Analysis: Scrapped Nissan-Honda merger highlights Japan’s restructuring challenges

Corporate reforms designed to extract shareholder value are at risk of being delayed but not derailed, even as trade tariffs prompt near-term obstacles, market experts told FA.

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A proposed merger between Nissan and Honda Motors was called off just months after the automotive rivals announced their intentions to combine resources to address the industry's evolving challenges.

The proposed deal has been among a string of high-profile Japanese companies looking to maximise shareholder returns by spinning off their assets or streamlining their operations to become more competitive. After Japan's Seven & I Holdings rejected a bid from Canada's Alimentation Couche-Tard (ACT) last year, the parent company of 7-Eleven convenience stores said it will IPO its North American business while selling down its ownership in Seven Bank to deconsolidate from the group's balance sheet and appoint its first foreign CEO, Stephen Darcus; meanwhile, talks are still ongoing with ACT about a renewed bid.

Such corporate restructures test whether 'Japan Inc.', long seen as resistant to change, will evolve through faster acquisitions or divestments. The revaluation of existing businesses comes at a crucial moment for Japanese companies facing an ageing population at home, and trade tariffs from the US.

While the tie-up to become the world's third largest car manufacturer was touted as a plan against increasingly competitive Chinese electric vehicles, the Nissan and Honda merger withdrawal reflects broader cultural and operational complications with any potential merger and acquisition in Japan, commented Steven Alain Lawrence, chief investment officer of Balfour Capital Group, speaking to *FinanceAsia*.

Despite their shared recognition of the rapidly evolving industry, "key differences in their leadership vision led to the [deal's] downfall, with each CEO having a distinct global strategy, making the integration complex," Lawrence explained. However, he noted that the decision isn't necessarily a bearish signal, since Nissan and Honda's reluctance reflects the more conservative, risk-averse mindset prevalent in traditional Japanese firms.

Shifting gears

Japan's corporate reforms are being confronted as prospective White House tariffs are being discussed. The added tax places the spotlight on bellwether industries such as Japanese automakers, which not only export directly to the US, but manufacture key components throughout North America, including Canada and Mexico, which are sold to customers in the world's largest economy.

The uncertainty has affected market sentiment. After breaching the 40,000 level in early 2024, the Nikkei 225 has slipped 5% year to date, roughly in line with major global benchmarks grappling with the uncertainty of US trade policies.

"Investments are often sidelined amid market turbulence, but historically in Japan, it became part of corporate behaviour following the asset bust of the late 1990s," commented Eric Ritter, adjunct professor of economics at Lakeland University in Japan, speaking to *FA*. This led to a period of economic stagnation where investments slowed and cash sat idle, inflating balance sheets and compressing financial metrics like return on assets (ROA), lowering the valuation assigned to them by the market, he said.

The shift toward corporate governance reform dates to 2013 when shareholder interest became a centrepiece of Abenomic policies, named after former prime minister Shinzo Abe. The introduction of the Corporate Governance Code in 2015, and revised in 2021, encouraged greater engagement between companies and investors, empowering changes now being expressed through proxy voting.

Mixed approach

Balfour Capital Group's Lawrence notes that while 'Japan Inc.' may take a more cautious near-term approach due to trade tariffs, this doesn't signal a return to defensive cash hoarding.

"Companies are likely to adjust capital allocation strategies selectively, balancing investments, buybacks, and dividends while navigating external pressures," he said, underscoring that recent reforms have forced Japanese firms to unlock capital efficiency and to increase their return on equity (ROE).

"This embodies the value-investing philosophy of Benjamin Graham and Warren Buffett, which underscored strong balance sheets and disciplined capital allocation," Lawrence explained.

Morgan Stanley estimates that the aggregate amount of announced share buybacks is expected to reach ¥12 trillion ($80 billion) for FY 2025, while the aggregate amount executed exceeds ¥9 trillion.

Forecasting high single digit EPS growth for the Topix this year, the US bank also observed that Japanese investments have recovered more swiftly post-pandemic than they did after the global financial crisis, with capital flowing into automation and efficiency to tackle demographic challenges.

“The M&A scene remains active in semiconductors, automation, and AI, where companies are investing for competitive advantages,” Lawrence said, adding that companies like Hitachi have expanded their global footprint through notable acquisitions, proving that strategic consolidations can work.

While Lakeland University’s Ritter agrees that combining rivals to form larger conglomerates might hold a competitive edge, a greater onus for changes should be placed on independent board directors unafraid to replace senior management to boost ROEs. Last week Nissan announced that its chief planning officer, Ivan Espinosa, will replace Makoto Uchida as CEO, as the $11 billion company battles its ongoing business obstacles.

Nissan shares still trade above their December lows, when the proposed tie-up with Honda was announced, suggesting that shareholders believe another type of deal can still go through, as few hope Japan’s corporate reforms end up hitting the brakes anytime soon.