The Specter of a Bear Is Haunting the World of Investment

By Kazumasa Kusaka

The G7 powers have entered into a holy alliance to exorcise the specter of the bear that has emerged from the pronounced risks to the global economy. Heightened political uncertainties, concerns about the effectiveness of monetary policy stimulus in some advanced economies, the pace of monetary policy normalization and policy-makers' ability or willingness to use expansionary fiscal measures if needed are mentioned in "Global Economic Prospects" (June 2016) issued by the World Bank.

The Ise-Shima G7 Summit in May saw some divergent views on how fragile the economy really is. Of course, governments have many roles and preparing for worst-case scenarios is one of them, but also they themselves are players in the market economy not only in terms of policy resources but as communicators. When they voice a too bearish view, that message itself might well undermine the confidence of consumers and investors. So the final summit communique wording was well balanced in tone by reiterating the G7 leaders' commitments to strengthening their economic policy responses in a cooperative manner and to employing a more forceful and balanced policy mix in order to swiftly achieve a strong and balanced growth pattern.

Over the past couple of years, we have heard the question of why businesses do not respond to prevailing low interest rates and the availability of abundant cash. This is a dilemma for policy-makers. To a lesser degree a similar question about why consumers are not willing to spend more is being asked. When looking at why business investments are not increasing, there may be a need to understand the geopolitical risks, such as a surge of nationalism in the world and terrorism by IS or other radical political groups. However, in the context of post-financial crisis aftereffects, can Japan's experience of its two "lost decades" offer some interpretation and lessons on this?

Some big business executives say that without an assurance about the current availability of low interest money, coupled with the uncertainty of sustainable economic growth, it is difficult to initiate "high-risk, high-return projects", and there are numerous subsequent reasons why they do not invest. Analysts name this phenomenon "lack of animal spirits syndrome". Why has this risk-averse contagion developed, notably in Japan, but also in other advanced economies?

One plausible explanation is that during the quarter of a century following Japan's post-bubble financial crisis businesses have simply muddled through, containing their non-performing debts and overcapacity of supply facilities and human resources, and by this process the most successful in cost cutting and divestment have survived — the principle of the survival of the fittest. Taking a leap into the dark has never been their trait.

One of my favorite reading assignments for my students is *The Innovator's Dilemma* by Harvard professor Clayton M. Christensen. A key message of the book is that most disruptive technological or business model innovation takes place not from within the big established organizations that enjoyed success in the wake of the last war, but from SMEs and ventures quite often belonging to different business fields.

This point leads to the strategic importance of diversity in management. If the management team consists of in-house professionals from the start of their career, of the same nationality and mainly the same gender, as has been the case in most Japanese businesses, it will be difficult to introduce a new perspective. Recent developments in the corporate governance code and the accompanying introduction of independent outside board directors herald changes in this area.

The social demographics of Japan are facing the challenge of an aging population combined with a diminishing number of children, but in corporate Japan the same applies with serious affect. We need a much higher birth rate of enterprises, even with a much higher turnover, and a greater willingness to take up challenges again after initial failures.

In North America and Europe, the post-financial crisis aftereffects seem to have had similar consequences due to damaged balance sheets and also to the malfunctioning of financial institutions. Pressure from institutional investors worldwide for high returns on equity continuously encourages CEOs towards short-term, less risky investments, which is in turn contradictory of what global policy-makers are pursuing as their goal, the increase of long-term investment.

"Abenomics" and other traditional policy measures may help lead a horse to water, in the sense of encouraging a business environment that favors private investment, but you still cannot force him to drink. It is up to businesses to make decisions on investment by themselves. Of course, questions remain over whether the current policy packages of major economies really help lead businesses to the water at all.

Improvement in the business and investment environment, such as through increased transparency in domestic policy measures and through FTA negotiations in emerging economies, has opened the door for increased corporate investment to targeted markets, replacing exportation from the country where the headquarters is located. So an alternative interpretation is that investment is taking place, not in the advanced economies but in developing economies. Taken as a whole, this might work for the global economy.

We at the Japan Economic Foundation are interested in discussing in future fora how to overcome this "lack of animal spirits syndrome", as well as the importance of diversity, learning from the success of Silicon Valley and other areas where the corporate birthrate is high.

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