loans to boost shareholders' equity, major banks already exceed the restriction (shareholdings are 1.6 times shareholders' equity as of the end of fiscal 2000), and need to choose which cross-shareholdings to keep and which to sell off. The shareholding restriction on banks will mark a major turning point in the entire structure of shareholdings.

Furthermore, companies that have held bank shares and enjoyed bank financing will be freed up to sell off their holdings of bank shares, and to explore other sources of capital. While a new entity is expected to absorb bank shares in the short term, banks will need to accommodate shareholders in the long term by improving capital efficiency and enhancing the governance structure.

(2) The Stance of Large Business Companies

We also examined the stance of large business companies toward cross-shareholding. According to a report by the Fair Trade Commission (*Survey Report on the Status of Large Business Companies and Group Management*, May 18, 2001), most companies expect to reduce but not eliminate cross-shareholdings (58.1 percent), followed by those who expect to make no change (37.2 percent), unwind (2.3 percent), and increase (2.3 percent) cross-shareholdings.

The main reason cited for unwinding or reducing cross-shareholdings is to reduce shareholding risk (61.5 percent), while the main impediment is the detrimental effect on the company's long-term shareholders (70.9 percent). This points out the dilemma companies face when reviewing their cross-shareholding relationships.

Moreover, 40.9 percent of companies say that the objective of cross-shareholding in the future is to maintain or stabilize share prices. Companies thus still believe that cross-shareholding is critical to controlling share prices, indicating that their attitude toward unwinding has changed less than the actual pace of unwinding would suggest.

(3) Forecast

Due partly to the introduction of shareholding restrictions on banks, there is no question that cross-shareholding will continue to unwind in the future. This raises concerns about the effect of massive sell-offs on the market environment. Essentially, since the sale of unwound shares represents capital that no longer serves its original role (establishing mutual corporate relationships), these shares should be quickly retired and the company's capital reduced. But as a practical problem, some companies will have difficulty retiring these shares, and thus must find new shareholders to replace the former cross-shareholders.

On this point, some hope comes from measures to encourage individual investors to participate in the market. However, this effort may be thwarted if investors do not find the companies attractive for investment. Of course, companies will need to take various measures to attract investors. Considering present conditions, rather than continuing to depend on a limited segment of investors with identical behavioral patterns such as banks, companies could achieve a more stable shareholding structure and firm management foundation by appealing to a broad range of investors.

For example, Toyota has been retiring its own shares since 1996. At the same time, it has continued its conventional practice of maintaining *keiretsu* shareholdings and contributing cross-shareholdings to a retirement benefit trust so as to retain voting rights (March 2001 period). Yet it has also actively sought out new investors by listing on the NYSE (September 1999) and reducing its trading unit size (August 2001).

In the future, with the growth in new public companies and increasingly borderless international investment environment, investors will have more places to put their money. And as capital markets vigorously compete for funds, these investors will be drawn to the companies that committedly strive to be attractive investments.

Notes

1. Due to the effect of retroactive revisions, some values may not match those reported last year and earlier.

2. Strictly speaking, due the problem of obtaining shareholder data, we omitted companies that were unlisted as of the final settlement date prior to the reference date at the end of March.

3. Under the previous definition, for example, both Tokyo Mitsubishi Bank and Mitsubishi Tokyo Financial Group would have been omitted from the survey.

4. In the past, among unlisted companies, only insurance companies were included as long-term shareholders. We expanded this to include unlisted banks.

5. Regarding the market valuation of delisted companies, we used the share price on the last trading day for convenience.

6. This is the difference between the retirement benefit reserve, (the difference between retirement benefit liabilities and the pension fund) and the reserve posted under the previous rules. Straight line amortization of 15 years or less is required by law.

7. Shares put in a trust are held in the name of the trust bank. According to the retirement benefit trust contract, companies can retain the right to give voting instructions for the shares.

8. In accordance with the new disclosure format in the rules regarding financial statements from fiscal 1999, the data from preceding fiscal years was restricted to eunsure continuity.

9. Under mark-to-market accounting, shares whose price has risen are easy to disclose, while shares whose price has fallen are difficult to disclose.

10. Strictly speaking, this is the total of cross-shareholdings, one-sided shareholdings of financial institutions, one-sided shareholdings of business companies in bank shares, and shareholdings of affiliated listed companies.

11. Financial institution refers to banks excluding trust banks, and life and non-life insurers.

12. The six corporate groups are drawn from president's club members as contained in the Fair Trade Commission's *State of Corporate Groups in Japan — The 7th Survey Report*. However, we also included holding companies that have member companies in their affiliation. The relevant holding companies this fiscal year are Mizuho Holdings and Nippon Unipac Holding Group (the consolidation of Japan Paper and Daishowa Paper).

13. Fuji Bank (Fuyo Group) and Dai-Ichi Kangyo Bank (Dai-Ichi Kangyo Group) were integrated to form Mizuho Financial Group, and Sakura Bank (Mitsui Group) and Sumitomo Bank (Sumitomo Group) were merged.

14. Shares contributed to a retirement benefit trust can be obtained only from the Major Shareholders Data. However, a large volume of other cross-shareholdings are believed to exist.