Bookshelf

Unequal Equities

—Power and Risk in Japan's Stock Market

By Robert Zielinski and Nigel Holloway
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This work is an analysis of the Japanese stock market by two non-Japanese observers. It is both general summation and scathing criticism.

Coming from a background in nuclear engineering, including time spent with a Japanese firm, New York-born Robert Zielinski has been a securities analyst in Tokyo for nearly a decade. He was one of 11 non-Japanese ranking among the top industry analysts in the *Nihon Keizai Shimbun*'s 1990 poll of institutional investors. London-born Nigel Holloway has worked as a journalist in the Amazon jungle and other sites throughout the world. He is currently business editor for the *Far Eastern Economic Review* in Hong Kong.

While the "unequal" in the title obviously means that the Japanese market differs from those in other countries, it also carries implications that the Japanese market is unfair. The main cause of this unfairness, the authors say, is the extensive cross-holding of shares. About 70% of all shares issued by listed companies are held by financial institutions or other companies. In effect, Japanese companies are holding each other's stock.

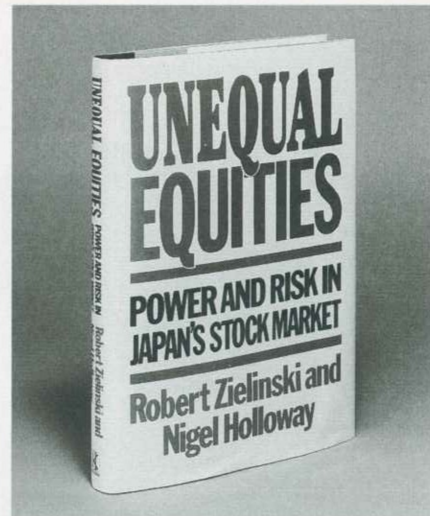
This cross-holding, they say, works to entrust management to the incumbents, with the result that the Japanese economy and stock market are structured conducive to the effort to maximize only the corporation's own profits. And because there are not enough floating shares to enable anyone to gain voting control through the market, Japanese companies are basically impervious to hostile takeovers. Freed from market pressures, Japanese managements do not need to pay strong dividends or to worry excessively about the current quarter's return. Instead, they are free to concentrate on risky investments and on adding value to their products. In short, corporate Japan is free to ignore the interests of stockholders and consumers alike.

Because of this cross-holding, the authors continue, stock prices are also inequitably set—as might be expected when shareholders hold their shares for reasons having nothing to do with dividend return on investment. Cross-holding thus means that stock prices are divorced from economic fundamentals—and that the Japanese stock market necessarily fails in its basic function of ensuring that companies are valued on the basis of their share price and that capital is optimally allocated. And because investors have no hope of any appreciable dividend, they are driven to seek short-term capital gains.

In addition, the authors contend, the small number of floating shares makes the Japanese market particularly vulnerable to price manipulation. Thus cross-holding is also implicated in the high price of Japanese shares—and the distortions that it has induced are cited as a cause of the market's collapse in 1990.

The extensive scandals rocking the Japanese financial world had not yet come to light when this book was written, yet it speaks eloquently to the eddying debate about structural flaws in the Japanese market. The oligopoly of the Big Four (Nomura, Daiwa, Nikko and Yamaichi) has, they say, combined with cross-holding to ratchet Japanese share prices higher and higher and hence to enable Japanese companies to raise new capital at very low cost. Through it all, the Ministry of Finance has protected and coddled the securities companies, not only shielding them from competition but defending the fixed-commission system that guarantees them massive profits. If the Japanese stock market is to be made equitable, they contend, it has to be reformed along American lines. There is nothing particularly new in this analysis. There is nothing particularly startling here. The Japanese media have said much the same thing.

There are, to be sure, many problems with the way the Japanese stock market operates. Yet I wonder if adopting an



American-like structure is the answer to Japan's problems. I would have hoped for a little less rush to judgment. While there is certainly much to be learned from America's experience, it seems a little rash to conclude that everything that is different about the Japanese market is inherently inequitable and unfair. It is impossible for a country's economic system to exist in isolation from its cultural traditions and history. That is why every country—including the United States—has its own system and why each should be left to select the system that fits it best.

There have been major changes in the stock market's role in the Japanese economy over the last decade or so. The market has become far more important than ever before, both for capital procurement and for capital allocation. And even though this increased importance carries with it a clear need for institutional changes and basic structural reform, the market system has been left essentially unaltered.

Indeed, the authors would argue that it is this pent-up pressure for reform that has exploded in today's securities scandals. Yet if I were to cite the problems that I think most demand reform in light of the securities scandal, they would be the conflict of interest arising from trust accounts and the fact that customer interests were unduly slighted.

The system has to be brought into line with reality as soon as possible, but that does not mean that the solutions are to be found on Wall Street. Surely it should be possible to devise an equitable market that respects Japanese traditions, and it is up to Japan to find an appropriate answer to this crisis.

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