Sea Change Looming in Makeup of Japanese Shareholders

– Online Trading Dramatically Boosts Number of Individual Investors –

Interviewer: Okabe Hiroshi

THE composition of shareholders in Japanese businesses is undergoing a drastic change for two major reasons. First, stock trading via the Internet has spread widely, leading to a sharp rise in the number of individual investors. The other factor is attributable to the strong growth of merger and acquisition (M&A) activities among Japanese companies. Matsumoto Oki, founder and CEO of online securities company Monex, Inc, who was once a general partner of Goldman Sachs, speaks about the background and outlook for rapidly growing online trading in Japan.

"Robust Growth of Online Trading Is Not a Craze"

The Tokyo Stock Exchange is going through an unprecedented boom. The current bullish atmosphere stems in part from active stock investment by individual investors riding on the bandwagon of online trading. How do you assess the current situation on the online trading front?

Matsumoto: There are two main trends. For one thing, the so-called day traders are boosting daily transactions on the strength of their daily capital gains thanks to the favorable market undertone. The other factor is that people who used to deposit their money at banks have begun to lose patience (with low returns on deposits) after seeing surging share prices, which sometimes increase 20% annually. Some people had hesitated to visit brokerage houses and open securities accounts. The launch of online trading has now encouraged such ordinary people to invest in stocks via the Internet as they can trade without an intermediary. These two trends are gathering momentum these days.

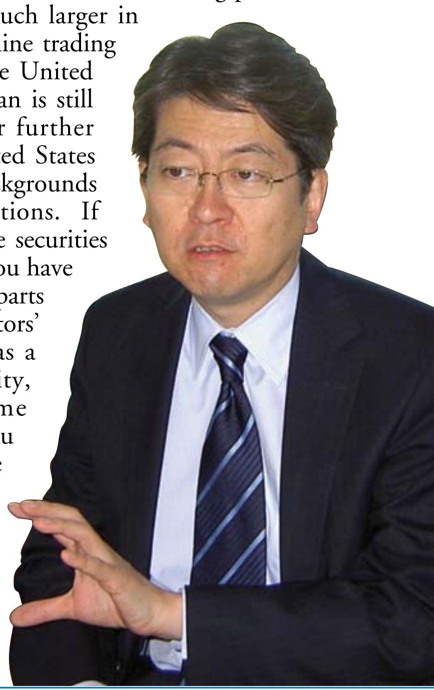
Although fostering a greater number of individual investors has been a longstanding issue, palpable results have not been achieved up until now.

Matsumoto: The government has taken the initiative in helping businesses shift to direct financing from indirect financing. During the age of high-flying economic growth with an increasing population, nurturing individual investors was not an urgent task. Today, however, a population decline is just around the corner. Once the population ceases to grow, economic expansion also comes to a halt. People cannot just sit and see their wages unchanged for years. Naturally, winners and losers will be created in the society. As a result, the economy will shift from a socialistic economy to a capitalistic one. Such a structural change lies behind the growth of individual investors. These factors alone are not enough to push individual investors into action. They do not start trading as long as ways of investment remain inconvenient and complicated. Online trading has played a role of lowering the hurdles for them and made it possible for individuals to transact stocks easily even at night without intermediaries after finishing their work at offices. The analysis of those factors indicates that the activated moves by individual investors are in no way construed as a temporary bubble but stemmed from a sweeping structural change.

"Basis for Online Financing Exists in Japan"

The United States is well ahead of Japan in online stock trading. What differences exist between the two countries?

Matsumoto: Stock investors account for about 40% of the total US population, compared with around 5% at most in Japan. By contrast, about 50% of US stock investors engage in online trading while such investors account for approximately 90% in Japan. Seemingly, Japan's online trading ratio is much higher than in the United States but the size of the trading pie involving individual investors is much larger in the United States. While online trading seems to have matured in the United States, the trading pie in Japan is still small and there is room for further growth. Japan and the United States also differ in the cultural backgrounds concerning financial transactions. If you want to launch an online securities service in the United States, you have to set up branches in various parts of the country to obtain investors' trust. In contrast, Japan has a kind of believable community, once your name has became widely known in Japan, you can win investor confidence without branches. In that sense, there exists a background that enables online financial trading to grow with ease.



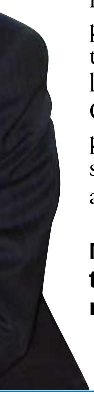
What outlook do you predict for online financial trading?

Matsumoto: Japan is a monocultural country. If you seek to do business in Europe, you will face various difficulties stemming from diverse languages and interests among people. In the United States as well, there are time and cultural differences between regions. In Japan, however, people speak the same language and are seeking matters of similar interest across the country. Such a cultural background is most suitable for the spread of online trading. Japanese society is highly compatible with the Internet, from the fact that you can dispatch information from one site without considering regional differences. Meanwhile, finance is compatible with the Internet as it does not involve the delivery of goods. Almost all retail financial transactions can be done if you are connected to the Internet. In view of the combination of high compatibility between the Internet and Japanese society, and between the Internet and finance, I believe the Internet could significantly change the financial structure and financial trading in Japan. If existing financial services are shifted to the Internet, the number of employees in the financial sector will fall substantially. It may take a long period of time to carry through reform involving a steep decline in the number of employees.

"Corporate Managers Are Not Allowed to Stand Idle"

The composition of shareholders in Japanese businesses is changing, reflecting activated investment by individual and foreign investors, and the structure of cross-stockholdings between companies has collapsed.

Matsumoto: Joint stock corporations in themselves exist for the sake of stakeholders. In Japan, however, such companies had tended to give priority to their relations with intermediate organizations rather than to raising their corporate value in the interest of their shareholders. This is mainly because cross-shareholdings served as intermediate organizations. The question of how to maximize shareholder value has now become a focal point through strict surveillance by the increasing individual investors. This in turn has left no room for corporate managers to stand idle. Previously, many Japanese business corporations had prioritized increasing internal reserves rather than dividends to secure bank loans. The idea that companies exist for a society and infrastructure development such as creating parks and roads is more important than paying out profits to the shareholders is not acceptable today. The practice of not looking toward shareholders no longer pays off today. Corporate managers have had no choice but to change their philosophy in favor of attaching importance to the interests of shareholders in the context of a trend shift from a socialistic to a capitalistic economy.



M&A activities are gathering momentum amid a growing trend of shareholder-oriented capitalism. An increasing number of stockholders have begun to seek managerial reforms of companies after becoming major shareholders by purchasing massive quantities of shares.

Matsumoto: Japan is perhaps the largest M&A powerhouse in the world today – eclipsing the United States both in number and frequency. Even though such moves as purchases of large amount of corporate shares by investment funds are obviously excessive, I think Japan's investment picture has only got off balance as the country goes through a period of transition to a capitalistic economy. It is moving in the right direction by seeking a shift to a capitalistic economy from a socialistic economy and excessive moves should be tolerated to some extent.

"Hostile Takeover Bids May Have Problems"

Many Japanese business executives are concerned about the rapid spread of M&A deals in Japan. The government has put off for a year the implementation of a "triangular merger"* – a special measure designed to make it easier for foreign capital to acquire Japanese companies. The action was apparently made in response to such concerns.

Matsumoto: Foreign investment in Japan is increasing, but compared with other industrialized countries, the scale of such investment is extremely small. Therefore, even if foreign investment in Japan went a bit too far, we should consider it acceptable. The government's decision to delay the implementation of the triangular merger can be seen as an over-reaction regrettably enough. I have doubts about the hostile takeover bids now underway in Japan as well. Corporate mergers can be compared to human marriages. In case of conditional linkups, such ties can be broken off if the partners are to blame. Once corporations have merged, however, the problems of the partner become those of your own. Corporate mergers should be carried out on the condition that first of all, executives of the two companies agree to work together, and then hold talks on what to do with capital and ways of managerial integration. A wave of hostile takeover bids took place in the United States more than 20 years ago – between the latter half of the 1970s and the first half of the 1980s. In retrospect, however, such practices turned out wrong.

Every time a high-profile M&A case occurs, it highlights that Japan lags behind in the creation of basic rules on takeover bids and disclosure of information. Japanese system reforms cannot catch up with realities, like a cat-and-mouse chase.

Matsumoto: In the United States, those who once played major roles on Wall Street later join the government and make rules. In Japan, however, bureaucrats make and change systems while court judges with little knowledge about financial deals hand down decisions. Such a mechanism itself is questionable and such a system and structure represent Japan's weakness. JS

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*Note : The triangular merger permits a kind of stock swap involving a foreign parent company, its Japanese subsidiary and a targeted Japanese business.