Parental Control on Subsidiaries in Corporate Groups with a Pure Holding Company

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ABSTRACT

Japanese anti-monopoly law was changed to allow companies to form a corporate group with a pure holding company in 1997. The number of pure holding companies has been increasing. While some research was done on the reason of forming a corporate group with a pure holding company, there is few researches on how parental holding companies control subsidiaries in their corporate group. This study explores the causal relationship between intensity of a parental pure holding company on subsidiaries in its corporate group in Japan. A hypothetical model to analyze this relationship is proposed, and the model is examined by some cases to be developed into hypothetical proposition. We suggest that relationship of subsidiaries' technology and geographical and/or industrial closeness of subsidiaries' business have effect on the intensity of parental control on subsidiaries in corporate groups.

Keywords: pure holding company, control on subsidiary, financial data analysis.

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1. INTRODUCTION

The purpose of this study is to explore how pure holding companies control subsidiaries in their business groups. A pure holding company is a company which owns outstanding stocks of subsidiary companies. The company usually does not produce goods or services itself; rather, its purpose is to own shares of subsidiaries to form a corporate group in which its subsidiaries produce goods or services. Establishing pure holding companies was banned by the anti-monopoly law in Japan for more fifty years from the end of the World War Second up to the end of 1997. When the war ended, General Head Quarters of the allied forces dissolved Zaibatsu which controlled the Japanese economy during the war period. GHQ thought that Zaibatsu should not be resurgent and forced the Japanese government under its control at that time to make a law to ban the establishment of a pure holding company.

However, the law was changed at the end of 1997 to allow Japanese companies to form a corporate group with a pure holding company. The Japanese economy was stagnant in the 1990s after the collapse of the bubble economy. Japanese government at the time changed the law to provide opportunities to restructure businesses in the country. Amendment of the anti-monopoly law began to have some effect at the beginning of the 2000s. According to the survey by the Ministry of Economy, Trade

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and Industry in Japan, the number of a corporate group with a pure holding company is 483 in total as of 2014. The number of pure holding companies listed in the first section of the Tokyo Stock Exchange is 282 for now.

Table 1. Number of firms established as a pure holding company

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total
Entire Industry	3	2	1	10	10	20	26	30	33	60	53	65	38	38	40	25	23	6	483
Whole sale/Retail		1		1	2	2	7	3	3	15	14	21	11	7	7	8	7		109
Manufacturing	1			1	1	8	11	5	7	7	8	8	4	9	13	6	3	3	95
Service	1			1		1	1	2	5	8	8	3	4	2	4	4	5	3	52
Finance/Insurance			1	1	3	3	4	4	2	3	4	5	5	5	1	1	2		44
Construction				1	1		2	4	2	7	2	7	4	4	1	1	1		37
Information/Communication	1				1	1	1	2	1	10	4	2	1	3	2	2	1		32
Transportation/Mail Delivery								1	7	4	2	2	2		2		1		21
Real Estate/Lease				1				3	2		2	4	2	2		1	1		18
Hotel/Restaurant					1				2	2	2	1		1	1	1	1		12
Entertainment		1		1	1			1		1		4	1		1				11
Research/Technical services				1		2				1	3	1					1		9
Education				1						1		1	2	2					7
Utilities								1							2	1			4
Medical/Welfare services								1						1	2				4
Others				1		3		3	2	1	4	6	2	2	4				28

Source: Ministry of Economy, Trade and Industry (2015)

Number of researches have been accumulated on Zaibatsu in the prewar period and its affiliated corporate groups after the war such Mitsubishi group, Yasuda group, Fuyo and so on. After the lift of the ban on establishing a pure holding company in 1997, some researchers devoting themselves to explore strategic aims, legal procedure, configuration of corporate groups and the historical path of each company to form corporate groups with a pure holding company. However, there is little research on how pure holding companies control the operation of their subsidiaries with detailed accounting data. Therefore, we try to bridge this research gap in this study. In the next section, we develop a hypothetical model to analyze the relationship between the control of pure holding companies on subsidiaries and related factors which have influence on it. We explore a causal relationship between those related factors with ten cases of corporate groups with pure holding companies in the third section. In the final section, we discuss the cases and conclude this paper with some hypothetical propositions on control of pure holding companies on subsidiaries.

2. HYPOTHETICAL MODEL DEVELOPMENT

In this section, we explore the causal relationship between the intensity of a holding company's engagement in its subsidiaries' operation and its determinant factors. First, we explain the relationship between a holding company and its subsidiaries, purposes and methods to form a pure holding company, configurations of subsidiaries and other factors which influence on the intensity of a holding company's engagement in its subsidiaries' operation. Then we propose an analytical model to examine the behavior of a pure holding company's control of its subsidiaries' operation.

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2.1 Control of a pure holding company on its subsidiaries

A pure holding company is a company that owns the stocks of its subsidiaries and earns income from the payment of dividends, rent or interest. The pure holding company does not produce goods or offer services itself, and instead acts as an integrated parental company, controlling its subsidiaries' operation to enhance its entire corporate group's performance.

In general. a holding company provide three types of services for its subsidiaries: investment, managerial service and lending assets. Accordingly, the company receive three types of revenue from its subsidiaries: dividends, management fees and rent. Management fees are cash-in-flows received as compensation for its strategic management, brand license management and shared services like accounting, payroll calculations for workers in its subsidiaries, system supports, procurement and logistic supports, and so on. A holding company receive several kinds of rents from assets provided for its subsidiaries.

Therefore, we defined the intensity of a holding company's services for the business operation of its subsidiaries rather than investment as the percentage of sales revenues other than dividends to total sales revenue of a holding company: (total sales revenue – dividends)/total sales revenue *100.

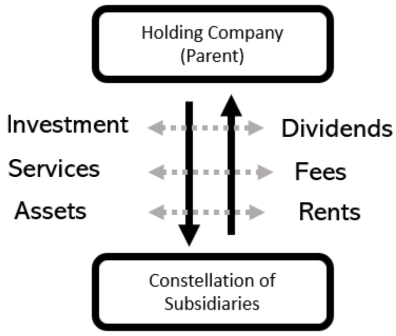

Figure 1. Relationship between a holding company and its subsidiaries

2.2 Strategic aim and method to form a pure holding company

The purpose of forming a corporate group with a pure holding company is classified into two patterns: internal business restructuring and external business expansion with M&A.

For the purpose to restructure internal businesses, some large manufacturing companies which own several subsidiaries transformed themselves into a corporate group with a pure holding company. The parent company becomes a pure holding company and transform the its own businesses and former subsidiaries' businesses to subsidiaries in a newly established corporate grope. The pure holding company newly established devotes itself into making strategy for its corporate group and controlling of them. For example, Seiko Co. Lid, which was incorporated in 1917 and was renamed Hattori Seiko Co., Ltd. in 1983 and Seiko Corporation in 1990, became a holding company in 2001 and was renamed Seiko Holdings Corporation as of July 1, 2007,

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reconstructing and creating its operating subsidiaries such as Seiko Watch Corporation and Seiko Clock Inc. The legal procedure which Seiko Holdings Corporation followed is called the shell-company method. Other than Seiko, NTT, Asahi-Kasei, Nippon Television and so forth formed corporate groups with a pure holding company with this legal procedure.

On the other hand, some of independent companies in the same industry jointly form a corporate group with a pure holding company with M&A. In this case, most of the companies follow the legal procedures of stock exchange or stock transfer. For example, when a business company-A absorbs a business company-B, the company-A can change the company-B's shareholders to be its own shareholders by exchanging its own stocks with ones of company-B's shareholders; and at the same time the company transform itself to be a pure holding company and former businesses to subsidiaries in in the newly established corporate group. Business companies can execute M&A deals easily with this method because they can force minority shareholders to be its own shareholders by exchanging the stocks of their stock into its own ones.

In addition, they can also establish a corporate group with a pure holding company through a share-transfer method. For example, suppose two business companies intend to establish a corporate group with a pure holding company. They firstly set a pure holding company. Then the shareholders of the two company transfer all the shares that they own in exchange for the newly issued shares of a holding company. Bandai Namco holdings and Sega Sammy holdings were established through the share-transfer method. Bandai and Namco were both in toy and amusement industry. They established a corporate group which comprises Bandai Namco Holdings, five business units, and affiliated business companies that support the work of the Units in 2006. The units, which encompass the operating companies in each field, formulate and implement business strategies and provide a diverse range of entertainment in Japan and overseas. On the other hand, in case of the Sega Sammy Holdings, former Sammy Inc. which engaged in a pachislot and pachinko machine business merged Sega, a digital game giant in 2003 and established The Sega Sammy Group in 2004. Subsidiaries in the corporate group are involved in a wide range of business operations, including Sammy's pachislot and pachinko machine business; Sega group's entertainment contents business, including digital game business, amusement machine development and facility operation, development of video contents and toys; and resort business. The holding company sets domestic and overseas business units under the entertainment contents business and resort business and owns 110 subsidiaries.

2.3 Configuration of subsidiaries in corporate group

Configuration of subsidiaries in corporate groups are classified into three types as described in Figure 2. Type A configuration is the one in which holding companies set several subsidiaries under independent business units. In this type of configuration of subsidiaries, parent companies sometimes set the business units by independent industries or such operational functions as production, sales and logistics. Type B configuration is the one in which holding companies set several subsidiaries under independent business units with overseas subsidiaries. In this type of configuration of subsidiaries, some overseas subsidiaries have only distribution function and others have

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all the functions from procurement, logistics, production, marketing to distribution. Type C is the one in which holding companies set domestic and overseas business units. In this type of configuration of subsidiaries, overseas business units are relatively large under which most of the subsidiaries have only limited functions like distribution and production.

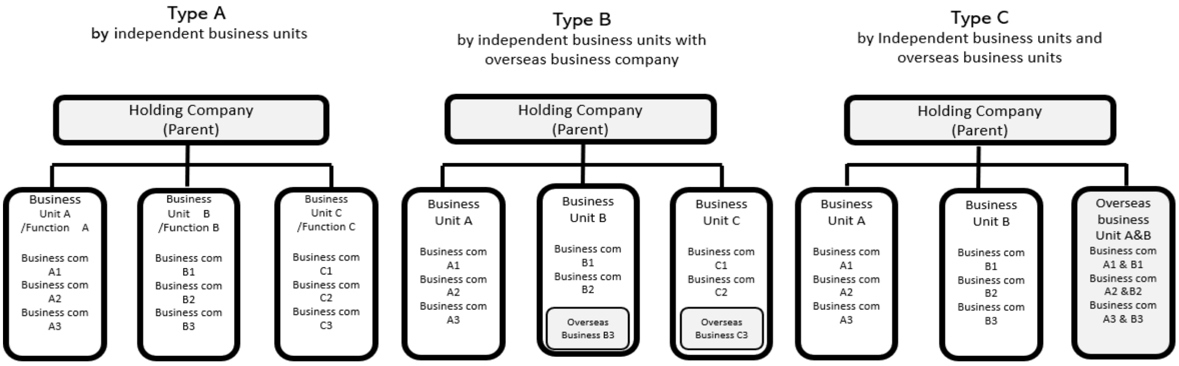

Figure 2. Configuration of subsidiaries in corporate group

2.4 Explanatory model for intensity of management control of holding companies

Several variables are considered as an explanatory factor on the intensity of a pure holding company's management control on its subsidiaries. Among them, family ownership in capital structure can be considered as a major factor especially in Asian countries. For example, based on Barney (2001), Peng and Yi (20069 and Bruton et al. (2003), Ng et al. (2012) demonstrate that pyramid structure of family ownership facilitates and promotes the cooperation of business operations such as sharing information, technology, capital and assets with each other in Malaysia. However, we do not consider the family ownership factor as an explanatory factor on the extent to which a pure holding company's control on its subsidiaries because family oriented corporate groups were dissolved at the end of the second world war.

We assumed that two linking factors of subsidiaries in a corporate group have influence on intensity of management control of a pure holding company on them. They are relationship of subsidiaries' technology and geographical and/or industrial closeness of subsidiaries' business field. When a parental holding company has subsidiaries with deferent kind of technologies, the holding company has difficulty in integrating entire business of all subsidiaries. If the parent company wants to do so, it will cost a lot both in money and in other resources. On the contrary, when a parental holding company has subsidiaries with similar kind of technologies, the holding company would easily integrate entire business of all subsidiaries. On the other hand, when subsidiaries in a corporate group have geographical closeness, the parental holding company easily control their business operations. In an opposite way, when a holding company has business units or subsidiaries abroad in its corporate group, the company would have difficulty in controlling their business operations. We may say the same things for the holding companies which have subsidiaries with different kinds of industries. These two factors are influenced by companies' strategic aim and method to from corporate group

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with a pure holding company; configuration of subsidiaries in corporate group; and numbers of business units and subsidiaries. In addition, types of domain industry of a corporate group have influence on the intensity management control of a holding company on subsidiaries. This factor, however, is an external factor in a sense that intensity of management control of parental holding companies differs by industry.

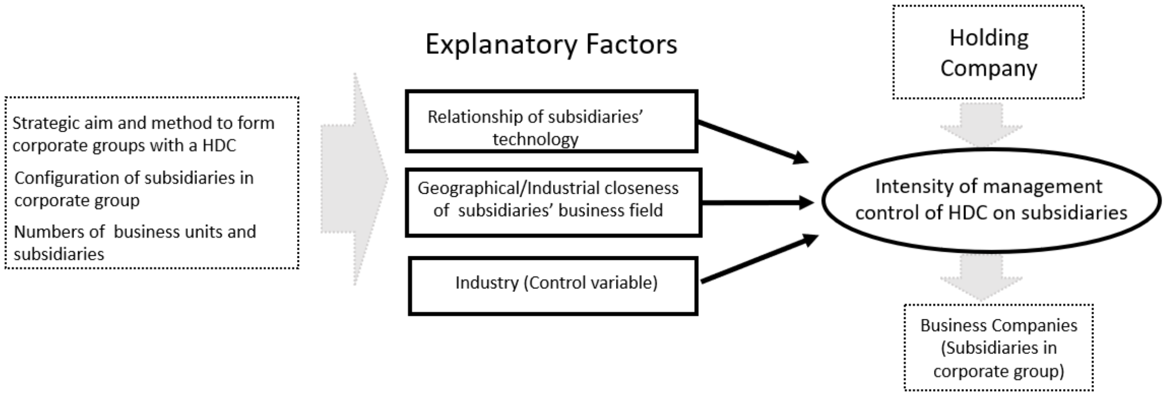

Figure 3. Analytical model to explain the relationship between the intensity of management control of a holding company on its subsidiaries and its determinant factors.

3. DATA and RESULTS

In this section, we measure values of factors in the analytical model in Figure 3. We measure intensity of a pure holding company's management on its subsidiaries by the percentage of total revenue of a pure holding company other than dividends to entire corporate group revenue: (management fees + rents+ other revenue)/ entire CG revenue*100; relationship of subsidiaries' technology by a yardstick with degrees of low, middle and high based on the technology which the subsidiaries utilize in the industry; and geographical or/and industrial closeness by the existence or non-existence of overseas business units and the numbers of business units including subsidiaries.

The values of intensity of a pure holding company's management on its subsidiaries is the average of last three years. The values of relationship of subsidiaries' technology are a relative measurement. We set a low value on the geographical or/and industrial closeness of the company with overseas business or/and more business units including more subsidiaries. As we explained, strategic aims of forming a corporate group with a pure holding company were classified into two types: the internal type of restructuring of exiting large company or corporate group and the external type for M&A purpose; and legal methods were classified into three types: type A: the shale company method, type B: the stock-exchange method and type C: the stock-transfer method in Figure 2. We gathered data of ten corporate groups with a holding company which provided detailed date about pure holding companies' proceeds: Sega-Sammy Holdings (Amusement industry), Bandi-Namco Holdings (Amusement industry), Seiko Holdings(Precision Instrument industry), Nissin Food Holdings (Foods industry), Meiji

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Holdings (Foods and Medicine industry), Kikkoman Corporation (Foods industry), Imuraya Group Co. (Foods industry), House Foods Group Inc. (Foods industry), Sapporo Holdings Ltd. (Beverage/Foods industry), Asahi Group Holdings (Beverage/Foods industry). Measured results of factors in the analytical model are summarized in Table 2.

Table 2. Results of measuring the determinant factors of HDCs' control on subsidiaries.

	Purpose of forming HD com.	Types of configuration of business units	Geographical/Industrial closeness of subsidiaries' business	Relationship of subsidiaries' technology	Accounting year	Sales of corporate group (A) (mi. Yen)	Sales of holding company (B) (mi. Yen)	Dividends (C) (mi. Yen)	Management fees (D) (mi. Yen)	Rent / Interests (E) (mi. Yen)	Others (F) (mil. Yen)	Parent company's managerial involvement in subsidiaries' operation: (B)/(A)*100 (%)	(C)/(A)*100 (%)	(D)/(A)*100 (%)	(D+E+F)/(A)*100 (%)	(D+E+F)/(A)*100 (%)Ave.
1 Sega Sammy Holdings	External M&A/ Stock-Exchange	Type B	Middle	High	2017	366,939	13,450	7,686	5,763	-	-	3.67	2.09	1.57	1.57	1.61
(Amusement industry)		Amusement, Entertainment, Resort	(3 busi. Units)		2016	247,981	12,282	8,010	4,272	-	-	4.95	3.23	1.72	1.72	
No. of group companies 107					2015	366,813	24,771	19,162	5,609	-	-	6.75	5.22	1.53	1.53	
2 Bandi Namco Holdings	External M&A/ Stock-Exchange	Type B	Low	Low	2017	620,061	24,309	21,151	3,157	-	-	3.92	3.41	0.51	0.51	0.44
(Amusement industry)		Toys, Network entertainment, Movie/Music produce	(3 busi. Units)		2016	575,504	29,241	26,592	2,648	-	-	5.08	4.62	0.46	0.46	
No. of group companies 110					2015	620,061	24,149	21,946	2,203	-	-	3.89	3.54	0.36	0.36	
3 Seiko Holdings	Internal restructuring/ Shell-company method	Type B	Low	Middle	2017	257,115	10,361	5,799	1,953	2,608	-	4.03	2.26	0.76	1.77	1.67
(Precision Instrument industr		Watch, Electronic devices, Solution	(3 busi. Units)		2016	296,705	11,984	6,951	2,168	2,864	-	4.04	2.34	0.73	1.70	
No. of group companies 68					2015	293,476	9,972	5,431	2,070	2,470	-	3.40	1.85	0.71	1.55	
4 Nissin Food Holdings	Internal restructuring/ Shell-company method	Type C	High	High	2017	495,715	47,611	16,937	18,285	-	12,387	9.60	3.42	3.69	6.19	5.70
(Foods industry)		Instant noddle, Frozen foods	(2 busi. Units)		2016	468,084	37,968	9,369	16,933	-	11,665	8.11	2.00	3.62	6.11	
No. of group companies 70					2015	431,575	32,382	11,592	12,651	-	8,139	7.50	2.69	2.93	4.82	
5 Meiji Holdings	Internal restructuring/ Shell-company method	Type B	High	Low	2017	1,242,480	17,286	15,726	1,560	-	-	1.39	1.27	0.13	0.13	0.13
(Foods industry)		Foods, Medicine	(2 busi. Units)		2016	1,223,746	9,674	8,066	1,608	-	-	0.79	0.66	0.13	0.13	
No. of group companies 93					2015	1,161,152	9,312	7,654	1,658	-	-	0.80	0.66	0.14	0.14	
6 Kikkoman Corporation	Internal restructuring/ Shell-company method	Type B	High (2 busi. Units)	Middle	2017	371,339	20,241	5,888	10,155	584	3,012	5.45	1.59	2.73	3.87	3.60
(Foods industry)		Soy sauce, Food seasoning			2016	408,372	18,412	4,218	9,991	567	3,635	4.51	1.03	2.45	3.48	
No. of group companies 108					2015	402,174	17,884	4,017	9,877	646	3,342	4.45	1.00	2.46	3.45	
7 Imuraya Group Co.	Internal restructuring/ Shell-company method	Type A	High (2 busi. Units)	High	2017	41,998	2,745	595	1,679	471	-	6.54	1.42	4.00	5.12	5.50
(Foods industry)		Japanese confectionary, Seasoning			2016	38,644	2,510	416	1,622	476	-	6.50	1.08	4.20	5.42	
No. of group companies 8					2015	36,346	4,577	2,414	1,690	472	-	12.59	6.64	4.65	5.95	
8 House Foods Group Inc	Internal restructuring/ Shell-company method	Type B	High (2 busi. Units)	High	2017	231,448	18,629	8,594	9,266	710	59	8.05	3.71	4.00	4.34	3.51
(Foods industry)		Food, Restaurant			2016	241,893	13,603	3,271	9,784	494	872	5.62	1.35	4.04	4.27	
No. of group companies 33					2015	283,812	5,570	82	5,259	200	452	1.96	0.03	1.85	1.93	
9 Sapporo Holdings Ltd	Internal restructuring/ Shell-company method	Type C	Middle	Middle	2017	555,548	11,739	6,510	4,984		244	2.11	3.71	4.00	0.94	0.81
(Beverage/Foods industry)		Beer, Beverage, Restaurant, Real estate	(5 busi. Units)		2016	541,847	14,142	10,051	3,867		206	2.61	1.35	4.04	0.76	
No. of group companies 79					2015	533,748	6,987	3,146	3,830		10	1.31	0.03	1.85	0.72	
10 Asahi Group Holdings	Internal restructuring/ Shell-company method	Type C	Middle	Middle	2017	1,890,310	136,388	101,541	33,318	1,529	-	7.22	5.37	1.76	1.84	1.82
(Beverage/Foods industry)		Beer, Beverage, Foods, Overseas	(4 busi. Units)		2016	1,857,418	56,851	22,074	33,306	1,469	-	3.06	1.19	1.79	1.87	
No. of group companies 167					2015	1,785,478	70,409	39,435	29,384	1,589	-	3.94	2.21	1.65	1.73	

Source: Financial Statements (2014, 2015,2016)

4. DISCUSSION and CONCLUSION

The results of ten cases are described on a diagram in Figure 4. In the diagram, the vertical axis represents degree of relationship of subsidiaries' technology, and the horizon axis does degree of geographical and/or industrial closeness of subsidiaries in the corporate group. The size of circle on the diagram represents intensity of pure holding companies' control on subsidiaries. Based on this diagram, we discuss the following three questions.

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Firstly, we examine whether the relationship of subsidiaries' technology has some relation with the intensity of pure holding companies' control on subsidiaries. Nissin Foods, Imuraya, Kikkoman, and House Foods are located on upper part of the diagram. These four companies have relatively high intensity of HDC' s control on its subsidiaries. On the other hand, Meiji and Bandai Namco are located on lower part of the diagram. These two companies have relative low intensity of HDC's control on its subsidiaries. Therefore, we may say the relationship of subsidiaries' technology has a positive effect on the intensity of pure holding companies' control on subsidiaries. For example, Nissin Foods Holding is a giant of instant noodles. Although the company has 70 subsidiaries in US, China, and other Asian countries including Japan, most of the companies devote themselves in producing and selling noodles. The technology of the companies is highly integrated. In the same way, Imuraya's business technology is specialized in Japanese confectionaries and seasonings; Kikkoman's business technology is producing soy sauces; and business technology of House Foods is integrated into seasonings including curry powders. On the hand, Meiji has two business units: foods and medicine business. These two business units have relatively low relationship in the technologies which they deal with.

Secondly, we examine whether geographical and/or industrial closeness of subsidiaries' business has any effects on the intensity of pure holding companies' control on subsidiaries. We can find that those companies which have relative low score in the value of the intensity of pure holding companies' control tend to be in left-side in the diagram. We gave low value to the company with high number of business units and subsidiaries. In the case that a parental holding company has many subsidiaries all over the world, the company has little control over the subsidiaries' business. For example, Imuraya has strong control over just eight subsidiaries. On the other hand, Sapporo Holdings has five business units and 167 subsidiaries. Sapporo is a big beer producer in Japan. The company's business units include domestic beer business, international beer business, food & beverage business, restaurant business, and real estate business. We can guess that Sapporo holding has little control over so many subsidiaries' independent business which disperse globally. Therefore, we may say that geographical and/or industrial closeness of subsidiaries' business has influence on the intensity of pure holding companies' control on subsidiaries.

Thirdly, we examine whether the intensity of pure holding companies' control on subsidiaries is different in industries. We cannot answer to this question based on our case study because of its limited number of samples. We used METI's survey data. This survey was done for pure holding companies in all over the country including listed and unlisted companies. In the table, management fees are different by industry. For example, holding companies in construction and service industry receive a high portion of entire sales revenue as management fees. On the hand, holding companies in bank and insurance industry have a small portion of management fees from subsidiaries. Judging based on this data, we may say that intensity of pure holding companies' control on subsidiaries is different by industry. In addition, we may also say that the parental control intensity is different in a single industry because other factors such as relationship of subsidiaries technology and geographical closeness of subsidiaries have

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effect on it. For example, in our case study, the holding companies in foods industry have different intensity of their control on subsidiaries.

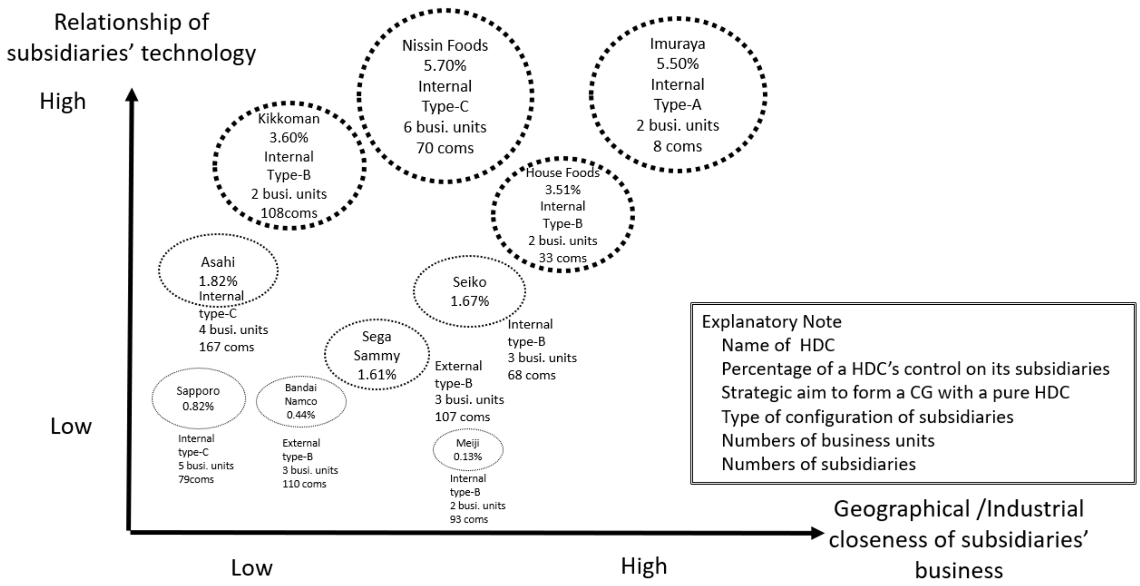

Figure 4. Causal relationship between intensity of a pure holding company's control on its subsidiaries and determinant factors.

Table 3.
(Percentage)

	Entire industry	Construction	Manufacturing	Wholesale Retail	Bank Insurance	Service
Number of company	458	37	92	102	46	50
Sales amount from subsidiaries	94.9	95.0	88.4	97.5	98.9	74.5
Dividends income	70.0	49.4	62.8	60.7	89.3	25.8
Interest revenue	1.3	0.0	1.3	0.2	0.8	0.1
Management fees	16.6	41.0	18.6	24.4	7.9	40.6
Rent from assets leased	3.6	3.9	3.5	8.6	0.2	7.7
Operational income	1.0	0.7	1.1	3.2	0.4	0.2
Others	2.4	0.1	1.0	0.5	1.2	0.1
Sales amount outside group	5.1	5.0	11.6	2.5	0.0	25.4

Source: Ministry of Economy, Trade and Industry, Japan (2015)

Based on the discussion so far, we may provide the following hypothetical propositions on the parental control on subsidiaries in corporate groups with a pure holding company.

HP1: Parental control on subsidiaries in corporate groups with a pure holding company is likely to be strong when the parental company owns subsidiaries which operate businesses with geographical and/or industrial closeness.

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HP2: Parental control on subsidiaries in corporate groups with a pure holding company is likely to be strong when the parental company owns subsidiaries which operate business with similar technologies.

HP3: Parental control on subsidiaries in corporate groups with a pure holding company is likely to be different in different industries.

However, we admit that these hypothetical propositions are still lacking in robustness. Quantitative test for these hypothetical propositions should be a future challenge of this study.

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