COLUMBIA BUSINESS SCHOOL

CENTER ON JAPANESE ECONOMY AND BUSINESS

PROGRAM ON ALTERNATIVE INVESTMENTS

日本経済経営研究所

THE ROLE OF PRIVATE EQUITY IN JAPANESE INDUSTRIAL RESTRUCTURING: THE CASE OF DAIEI

As Japan finally embraces corporate reform, the buyout industry has begun to make its mark. There have been several high profile cases over the past few years, but one transaction has been particularly notable: the restructuring of retailing giant Daiei by Advantage Partners, LLP, Marubeni Corporation, and the Industrial Revitalization Corporation of Japan (IRCJ). Daiei's restructuring is a unique example of how a private equity firm and a government organization are working together to implement a plan to restructure a large Japanese corporation. It is a test case that many observers are watching closely to see how private equity firms may contribute to the restructuring of corporate Japan.

To explore the role of private equity in Japanese restructuring, the Program on Alternative Investments organized a symposium and invited two leading experts on Daiei's ongoing reforms. The first speaker was Mr. Atsushi Saito, President and CEO of the IRCJ, a Japanese government-backed agency staffed with executives drawn from both the public and private sectors to restructure ailing Japanese companies. The second speaker was Mr. Taisuke Sasanuma, Representative Partner of Advantage Partners, one of Japan's leading buyout firms and the company principally in charge of restructuring Daiei. Following these presentations, Professor Hugh Patrick, Director of the Center on Japanese Economy and Business, offered comments and questions in his role as discussant. The symposium was held on November 15, 2005, on the Columbia campus, and was moderated by Dr. Mark Mason, Director of the Program on Alternative Investments.

The Program on Alternative Investments of the Center on Japanese Economy and Business analyzes three sets of alternative asset classes—private equity, hedge funds, and real estate—in Japan and elsewhere in East Asia in international perspective. The Program meets its substantive goals through a combination of research projects and seminars, conferences, and symposia, the latter featuring leading practitioners in each of these three alternative asset classes. For a schedule of upcoming events and other information about the Program on Alternative Investments, please visit www.gsb.columbia.edu/cjeb/alt_investments. For information on the Center on Japanese Economy and Business, please visit www.gsb. columbia.edu/cjeb.

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THE ROLE OF PRIVATE EQUITY IN JAPANESE INDUSTRIAL RESTRUCTURING: THE CASE OF DAIEI

November 15, 2005

From left to right: Mark Mason, Taisuke Sasanuma, Atsushi Saito, and Hugh Patrick

MARK MASON

Director, Program on Alternative Investments, Center on Japanese Economy and Business, Columbia Business School

I'd like to welcome you to this afternoon's symposium, the thirteenth event of this type held here in New York since the Program on Alternative Investments was established in 2002. Today's symposium will examine the role of private equity in Japanese industrial restructuring through a consideration of the Daiei case. Although buyouts have become an increasingly common form of business activity in the United States and Europe, they are still relatively new in Japan. And in part due to this newness, buyouts continue to meet with skepticism in some quarters in Japan.

One argument in favor of buyouts, of course, is their potential role to streamline business organizations and therefore make industry more efficient. Daiei is one of the largest, most visible Japanese companies ever acquired by a private equity firm in Japan—and is also a company that, in many respects, badly needs to be fixed. As such, the substantial interest in Daiei acquired this past spring by buyout specialist Advantage Partners, together with Marubeni, the Japanese general trading firm, constitutes what I would call a key test case for the potential role of buyout firms in restructuring Japanese business more generally.

Yet the case of Daiei, Japan's third largest retailer, is not a pure private sector story. Also critical has been the role of the Industrial Revitalization Corporation of Japan, or IRCJ, a Japanese government-backed organization designed to promote economic

The primary reason why Japan lost fifteen years of potential economic growth was due to the absence of revitalization components in the business recycling process.

—Atsushi Saito

revitalization through business restructuring. In fact, it was the IRCJ that selected Advantage Partners and Marubeni to lead the rehabilitation of the distressed Japanese retailer, and it is the IRCJ that still owns roughly one-third of the retail giant.

To explore today's topic, I have invited two of the leading players in this buyout case, together with our Center Director, to share their thoughts. It is now my pleasure to introduce our first speaker, Mr. Atsushi Saito, President and CEO of the IRCJ. Mr. Saito had a distinguished career in the Japanese financial services sector before taking on his current assignment more than two years ago. I can't think of anyone more qualified than Andy Saito to provide both an overview of the IRCJ and a context for the restructuring of Daiei. Saito-san?

ATSUSHI SAITO
President and CEO
Industrial Revitalization Corporation of Japan

It is my honor to be invited to this symposium to share my thoughts on private equity and corporate restructuring in Japan from the perspective of the IRCJ. Since my presentation is limited to twenty minutes, I would like to focus on only a few topics: first, I would like to talk about the previous absence, or even denial, of market-based principles in the Japanese social structure; second, how the IRCJ unveiled and challenged these obstacles; third, how the IRCJ successfully pushed forth financial and business restructuring; and fourth, what changes are occurring in Japanese society due to these efforts.

The IRCJ's mission is to play a leading role in promoting a market-based economic system through the execution of innovative business revitalization schemes. The primary reason why Japan lost fifteen years of potential economic growth was due to the absence of revitalization components in the business recycling process. This hindered the optimal allocation of capital and labor. Traditionally, the Japanese don't believe in the concept of the survival of the fittest, which would widen the income gap and raise social costs. In liberal, Anglo-American societies, you can argue that the losers are those whose existence is denied by society. In Japan, however, this kind of argument would be strongly criticized as arrogance. The IRCJ has boldly challenged these traditional Japanese conventions and practices.

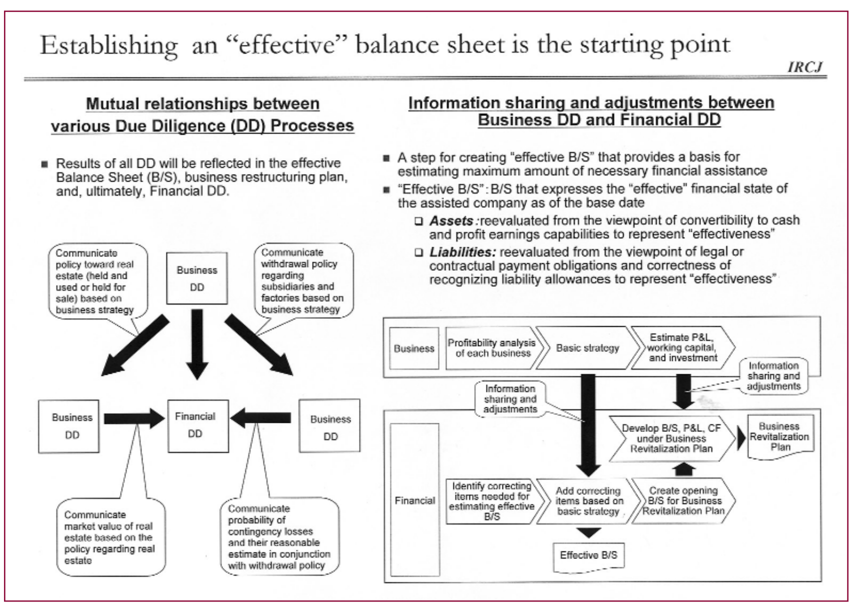
Japan's weakness manifested itself through crony capitalism and Japanese banks' nonperforming loan problems. As inflation continued to affect the economy, Japan developed a connection-oriented or bureaucratic allocation-oriented economy instead of a market-oriented economy. This system kept us inefficient. The banks would give out loans based on personal connections, not on any financial figures or accounting. The practices of marking assets to market or using impairment accounting were virtually absent, and stringent corporate governance was avoided. Most managerial decisions were made behind closed doors, making it impossible for a third party to appropriately analyze a company's risks versus returns.

Japanese banks focused primarily on securing the value of collateral against the value of a loan. They never concentrated on the profitability of the business. The banks didn't care much about how the money was used. In other words, they didn't pay attention to the content or value of the business for which the loan was supposed to be used, so long as the value of the collateralized assets exceeded debt, since most of the collateral was real estate. The bank's main interest was to figure out how to avoid debt forgiveness through cutting costs and wages, taking advantage of deferred tax assets, and so forth. Thus, Japanese banks continued to lend to companies that had major financial problems and thereby kept them afloat.

The IRCJ took a completely different approach to pursue capital efficiency and increase productivity through reorganization and revitalization schemes. Our starting point was to generate an effective balance sheet of the troubled debtor. A company's effective balance sheet is calculated by using the fair-value net-assets method, which means that you obtain a corporation's value by adding the value of liabilities and equity capital.

Effective assets are evaluated and classified by how readily they can be converted to cash and their profit-earning capabilities. For noncore assets, impairment accounting and market-value accounting principles were applied. This process enabled us to identify a company's effective core assets. Effective liabilities are evaluated by looking at legal or contractual payment obligations and liability allowances. The IRCJ then looked at the discounted cash flow as a method to calculate enterprise value so we could estimate the most appropriate amount of debt forgiveness. To elaborate, from the IRCJ's perspective, the maximum amount of debt that the assisted corporation could repay is the sum of the value of the going-concern business assets and the value of assets that are to be disposed of, as described in the business restructuring plan. For debts that exceeded corporate value calculated in this way, requests were made for the debts to be waived.

The IRCJ reiterated to companies that they must dispose of unprofitable



Certain elements of corporate restructuring laws that are not obstacles in the United States are often so in Japan and Europe.

—Atsushi Saito

Atsushi Saito

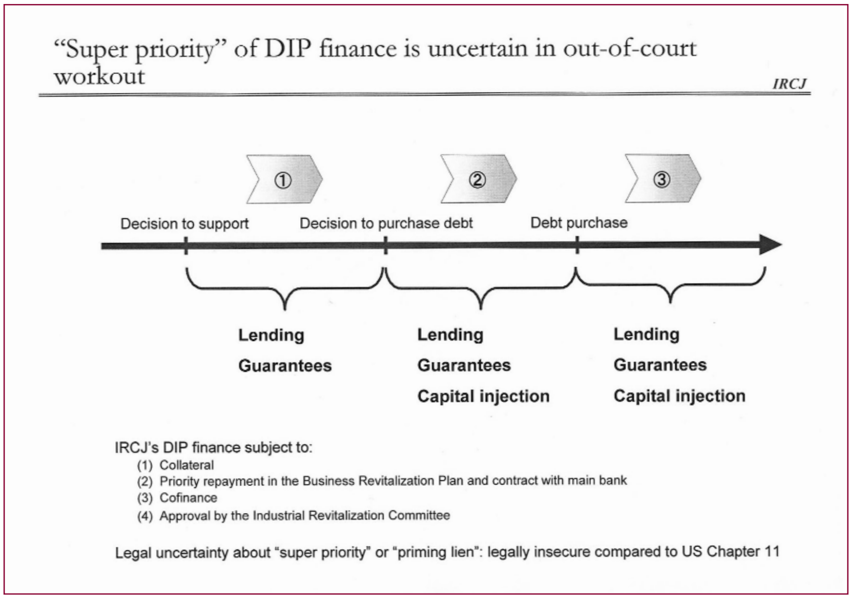
businesses and asserted the importance of correct accounting procedures to banks, businesses, and even government entities. The IRCJ thus explicitly pushed for companies to restructure to achieve an optimal mix of debt and equity, to adopt plans that would garner optimal returns, and to rebuild their business models to be consistent with their goals. This process looked beyond past cozy corporate relationships that sustained a business. We also tried to determine if the company's core competence was consistent with its future competition base, if their subsidiaries were consistent with the company's core business, and if strengthening the core business could lead to a better overall business.

In the case of Daiei, restructuring meant reclassifying everything, according to profitability, from those businesses that should be continued to those that should not, and reorganizing their poor retail business. We urged Daiei to depart from their former business model, including owning its retail locations, obsessing over having a nationwide network, overdiversification and expansion, and getting rid of its dependence on low prices to compete.

The IRCJ process also revealed various problems that existed in the Japanese social system that hindered the efficient revitalization of corporations. One of the most distinguishing characteristics of the IRCJ is that it has acted as an arbitrator, or an intermediary, in out-of-court workouts. Certain elements of corporate restructuring laws that are not obstacles in the United States are often so in Japan and Europe. One could possibly argue that U.S. bankruptcy laws are debtor- or management-friendly, whereas Japanese and European bankruptcy procedures are creditor-friendly. Thus, the wall between court proceedings and private, out-of-court workouts is relatively high in Japan.

The most difficult and time-consuming process for an out-of-court workout is to obtain unanimous agreement from all creditors. At this juncture, the IRCJ process has dealt only with financial creditors, giving priority to repaying ordinary commercial creditors. This is a departure from the equality principle of statutory reorganization proceedings, but it has led to a more practical and speedy conclusion. Our method has triggered a discussion on the possible inclusion of majority rule in the revised Out-of-Court Workout Guidelines. This new rule, which wouldn't require unanimous agreement from all creditors for settlement, will certainly help corporate revitalization in Japan.

The payment of debtor-in-possession (DIP) finance in preference to others is secured in statutory proceedings, but is not in private, out-of-court workouts. In addition, real estate and other marketable securities are used as collateral for general financial claims but not for DIP finance. Other highly convertible assets, such as accounts receivables and inventories, are used as collateral for DIP finance. But here comes a serious problem. If the process is switched to statutory proceedings thereafter, these assets are not considered a priority. Under the IRCJ law, payment of DIP finance in preference to others could be secured as long as it met certain conditions. This motivated banks to provide DIP financing together with the IRCJ—a problem, I have to admit, which still needs to be resolved.



Previously, debt forgiveness based on a reasonably viable restructuring plan could be tax-deductible if banks negotiated with the tax bureau for each waiver. To the contrary, debt forgiveness, as stipulated in the IRCJ revitalization plan, is authorized as reasonably viable through a blanket agreement with the tax bureau. This greatly facilitated the development of business restructuring plans. On the debtor's side, companies can offset gains from debt reduction against prior losses. And losses at creditor banks from debt waivers are, of course, tax-deductible.

The issue of tax advantages in business restructuring made great progress in the tax reform laws this year. Namely, debt relief in out-of-court workouts where the Resolution and Collection Corporation (RCC) or the Small and Medium Enterprises (SME) Revitalization Support Committee is involved, or one that follows the Out-of-Court Workout Guidelines, is tax-deductible if the amount of debt relief is based on an effective balance sheet and the restructuring plan is evaluated by specialists like lawyers and accountants.

The IRCJ has been vigorously pushing for companies to adopt the concept of effective balance sheets, develop new business models that are consistent with financial restructuring, and consistently follow up with their turnaround processes. All this has greatly influenced how Japanese financial institutions examine their loan portfolios. The IRCJ's activities have also exposed legal and tax problems associated with implementing business revitalization. I have no intention to give credit only to the IRCJ, but it is becoming clear that the Japanese financial and business models are changing and heading in a new direction. You may not agree with my argument that the sun is beginning to rise again since other lingering structural issues remain, including the nation's aging population. I should note, however, that population growth is not a dominant factor to determine the growth of gross domestic product (GDP). Technology and a better use of capital are much more important factors. To this end, furthering corporate restructuring holds a key.

To sum up, you cannot deny that Japan—a nation that has thrived by constantly finding new ways to revitalize itself—is waking up to a new dawn. Operating profits are rising as well as profit margins and return-on-investments. I am confident that the

Japan—a nation that has thrived by constantly finding new ways to revitalize itself—is waking up to a new dawn.

—Atsushi Saito

Mark Mason

sun is beginning to rise again in Japan.

MARK MASON

Thank you, Mr. Saito. I would now like to turn to Mr. Taisuke Sasanuma, Representative Partner of Advantage Partners. After obtaining graduate degrees from Keio and Harvard Universities and pursuing a career in management consulting, Taisuke co-founded one of the earliest, and what is today arguably one of the most successful, buyout firms operating in Japan. His firm's leadership position received further confirmation this past spring when a group led by Advantage was awarded the right to largely acquire and then restructure Daiei. Although the acquisition received enormous media attention when it was announced this past March, to date there has been little publicly-available information about Advantage's strategy to restructure the troubled retailer or what impact that strategy would have. So, here is our chance to find out. Taisuke?

TAISUKE SASANUMA
Representative Partner
Advantage Partners, LLP

Thank you, Mark. It is a great honor for me to give a speech at Columbia Business School.

Daiei was the first supermarket chain in Japan, founded in 1957. During the retailer's peak, it had $25 billion in sales, 378 stores, and roughly $500 million in profit. Daiei made three assumptions that led to its downfall. First, it assumed that a successful business model for supermarket chains could be applied to any kind of retail sector in Japan, including discount stores. Besides running a supermarket chain, Daiei tried to expand its business to discount stores, department stores, golf courses, hotel chains, bookstores, and pachinko parlors (Japanese pinball gambling chains). Unfortunately, there were strong specialists in each sector so the company lost a lot of money when it diversified. Its second mistake was to assume that Japan's real estate values would continue to increase. It made direct real estate investments every time it opened a new store. And as you know, in 1989, the real estate bubble burst in Japan, which made Daiei's asset-related balance sheet shrink to one-fourth or even one-fifth of what it was worth during its peak. Thus, Daiei's balance sheet was destroyed in 1989. In addition, Daiei management assumed that the leadership in the organization could be passed from generation to generation from within the founder's family. But the leadership skills of the second generation, in spite of their working really hard, could not resolve the huge problems they had to face.

These assumptions, as well as the death of the firm's founder, Mr. Nakauchi, led to the demise of Daiei even after the firm received financial assistance from banks and government organizations. Finally, after years of floundering, Daiei requested assistance from the IRCJ. In December, Mr. Saito started the due diligence process and decided to help Daiei with its revitalization plan. After Advantage Partners was chosen by the IRCJ to bail out Daiei, we placed Ms. Fumiko Hayashi as Chairman and CEO and Mr. Yasuyuki Higuchi as COO. It has been six months since we set up this new corporate structure, so I'll give you a quick report about what's been going on.

Within this process, how and what kind of role did a private equity firm play? First, we arranged for a sizeable and risky infusion of cash into a large corporation. This is the first time a private equity firm and other strategic investors worked together to revitalize such a large company. Second, we designed a plan of action based on the IRCJ's original and very thorough restructuring plan. Third, we arranged and brought on board a new management team. We monitor what the new team does, and sometimes I mentor the new CEO and COO. Fourth, we designed and introduced a new organizational structure, adding what we call the "key performance indicator program," which I'll explain later.

The IRCJ's support plan consisted of $400 million worth of debt forgiveness, the cancellation of $119 million of preferred stock, and the arrangement of a $600 million cash infusion by the new corporate owners. In addition, there was $500 million worth of equity swaps and the allocation of $100 million of additional cash for the future. With this, Daiei's once dynamic balance sheet shrank to $4.8 billion from $10 billion. It is still a highly leveraged company, but the profile of the balance sheet has improved considerably due to the efforts of the IRCJ.

Based on this balance sheet restructuring, we have started making operational or strategic improvements in the past six months. Advantage Partners governs and provides financial assistance, Marubeni Corporation helps Daiei with managing its retail chain, and the IRCJ is involved in the divestiture of Daiei's core businesses and its unprofitable stores.

Let me briefly explain recent trends in the market. Sales per store for Daiei and its competitors have been steadily decreasing over the past ten years. Those in the supermarket industry have common problems, including storage issues. In addition, the industry has been plagued by the invasion of certain retail specialists other than food suppliers, which causes further profit erosion.

As turnaround managers, this implied that we could not recruit people from Daiei's competition because they themselves were not doing so well. Even if we were to recruit people


Taisuke Sasanuma

from a competitor, they would surely apply the same mistakes. Even if that meant that these recruits did a great job, the future profitability of Daiei would not be more than 1.8 percent per sale. That meant we had to recruit management from a totally different industry, with a totally different perspective, or someone who was a strong leader in a turnaround process.

For those who don't know the geography of Japan, it is a nation made up of four major islands. Daiei was profitable in the Kanto and Kyushu regions, but not so in Chugoku and Shikoku. So we had to decide whether to maintain a presence in the two unprofitable regions. Also, we broke down their profitability and sales through various divisions. As part of our due diligence, we compared the profitability of Daiei's food business with its competitor Ito Yokado and found that Daiei's food section did better than its competi-

How and what kind of role did a private equity firm play? First, we arranged for a sizeable and risky infusion of cash. Second, we designed a plan of action. Third, we arranged and brought on board a new management team. Fourth, we designed and introduced a new organizational structure.

—Taisuke Sasanuma

tor's. So we decided to focus on their strong points, which turned out to be food and hardware. Hardware includes furniture and other small products for the home. For the latter, we decided to incorporate a sector specialist so that the total Daiei store or mall would be more attractive to the consumer. From an operational point of view, Daiei could then solely concentrate on what is profitable for them—their food business.

To summarize, we closed 54 unprofitable stores and gave up maintaining a business in those regions where we weren't making money. We will soon launch 100 small-scale supermarkets in the Tokyo and Kinki areas. We've already opened up a new experimental store this month, so if this trial works, we're going to expand this business model to other regions. We are behind on the renovation of 150 large-scale stores, however, by about three months. We really have to rush and play catch-up with that project.

We opened a newly-renovated store two months ago in the Osaka area, and sales, compared to the previous year, are up by more than 130 percent. So we are thinking this may work for another 100 existing stores.

Because Daiei had been suffering for decades, it could not make any new IT investments. So we're budgeting more than $150 million to improve its IT system over the next two years.

For top management, we implemented an early retirement program. We encouraged more than 400 people to leave the company, and the whole process was managed quite smoothly because Ms. Hayashi and Mr. Higuchi had discussed everything very carefully with the union.

Thanks to the efforts made by the IRCJ team, the liquidation of noncore subsidiaries is going quite smoothly. Daiei used to have 113 subsidiaries in a wide range of sectors. We categorized everything into core and noncore units, and the IRCJ is aggressively trying to sell the noncore units.

Let me talk about our CEO and COO. Prior to her current title, Ms. Hayashi was the President of BMW Tokyo. She was legendary as a manager in the car dealership industry. Everywhere she went, that company or branch became very profitable. So of course we wanted to employ her and incorporate her successful experience. After graduating from high school, she worked at Toray and Matsushita Electric. Since then, she's developed her own career very proactively for BMW and Volkswagen before becoming a turnaround manager for Daiei.

Mr. Higuchi was the President of Hewlett Packard Japan. He is a Harvard Business School graduate and a real high caliber guy. He oversaw the merger between Compaq and Hewlett Packard, and functioned as an integration manager as the President of the new Hewlett Packard

Japan. He conducted a very aggressive layoff program, and yet his integration process was very successful. Some of his former colleagues told me that his method of integration was something akin to magic. So I wanted his magic here, at Daiei.

I have high expectations that the combination of Ms. Hayashi and Mr. Higuchi—who hail from totally different backgrounds but have the same ethics and energy—will really turn around and revitalize Daiei, a really wilted organization.

When I was conducting my due diligence on Daiei, I found a poster that hung in every employee lounge area that talked about the link between a 3 percent return-on-asset and the employee's daily performance. Now how can a part-timer or shop clerk understand this? That's when I realized that Daiei was having a hard time communicating its goals, values, or direction to its employees. Company management didn't tell store managers what they wanted; it was like they were ignoring the store all together. Taking this fact, I figured there was a big possibility of success if headquarters communicated to those in the store to get involved in the rehabilitation process, to work together. This is also part of the reason why I hired Ms. Hayashi and Mr. Higuchi: they both know how to talk directly to the employees of each store. In addition, about 65 percent of Daiei's customers and 70 percent of our employees are female. So by putting a female CEO in charge of the new company, we wanted to deliver a message to our shareholders and customers that we were in tune with what the market wanted.

Daiei is an example of how private equity and other strategic investors can work together in a large-scale, corporate application.

—Taisuke Sasanuma

We also introduced what we call the key performance indicator, or KPI, program. The program is split into two parts. First, store managers have their own key performance indicators to help them understand what sales, campaigns, or programs work in their store. Second, store managers have access to activity indicators, so they can determine how they can achieve a selected—say 20 percent increase in sales—goal. These indicators could be reshelving certain items so they're more attractive to the customer, and so forth. It's about establishing a direct link from the store clerk to a customer's behavior. If people can understand the link between action and result, they are more motivated to conduct those kinds of actions. We have just hired a consulting firm to finish implementing the program. A test program was started in several stores, so we are looking forward to those results.

To give you an example of our successful renovation of our large-scale store in Osaka, we made the meat department very small compared to the actual size of the store, and intentionally stocked it with mostly local meats. People seemed much more interested in buying fresh, local products than national goods, especially the famous Kobe beef. We also cleaned up our bakery and general foods section, which was very dirty before. How can you enjoy shopping in that kind of atmosphere? So we made the amenities of the store much more attractive, which made the customer more comfortable to shop with us more frequently. In addition, we made our produce department smaller, thanks to Mr. Higuchi. One of the problems with Daiei's produce was that the vegetables were always wilted. So as his first project, Mr. Higuchi changed the whole supply chain system and bought the produce from the local market and not from a large, national vendor. The lead time from the market to the store became much shorter than before, which resulted in availability of fresher vegetables. And the customers also seemed happier buying local vegetables as well. The Osaka store also stopped operating their unprofitable cosmetics division and invited a specialist in, which turned out to be quite popular. These are the types of renovations that increased sales by 130 percent when compared to the previous year, so we'd like to quickly implement similar moves for our other large-scale stores as well.

Lastly, let me quickly explain about the development of our new mission statement. In order to share the new management's values, Ms. Hayashi and Mr. Higuchi wanted a new mission statement. So the first thing they conducted was a survey of all 50,000 Daiei employees, including 40,000 part-timers. We got a surprisingly high response rate of 90 percent. Each director was assigned to read some 4,000 survey responses, so nobody got any sleep. But we learned so much from it. For example, one housewife working as a part-timer confessed that she was hesitant to answer any customer inquiries, so much so that she would physically remove herself when she sensed someone needed her help. So some workers were reluctant to have direct contact with a customer. And as we read through each survey, several common themes came out. In the end, the directors talked through a two-night, three-day session to come up with a new mission statement.

Transferring the IRCJ's experience and skills to the private equity industry and private sector will be very important to build a stronger economic structure.

—Taisuke Sasanuma

With these actions, Daiei stock is up by about 70 percent since we took over the company. I hope the market is saying that the firm is taking concrete action to revitalize itself. I think Daiei is an example of how private equity and other strategic investors can work together in a large-scale, corporate application. By releasing a company from various constraints or assumptions given by former owners, a company is able to realize its potential. I believe private equity firms will be a catalyst and play a lead role in this movement in the future. I also think the IRCJ has played a significant role in accelerating this process in Japan. Transferring the IRCJ's experience and skills to the private equity industry and private sector will be very important to build a stronger economic structure.

HUGH PATRICK

R. D. Calkins Professor of International Business Emeritus and Director, Center on Japanese Economy and Business, Columbia Business School

We've had two excellent presentations from different, yet complementary, perspectives about Daiei's restructuring. I won't comment much on Advantage Partners, but will say a bit about the IRCJ because I think it is such a good success story and is unique among Japanese government institutions.

First of all, the IRCJ will only be around for five years. All Japanese institutions in principle want to be eternal. As I recall, the IRCJ comes to an end in March 2008. So its lifespan

Daiei restructuring has been a complicated, political game.

—Hugh Patrick

is already half over. Second, the IRCJ is also unique since it is run by outsiders such as President Saito, who was recruited from the private sector because of his expertise. It is not run by government bureaucrats. Also, as Mr. Saito stressed, the IRCJ is pro-market and pro-competition. Its task has been to overcome private market failures in restructuring and thereby set up the criteria and norms for how tough, but fair and effective, corporate restructuring in the private market can work in the future. It has had educational and institution-building roles that have been particularly important.

The IRCJ starts its restructuring essentially by buying the claims of the peripheral lenders, the non-main bank lenders, and getting them out of the way, so they can then work out a deal with the main banks in terms of write-downs of debt and other operations. Most of the IRCJ's 41 cases have been relatively small, but there have been two major cases. One is Daiei and the other is Kanebo. I don't know a great deal about the background of the Daiei case, but it has had a long and complex history with many layers and players involved: the company management, the founder family, the core banks, government officials (especially from the Ministry of Economy, Trade and Industry (METI) and the Development Bank of Japan), politicians, and most recently, the IRCJ, Advantage Partners, and Marubeni.

The specifics have already been dealt with thoroughly so I'm not going to say anything about them, but I'd like to provide a little historical context on Daiei, as I understand it. As Mr. Sasanuma said, Daiei was started in the early postwar period, in 1957, by a very bold, risk-taking entrepreneur. Mr. Nakauchi built Daiei to be a major retailer, but also expanded it into a range of other activities. As many of you know, Daiei also owned a baseball team and hotels, and was a provider of financial, real estate, and investment services.

Even though the company was public, I understand the founder and his family continued to really control the firm. Mr. Nakauchi maintained centralized control. A firm that has been started by an entrepreneur's family has both its strengths and, ultimately, its weaknesses.

Earlier, Daiei's three mistakes were mentioned; I will stress two. One was that in the late 1980s, Daiei expanded rapidly by increasing the number of stores and entering new business areas with borrowed money. Of course, when the financial bubble burst, Daiei was stuck with all that debt. The second mistake was made in the 1990s when Daiei thought the economy would be getting better and all they had to do was wait it out. However, things got worse and worse, and the family was very reluctant to sell their assets—even their good assets—until prices were too low. Daiei was very slow to carry out its own restructuring.


Hugh Patrick

UFJ, which was Daiei's main bank, had a heavy concentration of its loans to Daiei and to a few other zombie companies. This put UFJ into a very difficult balance sheet position of its own, and I would argue that this ultimately led to its demise. Of course, the polite term is "merger," which it recently concluded.

Another thing that's interesting is that METI became increasingly involved. It sent its senior staff to take management positions, arranged for financing from the Development Bank of Japan, and provided tax and other forms of support. I remember a conversation I had with a UFJ manager a couple of years ago. He had mentioned that Daiei was no longer a problem for them since it was now a problem for the government, or METI. He was feeling much more relaxed about it all.

Incidentally, it's my impression that METI opposed the IRCJ taking over Daiei because they were trying to engineer a private workout, though unsuccessfully And indeed, one reason that process was so slow was that METI was an obstructionist. I see some of you nodding your head in agreement with my interpretation. Daiei restructuring has been a complicated, political game, but that is another story. Maybe we'll be able to talk about it more openly two years from now.

Discussion

Patrick: I have two questions for each of the speakers. Let me start with Mr. Saito. First, both the government and distressed companies have been concerned that restructuring should not be done at the expense of reducing the number of employees. *The Financial Times* has said that part of the Daiei deal was precisely some sort of implicit employment guarantee. From the viewpoint of the IRCJ, how important has the maintenance of employees been as a Keiretsu criterion for your restructuring program? Second, in light of the ongoing cozy relationships between banks and core Keiretsu member firms, how far has the IRCJ gone in overcoming these market failures you stressed during your presentation? Are there any serious issues still out there?

For Mr. Sasanuma, first, newspaper articles have suggested that there are substantial areas where Marubeni and Advantage Partners interests overlap, but there exist areas of potential conflict and friction as well. I would like to hear a bit more about what they have been and how they have been resolved. Second, has the IRCJ's ownership of one-third of Daiei shares posed any problems for you? From the IRCJ's point of view, can you complete your restructuring before they have to go out of business? And what's going to happen to their shares two-and-a-half years from now?

Saito: To answer the question about employee reductions, that was naturally the most delicate, sensitive subject for us. Particularly in the case of Daiei, they have many local stores. Although Tokyo and Osaka may be recovering, the economic scenario outside of the cities is still quite gloomy. Thus layoffs quickly turn into a political or social problem in Japan. However, as Mr. Sasanuma mentioned in his speech, the labor union has been very supportive of the IRCJ. It is ironic that labor union representatives are more serious in their struggle to fix this problem than the executives of companies are. If you treat them very carefully and with respect, unions will accept many reforms. So far, that's been the case for Daiei. But the company did hand out special money for people to leave the company to minimize potential social upheaval.

As for the tradition of maintaining inefficient business relationships, of course this has been a very serious problem for Japan. In the United States, you often find very rational judgments being made. However, that is also unique in this world. Both Europe and Asia often maintain these so-called sticky relationships, and they play a major role when companies make business decisions.

However, our efforts with Daiei and its creditors were very strict. For example, when we were assessing the value of Daiei's balance sheets, we found excessive debt that was not commensurate with the real value of assets. We asked the banks to forgive this debt, and thereby introduced a rational and theoretical way of restructuring Daiei. The banks were hesitant at first but gradually accepted this method. And now, even bankers are establishing their own corporate restructuring departments internally to follow suit the IRCJ way.

So I think Japan is gradually changing, but it has not completed or finished this process just yet.

Sasanuma: To answer Hugh's first question, Advantage Partners basically needs Marubeni's help. When Daiei announced that it was going under the control of the IRCJ and conducting an out-of-court workout, many suppliers tried to withdraw from existing contracts, especially food suppliers. The suppliers got really

nervous, thinking they will soon be cut off, so before they could be damaged, they tried to withdraw. Marubeni thus stepped in to supply products to Daiei. So we don't feel like Marubeni has been aggressively pushing their products onto Daiei.

One small example I can give you about potential conflicts is what happened a few weeks ago. Without anyone realizing, Marubeni had introduced a new supplier to Daiei. This was first noticed at a meeting we had with Marubeni after the fact, so I just asked Marubeni to share their planned changes before implementing them. Basically we resolved the issue by acknowledging that we needed to communicate better. Larger conflicts will probably come about when Advantage Partners tries to exit from the investment. Marubeni has indicated its long-term commitment to Daiei, so it might be a possible buyer of our stock. Of course they would want a cheap price, and we would want to sell our shares at a higher price, which is where a potential conflict may happen between us, Marubeni, and the IRCJ. That said, Advantage will not exit before the IRCJ does. So we may end up buying the IRCJ's shares first, since we have the option to do so. But besides that, we are working very closely with the IRCJ team and we share the same values and goals, which is to encourage Daiei employees to really work together and rehabilitate their company. So we are very comfortable working with them.

Question: Daiei announced yesterday that October same-store sales were down by 10 percent. Could you please shed some light on what's going on with sales? Why did this happen?

Sasanuma: In November, sales were up by 1 percent so we have bounced back. That said, October sales were down since we changed our vegetable supply chain so that we could provide better products to our customers. Our supply chain management was a bit chaotic for the past two months. Please note, however, that this is not just occurring at Daiei. Sales at Daiei's competitors, such as Ito Yokado, have also been down by about 7 percent. So this is an industry-wide trend.

Question: I am wondering how you recruit people for top management positions. Do you go through an agency, your customer network? How do you find the right person for the job?

Sasanuma: We have about 50 to 70 candidates on a potential-hire list. We track their record, their strengths and weaknesses, their personality, their will to work at another company as a manager. So, when we have an opening, we look at this list, and hopefully we find an appropriate person to fill the position. But it doesn't always mean that we'll hire someone from the list. We do have a network in the headhunting industry, so we talk to them about finding the best person. A big issue for any shareholder is to identify the type of management a company has. By deeply analyzing this, we naturally can find a person who has the best profile, skill, or personality to fill a top management position. We go to the headhunter with a very detailed explanation of who we're looking for. From my experience, this enables us to find a better candidate more smoothly.

Question: Mr. Saito, you had mentioned that Daiei's equity value had almost doubled due to all the restructuring efforts. As a government entity, does the IRCJ have the incentive to increase its return from this investment?

Saito: The IRCJ uses taxpayer funds so we do not have to make a profit on our investments, but we also shouldn't take a loss, although we are not legally prohibited to take a loss. So far, fifteen out of our 41 cases were profitable. But since Daiei and Kanebo combined account for about 70 or 80 percent of the IRCJ's total investment value, if Mr. Sasanuma's management team fails, I would have to ask them some severe questions about what was going on since everyone is waiting for their debts to be paid back. Naturally, I am not working for the money. I am working to recover Daiei. My staff is very professional and many of them have spent fifteen or twenty years in the revitalization business. Some of them used to be very rich working for private firms, but their patriotism made them jump to the IRCJ. Japan has many things it can be proud of in manufacturing technology, but we are still behind in international market practice. The message we're trying to bring to corporate Japan is that we need new blood, for the sake of the national interest.

Question: Wal-Mart has been struggling to implement its business model at Seiyu. Do you think Seiyu will also have to go through a similar restructuring process like Daiei?

Sasanuma: Wal-Mart declared that they're going to provide full-scale help for Seiyu by infusing $1 billion or so. The firm is also trying to be more flexible and to change their method to a more Japan-oriented system, so I think things are going to work out. The situation at Seiyu is different from that at Daiei.

Question: There has been a lot of talk about the increase of buyout firms in Japan, both domestic and foreign. Are there more Daiei's out there? Will there be other significant opportunities available to the buyout community?

Sasanuma: I think the restructuring of large companies like Daiei is pretty much completed. I think buyout firms will have opportunities in the mid-size or middle-market areas for public companies. I'm quite skeptical if another large buyout of a public firm can occur, so I'm very interested to see how these companies will pursue different opportunities.

ダイエーの例に見る日本産業構造改革におけるプライベート・エクイティ投資の役割

（抄訳）

日本で企業改革が進む中、企業買収（バイアウト）は日本のビジネス業界にも浸透し始めた。 ここ数年増加傾向にある企業買収の中でも、特に新聞の見出しをにぎわせているのは、アドバンテッジパートナーズ LLP、丸紅、産業再生機構（IRCJ)による巨大小売チェーン、ダイエーの企業再建である。 ダイエーの企業再建は、プライベート・エクイティと政府機関が連携して民間企業の再建に取り組むめずらしい例である。 プライベート・エクイティが日本企業の再建に貢献できるか否かを決めるテストケースであるこの企業買収は、多くの人の注目を浴びている。

企業再建におけるプライベート・エクイティの役割を探るため、コロンビア大学ビジネス・スクール日本経済経営研究所のオルタナティブ投資プログラムは、ダイエーの再建をリードする二人の専門家を招き、講演会を開催した。 民間及び政府役員により構成され、企業再建支援を目的とする政府機関である IRCJ の最高経営責任者である斉藤惇氏が講演。 次に、日本を代表する企業買収専門会社であり、ダイエー企業再建の第一責任者であるアドバンテッジパートナーズの共同代表パートナー、 笹沼泰助氏が続いた。 日本経済経営研究所所長であるヒュー・パトリック教授がコメンテーターを務め、オルタナティブ投資プログラムのディレクター、マーク・メイソン博士が司会を務めた。 本シンポジウムは、2005 年 11 月 15 日、米国コロンビア大学にて開催され、本レポートはその講演内容をまとめたものである。

日本経済の低迷は様々な要因によるものだが、主な原因として挙げられるのは企業と政府機関や金融機関の持ち合い関係、及び日本の金融機関の不良債権問題である。 斉藤惇氏が責任者を務める IRCJ の主な目的は、グローバル市場での手法を日本の企業部門に紹介し、慣行化することである。

ダイエーは致命的なミスを三つ犯した。 第一に、旧経営陣は、成功していたスーパーマーケットチェーンのビジネスモデルが、ホテル業、金融業、ゴルフ業など、その他の部門でも通用すると信じていた。第二に、ダイエーの不動産ポートフォリオは、新規店舗開店のたびに大きく膨らみ、さらに 1989 年の不動産バブル崩壊後には財務状態が悪化。 第三には、外部からの影響に対し閉鎖的な家族経営、そして新世代の経営者がダイエーの直面していた問題へすばやく対応しきれなかった点である。

このような問題点を解決すべく、ダイエーは IRCJ に支援を要請。 IRCJ は、貸借対照表を効果的に維持する方法、国際会計基準の導入、そして法廷外での債務、債権者処理の概念を導入した。 IRCJ の役割は、ダイエー株式の三分の一を取得し、新しい経営戦略を実施するためプライベート・エクイティの採用を含めた再編計画の立案、また、ダイエーのノンコアビジネスの切り離し、更にはダイエー再建の法的側面をモニターすることである。

アドバンテッジパートナーズは、ダイエーの日常業務の責任者となり、まず最初のテコ入れとして外部からの人材を経営陣として採用した。 笹沼氏によると、他業界で成功を収めた経験豊富な役員を雇うことにより、ダイエーは自らの失敗を認識し、新事業計画を実行することができた。 当該事業計画には、アドバンテッジパートナーズやその他機関による資本注入の受け入れ、ダイエーのノンコアビジネスの切り離し、大胆な人員削減、不採算店舗・部門の閉鎖、そして店舗のレイアウト変更と社内業務の外部委託が含まれた。 ダイエーの新事業計画が走りだしてからまだ六ヶ月にしか満たないが、ダイエーの株価は買収以降 70%以上上昇しており、投資家や市場関係者がアドバンテッジパートナーズの戦略を好意的に見ていることを反映している。

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