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"Case study of Mitsubishi Motor"

Summary

The report studies corporate governance aspects in cost of capital and cross-holding shares. Mitsubishi Motor still does not recognize shareholders value as important, diluting shareholder's interest through scandals. The largest shareholders of 3 Mitsubishi companies should be responsible of explaining cot vs. benefit of the investment to shareholders as one of important investments of cross-holding shares. Not a few case of easy decision of equity issuance destroyed shareholder value, leading to weak corporate governance and scandals.

Scandal again

Mitsubishi Motor Corp. (hereafter MMC) booked JPY19.1 billion loss for a fuel efficiency testing scandal for FY2016/3. The new scandal shakes the management again after a failure to report recalls in year 2000. At the previous scandal of recall cover up, Mitsubishi Heavy Industry, Mitsubishi Corp and Mitsubishi UFJ Bank supported MMC to inject capital through JPY380 billion preferred shares after Daimler-Benz ended the alliance. Now, Nissan gives the 7th automobile carmaker in Japan a helping hand, underwriting JPY237 billion new common shares, aiming at gaining world auto sales and particularly strengthening sales in South East Asia. Anecdotally, Nissan leaked the scandal as the rescuer had planned to take over the company. Needless to say, there is no doubt that the weak corporate governance would help scandals occur frequently. We should keep an eye on the following report why scandals repeated over and over again and how the management missed supervising the wrongdoing. On this report, I would like to focus on another aspect of the incident.

Cost of capital

MMC raised equity capital of JPY257 billion by issuing common shares in January 2014. This capital was used for repurchasing and canceling preferred shares of JPY270 billion from 3 Mitsubishi companies. The issue is how MMC management recognized cost of capital as important, as the carmaker issued common shares resulting in diluting shareholder value 39%. MMC redeemed all preferred shares (partially JPY110 billion was converted to common shares for maintaining 34% ownership by Mitsubishi 3 companies) and increased dividend to JPY25 a common share from no dividend in FY2014/3. Dividend payout was only 16% of net profit, but the equity issuance diluted shareholder's interest by 39%. Dividend a share has not risen since the year, staying at JPY16 for FY2015/3 and FY2016/3. The equity issue has not benefit to the shareholders. Basically, cost of capital of common shares is much higher than debt or preferred. MMC management does not seem to recognize cost of capital of equity and shareholder value, as the carmaker plans to issue 506 million shares to Nissan, increasing outstanding shares 34% again. Easy decision of equity financing would lie behind one of the important issues of corporate governance. MMC should have replaced preferred shares by its own free cash flow generated or debt financing.

Cross-holding shares

Another issue is on the side of Mitsubishi companies that are large shareholders of MMC, holding 34% ownership at this moment. Mitsubishi Heavy and Mitsubishi Corp send people to the board of directors of MMC, but supervision has not work well. In addition, considering the investment in, JPY270 billion of total JPY380 billion preferred shares were redeemed at JPY200 billion with no dividend for 10 years. The rest JPY110 billion preferred shares were converted into common shares at low exercise price (probably compensated the difference between redeem price and cost of preferred shares). There is another question whether those companies explained shareholders the performance or return vs. cost of the preferred investment in FY2014/3. Although they would say comprehensive return of overall business might be adequate well, they should be responsible to explain the performance of it as an important investment of cross-holding shares. From now, their influence to the carmaker decreases behind Nissan, and should reconsider the cost benefit as far as they maintain owning the stake.

Conclusion

The report focuses on 2 aspects on corporate governance such as cost of capital and cross-holding shares. Needless saying, both issues are connecting the goal of a public company, maximizing shareholder's value for long- term. As mentioned above, the case of MMC scandals, management of MMC and Mitsubishi companies does not seem to recognize the both issues and goal of a public company appropriately. For MMC, the company has made wrong decision again, diluting shareholder's interest, but should sell existing shares of current shares outstanding to Nissan if needed. Not a few case of easy decision of equity issuance destroyed shareholder value, leading to weak corporate governance and scandals.

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