

# Emerging Stock Markets in Shakeup Prompted by Overcrowding, Prolonged Slump

By *Katsuhiko SAKAI*

**NEO**, Hercules, Q-Board, Ambitious, Mothers, Centrex and Jasdaq...If you know what they have in common, it is fair to say you are well versed in the Japanese economy. The last name may remind you of something familiar. You may suspect Jsdag as a Japanese version of Nasdaq. Correct! All these seven names are those of stock markets for emerging companies in Japan, listed in a reverse chronological order. There is another thing common to the emerging equity markets — their respective independent survival is doubted amid sluggish trading. Their realignment has become an urgent challenge for Japan's securities industry.

## 7 Markets at 6 Exchanges

Jasdaq, which boasts the longest history and the largest number of listed companies among the seven, originated from an over-the-counter stock trading system that the Japan Securities Dealers Association (JSDA) created in 1963, when the first venture boom came on a

fast increase of emerging companies amid high economic growth. The system then was simply an auxiliary market where shares in small companies falling short of meeting requirements for listing on stock exchanges were traded over the counter at securities companies. Nevertheless, the over-the-counter stock market alone has provided investors with opportunities to meet promising growth companies for more than 40 years.

A turning point for the Japanese securities industry came in the second half of the 1990s when the Japanese version of Britain's Big Bang financial market deregulation started. In the securities industry, regulations were eliminated or eased to encourage Japanese companies to shift their fund-raising focused on indirect means — bank loans — to direct fund-raising from the market. Then, the Japanese economy was in the midst of a long slump after the burst of economic bubbles, leading to growing calls for industrial restructuring through the development of venture companies.

Against that background, stock exchanges launched emerging-company markets one after another. In 1999, the Nagoya Stock Exchange created the Centrex market and the Tokyo Stock Exchange (TSE) established the Mothers market. In 2000, the Osaka Securities Exchange (OSE) formed an alliance with the US Nasdaq market to set up Nasdaq Japan. Then, the Ambitious market was born at the Sapporo Securities Exchange and the Q-Board market at the Fukuoka Stock Exchange. In 2001, the JSDA assigned its Jsdag Market Inc. unit (now known as Jsdag Securities Exchange Inc.) to running the over-the-counter market.

As Nasdaq withdrew from Nasdaq Japan in 2002, the OSE renamed the emerging market Hercules. Jsdag acquired the stock exchange license in 2004 and created the NEO market in 2007 for companies with new business models. At present, Japan now has seven emerging markets at six exchanges, becoming a rare country with such a large number of emerging markets.

## Harmful Effects of Excessive Competition

As a matter of course, the large number of emerging markets forced them to wage a fierce competition for their respective survival at the cost of investors. They tried to increase listed companies so desperately that these exchanges' screening of initial public offering (IPO) applicants grew laxer. As a result, some companies that lacked business bases or executives suitable for publicly traded firms made IPOs for listing on these exchanges.

Falsified financial statements, window-dressed earnings reports, relations with antisocial forces and other problems began to surface in 2005 for companies listed on these emerging markets. Coming in January 2006 was an event

Photo: Kyodo News



Passers-by glance at brokerage bulletin boards showing the 11th straight day of decline in Tokyo stock market prices on July 3, 2008, the longest uninterrupted drop in 54 years.

**Table Overview of emerging markets** (as of the end of May 2008)

Market	Date of founding	Number of listed companies	Market capitalization (¥1 Bil.)
<b>Jasdaq</b> (Tokyo)	<b>Feb. 1963</b>	<b>949</b>	<b>11,983.8</b>
<b>Centrex</b> (Nagoya)	<b>Oct. 1999</b>	<b>32</b>	<b>83.4</b>
<b>Mothers</b> (Tokyo)	<b>Nov. 1999</b>	<b>198</b>	<b>2,166.9</b>
<b>Ambitious</b> (Sapporo)	<b>April 2000</b>	<b>12</b>	<b>17.4</b>
<b>Hercules</b> (Osaka)	<b>May 2000</b>	<b>172</b>	<b>1,580.5</b>
<b>Q-Board</b> (Fukuoka)	<b>May 2000</b>	<b>10</b>	<b>6.9</b>
<b>NEO</b> (Tokyo)	<b>Aug. 2007</b>	<b>4</b>	<b>38.5</b>
<b>Nasdaq</b> (US)	<b>Feb. 1971</b>	<b>3,009</b>	<b>443,382.4</b>

Source : Data from respective exchanges

that seriously deteriorated investor confidence. Executives of Livedoor Co. were arrested for their alleged fraud after the Internet company attracted public attention through its high-profiled attempts to acquire a professional baseball team and a major television broadcaster, and took advantage of frequent stock splits to raise its stock price and achieve the largest market capitalization on the TSE Mothers market. The popular company's questionable practices prompted investors to dump shares in wide-ranging businesses. The "Livedoor shock" forced the Mothers market index to lose more than 10% for two consecutive days, sending all emerging markets on a roller coaster ride from hell.

### Jasdaq to Merge with Hercules

Emerging markets have shown no sign of full recovery over two years and a half since the debacle. At the end of June this year, the Jasdaq stock index was at only half the level before the Livedoor shock. Indexes on the Mothers and Hercules markets were a quarter of their respective before-shock levels. Their slack performances have led to plunges in IPOs. Many IPO companies have seen their first market prices slipping below their respective IPO prices. Share prices of some companies on these markets continued to decline, forcing the firms to be delisted from markets due to insufficient market capitalization.

A panel at the Ministry of Economy, Trade and Industry released a report in April warning that venture company owners were hesitating to implement IPOs that could not be expected to bring about fund-raising planned for investment needs. "Emerging markets in Japan are far more and smaller than in any other country," the panel said. "Each emerging market should reconsider its own role from such perspectives as market size, international competitiveness and market efficiency." The panel was concerned that emerging markets' shrinking financial intermediation could endanger the regeneration of the Japanese economy.

Recently, however, a breakthrough has emerged. Following twists and

turns, the Osaka exchange has decided to acquire the Jasdaq Securities Exchange, the largest Japanese emerging market. On a prolonged slump in stock trading, Jasdaq posted a loss in the year to March 2008 for the first time ever. The Osaka exchange plans to merge Jasdaq with its Hercules emerging market in two years. Jasdaq President Takashi Tsutsui emphasized the effects of the merger. "The greatest advantage would be cost reductions and effective utilization of human resources through the integration of trading systems."

### Pursuing Big Market Close to Nasdaq

The planned merger of Jasdaq and Hercules has stimulated discussions on realignment of the Japanese emerging markets that have agonized over how to attract investors. This is because securities industry people have acknowledged a fierce competition between similar small markets may fail to invigorate investment in startup companies. The JSDA has indicated a plan to create a panel to intensively consider how best to reform the emerging markets. It hopes the panel will draw up recommendations in one year.

An ideal model under consideration by many securities industry people is Nasdaq, the world's largest venture market boasted by the United States where venture companies prosper. The reason Microsoft Corp., Intel Corp. and other famed companies stay on Nasdaq is that the market features high liquidity stem-

ming from its large size and dominance by institutional investors.

The Japanese emerging markets, where the market capitalization of each issue is small, are too small to be liquid for institutional investors. Individual investors dominate transactions on these markets. This is the reason many companies that have grown through Japanese emerging markets such as Jasdaq move to the Tokyo exchange to emphasize themselves as leading businesses. If any Japanese emerging market were to prevent companies from fleeing to the Tokyo exchange, it would have to create a mechanism to attract institutional investors.

As a matter of course, any large-scale realignment involving the Sapporo exchange's Ambitious, the Nagoya exchange's Centrex and the Fukuoka exchange's Q-Board as well as Jasdaq and Hercules would not be easy. This is because consolidation of these emerging markets could develop into the question of whether regional stock exchanges should be eliminated. In fact, regional stock exchanges have been determined to remain independent under their respective goals of developing regional businesses. But the Jasdaq-Hercules merger could spur a greater-scale realignment of emerging markets. "If a dominant emerging market is born, the others may move to join it," said a JSDA executive.

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