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Hurdles and Rewards: Navigating Japan's Financial Services Market

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The event was moderated by Leslie Norton, foreign editor, Asia, *Barron's*. Welcome remarks were given by Susan Green, cochair of the Events Committee, Woman's Bond Club. The introduction was given by Daniel Rosenblum, director of Corporate and Policy Programs, Japan Society. Concluding remarks were made by Philippa Girling, global cohead of Operational Risk, Nomura Holdings America Inc.

This report highlights the speaker's remarks and the following discussion that took place. The event was cosponsored by Nomura Holdings America Inc., the Woman's Bond Club of New York, and the Japan Society.

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SUMMARY

Japan faces a multitude of challenges with respect to the regional and global competitiveness of its financial market. Not only must it deal with increased competition from stock exchanges in Hong Kong, Singapore, and Shanghai, but it must overcome remnants of its own past economic success—mainly the postwar system of cross-shareholding, which stifled financial innovation and protected Japanese management from market discipline. As Ms. Alicia Ogawa noted, the fundamental question is whether Japan has the consensus to maximize profit and shareholder value. The financial services sector is emblematic of this challenge because it requires entrepreneurialism and risk taking.

Ms. Ogawa explained that while there has been significant regulatory reform and much still remains to be done, many impediments to the development of a vital fund management industry cannot be solved by legislation. She emphasized the corporate personnel rotation system, the values of the education system, and the unwillingness of corporations to give bright young talent sufficient responsibility and compensation as critical hurdles that need addressed.

Mr. Brian Kelly articulated how technology has made the development of several competitive East Asian financial centers possible. He also stressed that as Japan rapidly evolves into a postindustrial society that cannot rely on manufacturing for economic strength, it must ensure the competitiveness of its financial industry. Accordingly, he remarked that Japan must follow through on creating a comprehensive exchange that encompasses commodities and derivatives, thereby increasing the volumes traded. Additionally, improving regulatory oversight is necessary, and transparency is a critical aspect of a regulatory regime that must allow for enough certainty of outcomes to foster financial innovation.

Mr. Masatomo Harigaya discussed the importance of investor relations and explained that Japanese corporates must become friendlier to shareholders if the Japanese market is going to attract more investment. Citing the "Mrs. Wantanabe" phenomenon and an increasing trend in exotic investments, Mr. Harigaya challenged the notion that all Japanese individual investors are risk adverse. He noted the bipolarization of many individuals' investments and therefore the need for a middle-risk, middle-return product. Mr. Harigaya further thought that increasing divided payout when profits are high is one way to increase capital efficiency.

This event was hosted by the Japan Society and was cosponsored by the Women's Bond Club of New York, the Center on Japanese Economy and Business, and Noruma Holding America. About 200 people were in attendance.

WELCOME REMARKS

SUSAN GREEN
Cochair, Events Committee, Woman's Bond Club of New York

Good evening. I am Susan Green. I cochair the Events Committee for the Women's Bond Club along with Deb Baker, and we would like to welcome you on behalf of the Club.

The Women's Bond Club has been around almost as long as the Japan Society. It was started in 1921. Our mission is to create an environment in which women are encouraged to develop their potential to become leaders in the financial services industry. We do this by community involvement and charitable giving; we have a scholarship program; we do outreach programs for our corporate members; and we organize events such as this one. We do these things for two reasons: first, to give people exposure to thought leadership; and second, to allow people to develop their professional networks.

For this event we are very grateful to the cosponsors, Nomura Holdings America, the Japan Society, and the Center on Japanese Economy and Business of Columbia Business School.

Let me introduce Daniel Rosenblum, the Japan Society's director for corporate and policy programs. Mr. Rosenblum develops the Japan Society's programming and also its Innovators Network, which is a forum for collaboration across a number of industries, functional areas, and continents. He began his career by spending 16 years as a financial journalist and, therefore, should have an interesting perspective on tonight's program. So without further ado, please allow me to welcome Mr. Rosenblum.

INTRODUCTION

DANIEL ROSENBLUM
Director, Corporate and Policy Programs, Japan Society

Thank you. It is a pleasure to be working with the Women's Bond Club of New York, and I am glad to see so many of its members here tonight. Tonight's program is particularly relevant with regard to what is happening today in the global markets. We are also going to have a unique set of insights into the Japanese market tonight.

I would like to quickly introduce the moderator. Leslie Norton is no stranger to our stage, and we have had the honor and privilege of welcoming her here on many occasions. She is the foreign editor for Asia for *Barron's,* the Dow Jones business and financial weekly. She edits an *Asian Trader* column focusing on Asian companies, analyzing their prospects from the viewpoint of U.S. investors. She just came back from Japan, I understand, where she did an intensive round of speeches and discussions with international relations professionals on the economy. So with that, I will turn the proceedings over to Ms. Norton. Thank you very much.

PANEL DISCUSSION

LESLIE NORTON
Foreign Editor, Asia, Barron's

Thank you very much. Good evening. And thank you to the Women's Bond Club, to Nomura Securities, the Center on Japanese Economy and Business of Columbia Business School, and, as always, to the Japan Society for so generously organizing this conference.

The title of our panel discussion is "Hurdles and Rewards: Navigating Japan's Financial Services Market." Before I introduce our distinguished panel to address this issue, I would like to put our discussion into context. At the moment, we have a consumer spending slowdown and a housing market contraction under way in the United States. As recently as several weeks ago, the betting was that it would not hurt world growth and equity markets badly. But that view clearly changed, and markets took a frightening tumble this week.

The big financial institutions, which employ so many of us, have taken major losses. Recently, we have seen many headlines about capital injections from a number of players, including the large sovereign wealth funds. We can obviously expect to hear more about these funds as the present $2.5 trillion in sovereign fund assets is forecast to quintuple in the next eight years, but they are merely some of the new players in what is definitely a new global landscape.

Despite the unsettling feel of today's markets, obviously the turmoil has created opportunities. No wonder all of you have been so busy lately. And indeed, this month one of the big investors in Merrill Lynch was a major Japanese financial institution.

At one time, of course, Japan was the go-to source of capital. Japan remains the world's second largest economy, but its market was one of last year's worst, and it is down by double digits this year. This is clearly no safe haven, despite the perceived value of Japanese securities. This obviously creates a set of challenges for Japan's financial institutions and big investors. There is clearly increased competition from people who can supply capital more quickly and readily.

At the same time, corporate Japan must compete for investment with the more swiftly growing big caps of the Asian Pacific. At best, Japan's market has been virtually deserted. Domestic investors prefer to buy bonds in South Africa or equities in Mumbai, and savvy global investors have used Japan as a source of ideas for short investments and the rest of the Asia Pacific for their long investments.

If certain conditions change, however, Japan could be a major opportunity for financial institutions. Japan's advantages are numerous, including its location at the heart of the Asia Pacific. For now, as Macquarie Securities pointed out today, the economic situation is far from desperate compared to the depths of 1998 or 2002, when the domestic financial system was crumbling and earnings of listed firms were negative. A drop in profits today seems like a pretty serious risk, but this comes from a starting point of record high margins and record low leverage.

Given that as a background, let me introduce the panelists who will discuss the subject for you today. Mr. Brian Kelly will look at the competitiveness of Japan's capital markets and at different investor classes. Mr. Kelly is managing partner of Asian Century Quest, and prior to founding that firm he oversaw Japan Asia from Maverick Capital.

The second speaker is Alicia Ogawa, one of the best-known authorities on Japan's financial system. She will talk about Japanese banks and how they have helped shape the current market environment and about their efforts to boost corporate attractiveness and develop a fund management industry. Ms. Ogawa is director of the Program on Alternative Investments of the Center on Japanese Economy and Business at Columbia Business School. Until 2006, she was managing director of Lehman Brothers, where she was responsible for managing the firm's Global Equity Research product.

And our third speaker is Masatomo Harigaya of Nomura Securities, who will examine global investor attitudes about Japan and the notion of Japan as a value trap. He will also address how corporate Japan can boost its competitiveness. Mr. Harigaya joined the New York Nomura office in 2006 director in International Sales. He is responsible for promoting the sale of Japanese and Asian stocks to institutional investors, hedge funds, and investment advisers.

With that, I would like to turn the discussion over to Mr. Kelly.

BRIAN KELLY
Managing Partner, Asia Century Quest Capital LLC

Thank you, Leslie. Let me give a brief introduction. I was fortunate to move to Japan in 1981 with my parents. I lived in Japan from 1981 to 1991 and actually worked at the Tokyo Stock Exchange (TSE) for a number of years during the heyday in the 1980s, when Japan's financial markets were a little different from what they are today.

And as Leslie mentioned, I am managing partner of a New York–based, Asian-focused alternative investment vehicle. We have about $1.3 billion invested across Asia, and Japan accounts for 60–65 percent of our assets, so we are quite involved in the Japanese market, but also in Korea, mainland China, and Taiwan in East Asia. Essentially, the investment thesis is that as these latter markets mature, they will come into confrontation with other more mature economies in the region, in both a beneficial, as well as a potentially negative, way.

So the economic integration of East Asia is very exciting, but it leads to creative destruction at the same time. How the different regulatory vehicles and private sector companies are able to respond to the rapidity of change we are seeing today is a topic that I am comfortable speaking about, and I will be happy to address audience questions about it.

So I have prepared a couple of remarks today on a couple different subjects. As Leslie mentioned, the competitiveness of Japan's capital market is something that I will go into, and although I am not an expert on the topic, I will offer my thoughts to the extent that they are helpful.

Let me note a couple of things. Starting around 2002 or 2003, the ability to become much more mobile by using the Internet, voiceover IP technology, and many other technologies has greatly accelerated globalization. I think that is a pretty straightforward comment that everyone can understand. But for practitioners in the financial markets, the velocity of capital moving around the globe has caused a higher correlation of different asset classes, and I think this has been observed most notably in the last couple of weeks.

But it has also caused other changes. Again, I think the statement I just made is rather straightforward, but what may not be as straightforward is the fact that 10 or 15 years ago, it was unthinkable that if you were sitting in Singapore, for example, you could very aggressively manage assets that were essentially traded in Japan. At that time the primacy of Japan as a financial center in East Asia and the Japanese capital markets were not under threat. It has been a combination of the very rapid and dynamic economic growth that has taken place elsewhere in Asia, as well as technology, that has reduced many of these distance-space issues.

The barriers to entry have effectively been reduced. I started my firm just three years ago. I can manage my portfolio using my laptop from Brazil, Hawaii, Tokyo, New York,

The economic integration of East Asia is very exciting, but it leads to creative destruction at the same time.
—Brian Kelly

or wherever I need to be. It is a fact that technology allows us to do that today much more efficiently than we could have ever imagined, even as recently as even ten years ago.

In that context we have seen the aggressive development of stock exchanges in Asia, outside Japan. The most notable examples of this are the Hong Kong and Singapore Stock Exchanges. But the Chinese are also quite determined to see the Shanghai Stock Exchange take a large role. Given the rapidity with which trading volume has developed in these other centers in Asia, they have significant momentum and have generated the key factor for most financial exchanges: liquidity. However, they do not have liquidity in Japanese assets, and I think there has been complacency in Tokyo regarding Japanese assets being traded outside Japan. Also, Japan had the largest commodity exchanges in Asia for a long time, but now those non-Japanese assets are arguably much more likely to be traded away from Japan and Asia in a way that could not have been foreseen as recently as four or five years ago.

The Tokyo Stock Exchange and the other exchange agencies in Japan are under threat.
—Brian Kelly

The rate of change is actually accelerating in this regard. I think we can expect this to continue, and the events of the last two or three weeks have yet again shown how things can be reshuffled in a way that is not necessarily beneficial for the non-Chinese elements in Asia.

If you speak to the managements of the Hong Kong or Singapore Stock Exchanges, as I have done many times, they are able to clearly articulate a strategy and discuss taking market share and growing products that do not currently exist elsewhere in Asia. And they have their sights set on products that could include Japan going forth. I think it suffices to say the Tokyo Stock Exchange and the other exchange agencies in Japan are under threat from people who are located in the same time zone in a way that was not the case four or five years ago.

This is in addition to the fact that as we go through this period of economic integration in Asia, Japan is rapidly evolving into a postindustrial society. So Japan is looking around the world for an example of a postindustrial society that does not rely on manufacturing to generate economic growth in the way it has over the past 50 years and Japan finds a place like the United Kingdom (UK). Well, the UK has seen tremendous growth in financial services and in very high wage employment, and this has had strongly beneficial implications for the UK economy. Some cynical comments could be made in that regard, given the events of the last couple of weeks, but on the whole it has been a very beneficial development for the UK.

So, as Japan comes to the realization that its industrial competitiveness is now being called into question because people in other countries will work for one-twentieth of what Japanese nationals are paid for the same work, the search for the next level of evolution continues. What is the next industry for Japan to embrace?

The answer to this question highlights the importance of Japan's ensuring that its financial markets are as competitive as possible. Accordingly, there have recently been several proposals forthcoming in addition to the piecemeal discussions over the last several years. Unfortunately, Japan suffers problems in terms of regulatory oversight; however, these are not unique to Japan. Many other countries have these same problems, but in Japan there are a number of different ministries that have their hands in the till, and they are often not on the same page. This frequently leads to a conflict between one ministry that is more forward looking and likely to address the issues, and other more tradition-bound ministries that do not wish to see their views defeated or reduced.

This conflict has perhaps slowed the pace of change in Japan, but more recently there have been some discussions about creating a comprehensive exchange that would encompass derivatives and commodities. With this, hopefully, they could raise volumes traded to a level competitive in an Asian context.

There is also a desire—at least it appears so—to create a more transparent regime. Alicia, I know you have spent a lot of time in Japan, and I am sure you encountered the opacity of Japanese regulations. There are many good reasons why regulations need to be opaque, because often there was not a clear answer. Frankly, going back to the analogy with the UK, it is the case that a principles-based regulatory regime may make a lot of sense in many situations.

Here in the United States, we follow a more rules-based approach, and we live with the pros and cons that go with it. I am certainly not saying that a principles-based approach is necessarily wrong, but a principles-based approach that is unclear in terms of outcomes until after actions are committed can easily thwart financial innovation. It creates a lot of uncertainty, and financial markets, in particular, do not like uncertainty. The events of the last couple of weeks are a perfect example of that.

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

I think Brian has set the stage beautifully for the main topic—the international competitiveness of Tokyo as a world financial center is a question of whether Japan has a consensus to maximize profit and shareholder values. Nowhere does that become more apparent than in the financial services industry, which demands entrepreneurialism and taking risk. Similarly, it requires facing the possibility that the rewards may not be distributed evenly in this kind of a game, which runs counter to the tradition upon which Japan has built its postwar economy.

Why is this important to discuss? As Brian has already touched upon, Japan will at some point have to face the reality that it is no longer the main source of economic growth in Asia and that economic power is shifting away from Japan. This is not necessarily a bad or a good thing, but the question in my mind is: does Japan want to influence the process of the shift of power, or does it want to be a passive observer?

In terms of the importance of making the domestic financial industry globally competitive, Brian mentioned the past role of Tokyo as a center for trading commodities. To give you an example of how things have changed, the Chicago Mercantile Exchange is open 23 hours a day and trades just about everything. The Tokyo Commodity Exchange is currently open six hours a day and is not allowed to trade rice futures. So there is obviously a big difference in terms of the potential market share and global competitiveness of these two exchanges.

In the case of the UK, financial services account for 12 percent of GDP. In the United States the figure is 10 percent, and in Japan it is 6 percent. I am surprised it is even that high in Japan. But in an environment of a declining and aging population and a pension fund that is under as much stress as pension funds in several other rapidly aging economies, it is obvious that moving to a high value-added services industry, such as financial services, is one way to help assuage the problems and the challenges.

One important question is: Is Japan cheap? I think it is interesting to raise the question because if one assumes that the market is cheap, then one has to ask why it is cheap and what kind of catalysts are going to appear that will increase the value of companies in the market, that will unlock the value of Japanese companies and the potential of Japanese human capital.

I have some brief comments to make about that as regards the fund management industry. But again, in gross oversimplification, the biggest hurdle is Japan's past success. I think—though some disagree—that its success was due largely to the heavy-handed guidance by the state, which provided a safe, rapid-growth economy with very few risks and equally shared rewards for everybody.

The banking industry, in particular, was essentially an arm of state development policy. Its job was to gather up consumer savings and channel them to the industries that the government identified as promising. There was absolutely no risk pricing involved, because there was no risk. There was no credit analysis, because no one was allowed to fail. It was a convoy system, so everyone shared the pain as well as the rewards, no matter how much value they were adding.

The system of cross-shareholding was built to reinforce the convoy system, but this in turn protected managements against market discipline. Corporate governance was generally accomplished by intervention from main banks and from the Ministry of Finance. To make matters worse, the banking system had incredible competition from the huge public entities, chiefly the Post Office and the Housing Loan Corporation, which at the height of its activities, owned 70 percent of the housing loan market in Japan.

There was little pricing and little transparency in disclosure of Japanese corporates because the banks knew everything they needed to know. There was no reason for anybody else to know anything. Financial innovation was discouraged because the government wanted all the banks to be equally strong. There was no incentive to take any risk because there was no reward. All of these factors contrived to protect Japanese management from market discipline.

And to put the last nail in the coffin of this argument, I wonder how many of you know how long it was that Japanese banks themselves were protected from market discipline. The very first public share issue made by a Japanese bank at a price set by the market did not occur until 1985. Until

The international competitiveness of Tokyo as a world financial center is a question of whether Japan has a consensus to maximize profit and shareholder values.
—Alicia Ogawa

that point, new share issues were allocated only to the insurance companies and other major shareholders of the banks—a kind of rights issue only to existing shareholders. It was only in 1985 that, after some of the insurance companies refused to take up new shares issued by one particular bank, the issuer went and sold shares in the market to new investors. Some people point to this new capital raising by the banks in the late 1980s as one of the factors that helped trigger the asset price bubble of that era.

So Japan has had a lot of catching up to do when it comes to market discipline, although there has been significant reform. We had the big bang under Prime Minister Hashimoto, which did things such as deregulate trading commissions on all kinds of securities and liberalize several of the business barriers between banks and brokers. Additionally, the monopoly of pension fund management, which had been previously enjoyed by the trust banks and the life insurance industry, was loosened somewhat.

Under Prime Minister Koizumi, there was privatization of not only the Post Office, but also of some of those public sector financial institutions that had been distorting prices for the private sector financial service providers. Furthermore, holding companies were permitted; the Financial Services Agency (FSA) was established; the Securities and Exchange Surveillances Committee (SESC)—the Japanese equivalent of SEC—was established, etc. But there are many remaining regulatory challenges. The tax treatment of certain hedge fund and alternative investors in Japan is very unclear and has been a barrier to development of that industry. Many Japanese "poison-pill" defenses have been put in place with little consideration for how they are really going to affect the interests of shareholders, particularly the minority level.

There is not a true professional fund management industry in Japan.
—Alicia Ogawa

I am more interested in the remaining challenges that cannot be deregulated away. Looking at the fund management industry, or lack thereof, somewhat encapsulates these challenges. There are no specific rules or laws that inhibit the emergence of a substantial and professional fund management industry in Japan, yet we see few signs of robust development. Japanese personal savings yielded 0.7 percent in 2006; 50 percent of personal savings are in cash deposits. One of the problems is that there is still too much public sector involvement in the fund management industry. Twenty-nine percent of personal financial assets are managed by the National Pension System or its cousins, and of that amount, 85 percent is in Japanese Government Bonds (JGBs). So as a consumer and a personal saver, about 90 percent of the average Japanese person's net worth is in low-risk investments.

There is not a true professional fund management industry in Japan, and I would offer a couple of possible explanations of why this should be the case, noting again that these are challenges that cannot be solved by legislation First, at the heart of the problem is the personnel rotation system, which is at the foundation of most Japanese corporate environments. People spend a couple of years in one department and then get rotated to another, rather randomly, so employees never manage to develop a specialization. Pension fund management has traditionally been where people get their last position prior to retirement.

Another issue relates to the education system. My observation, as a former manager of Japanese securities analysts, is that the education system does not necessarily encourage people to be aggressive about questioning and attacking assumptions. There are many other related challenges including the lack of cosmopolitanism and the lack of English language ability. The lack of an entrepreneurial culture has to do with many things, including low interest rates—and therefore low potential returns—and regulation. In addition, risk taking and asking hard questions were discouraged by the cross-shareholding system. What is the need to manage money actively if so much of it is held for noninvestment purposes—that is to say, it is invested principally to keep friends safe?

A fund management industry needs to develop in Japan. I think whether Japan decides to start a sovereign wealth fund is a complicated issue, but there is one benefit that has nothing to do with the proper management of foreign exchange reserves. It should be noted that the Government of Singapore Investment Corporation (Singapore GIC) kick-started that country's domestic fund management industry by giving young people real responsibilities at managing money. Singapore GIC recruited the best and the brightest from local universities and paid them reasonably well but not excessively so, on the assumption that after a bit of experience and accumulation of a track record they would quit and go out and start their own businesses. I think that is an interesting model for Japan to consider, and in a sense the Industrial Revitalization Corporation of Japan (IRCJ) accomplished something similar on a very small scale. By hiring young bright people eager for some senior management responsibility and giving them rather short-term employment contracts, the IRCJ did succeed in creating at least small pool of professional corporate managers.

Given the political paralysis inhibiting reform in Japan, fund managers can be a very important force in encouraging better asset and capital allocation. They can reward companies for transparency. They can encourage the development of roles such as chief finance officer, chief technology officer, chief restructuring officer, and investor relations officer, which, believe it or not, often do not exist in Japanese corporations today, or at least not in the way those roles are defined in much of the rest of the world. The professionalization of all these roles will encourage transparency, which will in turn lead toward better corporate governance.

Also, 60 percent of TSE-listed companies have no outside director—this is different from an independent director, which is a looser category. Three hundred and fifty companies listed on the TSE are subsidiaries of companies that maintain majority control at the parent level and that, therefore, may not be operating that subsidiary for profit maximization. In comparison, the United States only has 23 listed companies that are subsidiaries of companies maintaining majority control. I think that for Japan the challenges and hurdles for reforming the financial industry are also its reward—that is, the development of a vital fund management industry.

MASATOMO HARIGAYA
Director, International Sales, Nomura Securities Co., Ltd.

Thank you very much. Being an intermediary in the market and for foreign investors, I am in a very good position to judge the temperature, or rather the interest in, the Japanese market. At this moment, as the market suggests, interest is very low. And this is very sad to see for a Japanese specialist in sales.

I want to discuss the corporate attitude with respect to making the Japanese market attractive again. Nomura, for example, has taken the initiative to host nearly 150 investor relations (IR) activities in the United States and probably more than 200 in the United Kingdom. The attitude most commonly portrayed by Japanese corporates to investors has been far from ideal. Japanese individual and institutional investors consciously or unconsciously understand that Japanese corporates are not friendly to them. Many of my clients are asking me when Japanese investors are going to come in to the Japanese market. I think the answer is probably not until the Japanese corporates change their attitudes toward shareholders.

Japanese individual investors are said to be very risk adverse, but I do not think so. There have been many recent examples of Japanese individual investors going for exotics. "Mrs. Watanabe" is a term used to describe the ordinary housewife who makes investments with the family's savings. These are increasingly becoming higher risk investments, such as leveraged FX trade. Certain individuals are even taking travel tours to Dubai or Hong Kong to open a stock trading account.

Such attitudes are most likely the exception, but I still think individual investors are not as risk adverse as they are portrayed to be. At this moment, for many individual investors there exists a bipolarization of their assets. On one hand, they have more than 50 percent of their assets in a bank safe deposit, and on the other hand, with the remaining portion, they make very risky investments.

So I understand that the middle-risk, middle-return type of investment management companies are need, as Alicia mentioned. And this includes pension fund management as well. If a Japanese blue-chip company is paying a constant gross dividend, what is the attitude most likely going to be? At the moment, thanks to the share price decline, the dividend yield of many companies is hitting more than 2 percent, which is basically 70 basis points more than the Japanese Government Bond (JGB).

At Nomura, we recently created the type of fund called "My Story," which basically secures income gain while seeking a modest capped appreciation. My Story attracted 2 trillion yen immediately, which means that many Japanese individual investors are in need of this type of product—middle-risk, middle-return.

When hosting IR activities for Japanese corporates, the management always tells investors that it tries to achieve a stable dividend policy—it does not want to increase the dividend payout on a sunny day or decrease it on a rainy day. However, many investors feel oppo-

> *The attitude most commonly portrayed by the Japanese corporates to investors has been far from ideal.*
> *—Masatomo Harigaya*

sitely—they want to receive a better dividend when it is sunny, and they will probably accept a lower dividend when it is rainy.

The Japanese return on equity (ROE) has been increasing over the last five years or so, and, interestingly, if you break down the ROE, the improvement has been at the margin. Capital efficiency has actually deteriorated, so paying a generous dividend is one of the ways to improve capital efficiency.

Nomura is prompting foreign investors to say these types of things to Japanese corporates, but pressure from foreign investors alone is not enough. In order to create the required pressure on Japanese corporates, we need a proper Japanese asset management fund and better pension managers.

So in that respect, I agree with the establishment of a Japanese sovereign wealth fund. If Japanese people themselves exert pressure on Japanese corporates to be more shareholder friendly, then Japan is going to be able to attract capital. Thank you very much.

I do not see any examples of the Japanese financial industries really going global and making it pay off in a big way.
—Alicia Ogawa

QUESTION & ANSWER

LESLIE NORTON

I have a question to start off with. Mizuho Bank's $1.2 billion stake in Merrill Lynch was the biggest international move by a Japanese bank since 1986, when Sumitomo Bank bought a $500 million stake in Goldman Sachs. Should we expect to see more Japanese banks investing abroad in this way? Are there opportunities for Japanese financial institutions abroad?

ALICIA OGAWA

Those may be two different things. They may acquire overseas assets, but the question is whether it is a good opportunity for them; the answer is yes. The challenge is, however, that historically, Japanese banks have not had good experiences franchising the local operations into the head office. Thinking of all the Japanese financial institutions, the only major one I can think of that is remotely global is Nomura. It has had longstanding operations in London and the United States, but I am not sure how well integrated those operations are with the head office.

The manufacturing industry has done a splendid job of bringing the best practices from Tokyo into the United States and other places, and vice versa. So when you look at the car companies and the electronics companies, it has been wonderful. But I do not see any examples of the Japanese financial industries really going global and making it pay off in a big way.

There is one smaller institution I can think of, Orex, which has really done a good job going global. But this is a very special case, and I am not sure Orex is really a Japanese organization. Japanese financial institutions will be making overseas acquisitions, but the challenge will be to see if they can do a better job devolving authority to the local managers and making these operations a vital and long-lasting part of the organization.

LESLIE NORTON

Is it a good idea for Japan to create a sovereign wealth fund? Is it something that you expect to happen?

BRIAN KELLY

The sovereign wealth fund idea has certainly been talked about in Japan with all the related activity that has taken place in the last year or so. The Japanese government, as far as I understand, has pretty much come out and said that it is not interested in active investment. It intends to remain largely in US Treasuries, even short-term Treasuries, to some extent. It is my understanding that it is not likely to develop.

However, I was intrigued by Alicia's comment that to some extent a sovereign wealth fund may foster a rebirth of the Japanese domestic fund management industry. From that particular perspective, it is a great idea. And indeed, the Korean government, which sits on about $200 billion, is going precisely in that direction. The experience of Korea over the last couple of years is very interesting in the sense that it shares many similar societal and financial sector structures with Japan. At the peak, in the first or second quarter of 2005, foreigners owned 45 percent of the Korean equity market. And so the Korean government wanted to create a domestic fund management industry to buy some of the equity market back. In order to do this, it decided to raise capital by putting together a pretax savings account, like a 401k, funded by mandatory deductions at the income source.

Japan has been dithering on the notion of making a 401k take hold for, I think, more than 15 years now. In the space of two and a half years the Koreans have bought back 20 percent of their entire stock market, and the market has appreciated tremendously over this period. Mirae Asset Management is a financial institution in Korea that basically did not exist five years ago and today is a very large, domestically oriented institutional investor in Korea. Over the period of about three years, Korea has developed a domestic institutional investor class that did not previously exist. The fund flows into the industry continue.

QUESTION

With the recent implementation of the financial instruments exchange law, how do you expect the implementation of those new rules to potentially create unintended consequences in the movement of your capital within Japan? To the extent that you can invest in equities in Japan, how do you get your money out?

BRIAN KELLY

There still seems to be a lack of transparency with these regulations. That is the problem. There have been three or four major initiatives, including the one you referred to, and it looks like they are taking a step in the right direction. Unfortunately, it ends up being a trial balloon, and trial balloons have a history of getting shot down by a fiefdom that is not responsible for direct oversight of that area.

I would like to think that progress can be made in that regard. I think consolidation of the stock exchanges in Japan is good, but it should have happened a long time ago. It is a high fixed cost business, but costs can be reduced, and there are all kinds of costs that can come out through consolidation. At the end of the day, it is not that big a market, so there is no excuse not to do a lot of this.

I am a little skeptical of the government's desire to welcome lots of hedge funds. It is informative to note that in one of the most emerging markets in the world, India, the Securities and Exchange Board of India (SEBI) just announced it is going to allow short selling. That is a big step forward, and it is fully of the view that hedge funds can contribute to the reduction of volatility because they are often on the other side of many of the trades in the market.

So even the Indian government is coming to the conclusion that it is very worthwhile to permit alternative investment forms of fund management. I am sure a few fund brokers nudged the Indian government on that path, but I would say that the Japanese government still needs to recognize that this is clearly in its best interest to do. We are still a couple steps short of that realization.

QUESTION

When I think about the fund management business and how it developed in the United Kingdom and the United States, insurance companies played, and continue play, a central role in investment management activity. What are the impediments, if any, to the insurance industry in Japan's becoming a leader in this area?

ALICIA OGAWA

There are no regulatory impediments. But if big fund management companies—including the insurers—have historically held shares in order to cement friendly relationships, rather than to maximize the profit of that portfolio, then the fund manager is not really managing money. He or she is managing relationships. Accordingly, until very recently, the fund management department has been where a person retires, because it has not required a specific skill set.

But there are some insurance companies, including Daido Life, that are leading the way in terms of alternative investments. But again, it comes down to whether fund managers get compensated for the returns that they generate. Right now they probably do not. Is there a business school education available in Japan for securities analysts? No. I visited the financial program at Tokyo University in December, and I was told that even there they could not recruit or identify someone to teach a securities analysis course.

BRIAN KELLY

It certainly is the case that insurance companies play a very important role. They have long-dated liabilities and, therefore, they are looking for assets with long duration, and equities are the longest duration assets out there. The problem in Japan is a lack of dynamic asset reallocation occurring in the Japanese asset management market. Many people ask, are Japanese equities cheap? The answer is that Japanese equities are extremely cheap.

To define cheap, just look at the U.S. Federal Reserve model, which looks at the earnings yield—basically the inverse of the price earnings ratio (PE). The answer in Japan is 6 or 7 percent right now. And a 10-year bond yields a risk-free rate of 1.3 percent. There is no other country in the world where you see prices this out of alignment.

Putting aside the discussion of what a deflationary environment can do for correlation of those asset classes—which partially explains this mismatch—these

Many people ask, are Japanese equities cheap? The answer is that Japanese equities are extremely cheap.
—Brian Kelly

equities are still extremely inexpensive. The market is basically saying: "Here is an asset that yields 7 percent. Here is an asset that yields 1.3 percent. I am so convinced that I will get a minimal amount of that 7 percent that I would prefer to have this 1.3 percent, which admittedly has lower volatility."

That is an incredible tradeoff, but what you need are people in the market who have a longer duration liability structure, like life insurance companies, who may not know where the next two weeks are going but probably know where the next two or three years are going and can weigh accordingly the upside of an asset that is yielding 7 percent versus a bond at 1.3 percent. This is not currently happening and represents an important dysfunctional aspect of the Japanese financial markets.

The insurance companies can play an enormous role in correcting this injustice, but there are reasons they do not do this. There are relationships that are driving where those asset allocations go. That leaves it a very attractive market to foreign investors, which is why foreigners are so active in the market. But until that value proposition can be recognized as an asset reallocation out of fixed income, yielding 1.3 percent, and into equities with earnings yield of 7 percent, the mechanism is still broken.

A more practical way of education is needed for Japanese university students.
—Masatomo Harigaya

QUESTION

My question is for Harigaya-san. You have talked about what is happening with the financial capital in Japan. I would like to know what is happening with the intellectual capital, particularly young people. Where they are going for employment?

MASATOMO HARIGAYA

This is a very good question, but it is very difficult to answer. Some young graduates are choosing not to have a full-time job. That is partially because they do not know what to do after graduation or they do not desire the career path offered by the Japanese corporates. Lifetime employment is prevalent in Japan, although it is gradually fading.

For the financial industries, we need more attractive options to entice the best of these graduates. One thing would be to create a little more freedom with respect to career path. I have been with Nomura for about 12 years, and I have mobility within the company thanks to the corporate company's management. I think that offering this freedom is necessary for attracting young human capital.

And also, the educational system in Japan may be part of the problem. A more practical way of education is needed for Japanese university students so that they will know at least vaguely what kind of work is done in the financial industry. When I entered Nomura, I did not know much about the industry or the function of my company.

PHILIPPA GIRLING

Global Cohead, Operational Risk, Nomura Holdings America Inc.

My name is Philippa Girling. I am the global cohead of Operational Risk at Nomura Holdings America. Thank you all for joining us this evening for such an exciting panel discussion. I want to personally thank the Japan Society for providing the wonderful facilities for this evening's event, and Columbia Business School's Center on Japanese Economy and Business for providing the summary of the event, which will be available online soon.

We at Nomura are delighted to be hosting our first Women's Bond Club event. We took on corporate membership with the Women's Bond Club just over a year ago, and we are proud to be the first Japanese financial services firm to do so. In the past year we have benefited greatly from the learning and networking opportunities that the Women's Bond Club has offered, and as a result of this new relationship, we have also started our own informal network internally.

Whether we are in times of recession or growth, opportunity, challenge, or volatility, networking is a valuable resource, and we are delighted to be part of the Women's Bond Club. Please join us now for the Nomura-sponsored networking session upstairs and take this opportunity to meet with panelists and your peers to discuss this evening's topics further. Thank you very much.

課題と恩恵：日本金融サービス市場の舵取り

（抄訳）

日本は現在、地域的、国際的な金融市場の競争に関し、多くの課題に直面している。香港、シンガポール、上海の株式市場との激しい競争に対処しなければならないだけでなく、日本自身の過去の経済的成功の名残も克服しなければならない――主たるものとして、金融革新を抑え込み、市場原則から日本的経営を保護してきた株式持ち合いの戦後システムがある。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小川アリシア氏が指摘したように、根本的な問題は、日本が利益と株主価値を最大化させるというコンセンサスを持っているか否かということだ。金融サービス（セクター）部門はこの課題を象徴している。それは、起業家精神と冒険心とを必要とするからである。

小川氏が説明したように、重要な規制改革やまだやるべき事が山積する間は、活発な資金運用業界の発展に対する多くの障害が、立法によってなされることはない。小川氏は、企業の人事異動制度、教育制度の価値、そして、輝かしい若い才能に十分な責任と報酬を与えることを渋る企業の姿勢を、本気で取り組むべき重要な課題であると強調した。

アジア・センチュリー・クエスト・キャピタル社のブライアン・ケリー氏は、テクノロジーがどのようにしていくつかの有力な東アジアの金融センターの発展を可能にしてきたかを明確に述べた。ケリー氏はまた、経済成長を製造業に頼ることの出来ない脱工業化社会に、日本が、急速に発展してきたことによって、日本は、自身の金融業界における競争力を確かなものにしなければならない、と強調する。従って、商品や金融派生商品を網羅する包括的な為替制度を作り上げることを日本は最後までやり遂げなければならないし、それによって、取引量を増やすことが出来る、とケリー氏は述べた。加えて、規制監督を改善していくことが必要であり、また、透明性は、金融革新の促進するため、成果の十分な確実性を許容していかなければならない規制制度の重要な側面であると指摘した。

米国野村證券の針ヶ谷真朝氏は IR の重要性を論じ、もし、日本市場が更に投資を誘致するのであれば、日本企業は株主に対して好意的にならなければいけないと説明する。「ミセス・ワタナベ」現象やエキゾチック投資の増加傾向に言及しながら、すべての日本人個人投資家はリスク回避傾向にあるという考えに疑念を示した。また、多数の個人による投資の二極分化と、それ故に、ミドル・リスク、ミドル・リターン商品の必要性を指摘した。更に、利益が高い時に配当分配を増加 することは、資本効率向上の1つの方法だと述べた。

本イベントは 2008 年1月 23 日にジャパン・ソサエティが主催し、ニューヨーク女性証券クラブとコロンビア大学ビジネス・スクール日本経済経営研究所、そして野村ホールディングス・アメリカの協賛により開催され、約 200 名が出席した。

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