

# The Japanese Securities Market Today and Tomorrow

By Yoshitoki Chino

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The deregulation and internationalization of Japan's financial and capital markets are gradually picking up

speed, while in the United Kingdom the "Big Bang" took place on October 27 last year. Deregulation and internationalization have clearly become a global current, and mutual relationships among the markets of various countries are becoming closer every year. I would like to comment briefly on the world's financial and capital markets, and then take a look at the Japanese securities market today and its prospects for the future.

## The Big Bang's fallout

The sweeping reform of the City was dubbed the Big Bang after the great explosion with which the universe is said to have been created. The reform was in accord with the overall financial policy and administration of the British government, which wished to deregulate, internationalize and revitalize the City in one fell swoop. The City has three centuries of history and tradition behind it, but it has been unable to function satisfactorily as an international financial market. It was bound and fettered by long-standing restraints and regulations.

Before the Big Bang, London's financial and capital markets were divided into two—the London Stock Exchange, where member securities dealers traded, and the market outside the exchange where merchant banks and foreign securities dealers were the main traders. The weight of exchange-centered trading, however, has diminished in recent years. In terms of stock turnover, the City of London boasted an 8.1% share of total worldwide stock transactions in 1975. However, by 1985 its share had dwindled to 4.5%, even though in scale it was still third in the world after New York and Tokyo. In terms of the total market value of listed stock, London accounted for only 6.9% of the worldwide total as of September 30, 1986, as against 38.5% for New York and 33.6% for Tokyo.

The old stock exchange-centered market was sustained by three pillars: the single-capacity system of stock exchange members (separation of jobbers from brokers); fixed commissions; and restrictions on nonmember firms' capital participation in exchange member firms (in the old days, totally prohibited). In short, the traditional guild-like constitution unique to the City had been preserved. But, the City was also the center of the Euromarket. As a fully liberalized market, it attracted many foreign dealers, absorbed much foreign capital and prospered.

However, as British and foreign institutional investors grew in size, and as foreign securities firms entered the market and rapid progress was achieved in technological innovations, the disparity in size of capital between British dealers and their foreign counterparts became an obstacle in conducting transactions. This in turn led to an increase in outside-exchange transactions in listed stock. The hollowing out of the exchange market and the relative decline in the ranking of British dealers became ever more pronounced.





The objective of the Big Bang was to remedy this situation and restore the Stock Exchange's position in the City, thereby saving the City's reputation as an international financial center and securing its important position in Britain's invisible trade earnings (a total of £7.1 billion in 1985). As such, it was very much a part of Britain's policy of financial deregulation. However, it has had both a direct and indirect impact on Japanese financial and capital markets.

Indeed, there are no national boundaries in finance. Money moves freely. London is the center of the Eurocurrency market, where as much as \$1 trillion has gathered. Because the City is situated at the center of the world's biggest stateless market, any rise in the City's position would eventually significantly boost London's position in the international financial market. London's voice in and influence over international finance would be greatly increased. Naturally, this would have a major impact on Japanese and American financial markets as well.

The effects of the Big Bang have already appeared in the form of 24-hour global trading, linking the three poles of London, New York and Tokyo. Moreover, deregulation and internationalization are expected to standardize to a great extent financial trading around the world. Just as there are international industrial standards and international specifications for manufactured products, common rules will be developed as well for financial transactions. Although they may differ slightly from country to country according to indigenous circumstances, I believe the majority of nations will adopt and abide by common rules.

The internationalization of financial markets also has a significant impact on the flotation of bonds by corporations. Even before the Big Bang, issues of so-called "samurai bonds"—yen-denominated bonds issued in the Japanese capital market by nonresidents—had reached ¥1 trillion annually. There is a strong tendency among Japanese corporations to float foreign currency-denominated bonds in the Euro- and other markets where issue terms are favorable. This trend will only increase in the future.

## Japan's new status

In Japan's case, deregulation of the financial market was obviously due to the fact that Japan has grown into the world's second-largest economy. It must shoulder responsibilities befitting its status in the international community of nations.

Immediately after World War II, Japan aspired to become the Switzerland of the Orient. It never dreamed that it could become an economic superpower as it is today. Even had Japan become an Asian Switzerland, it would not have been able to keep its capital market small in scale. A nation's capital market should grow in size to match the scale of the national economy, and should be both deregulated and internationalized.

The opening of the Japanese capital market has made progress over the past few years. Monthly statistics on turnover on the Tokyo Stock Exchange (TSE) show that foreign investors account for about 15%. In some months, the percentage has reached 19%.

The number of foreign corporations listed on the TSE at the end of 1986 stood at 52, almost equal to the 54 foreign corporations listed on the New York Stock Exchange at the end of 1985. Foreign companies are keenly interested in being listed on the TSE. They hope to raise funds in Japan, the world's No. 1 creditor nation. At the same time, membership raises their profile in the country and can lead to expanded business opportunities.

The Foreign Stock Section of the TSE started out in 1973 with only six listed companies, including Citicorp, which was managed by Daiwa Securities Co. Later, IBM and ITT (both managed by Daiwa) and others joined in to raise to 17 the number of foreign companies listed on the TSE. For a number of reasons, however, membership had dwindled to 11 by 1983.

## Deregulatory measures

Alarmed, the TSE took measures at the end of 1983 to encourage the listing of foreign companies. These included easing listing standards and extending floor hours for foreign stock last year. Moreover, in 1986 the TSE made special exceptions for the listing of privatized corporations and mammoth enterprises. The number of listed foreign companies increased sharply, beginning with Sears, Roebuck & Co. in June 1984. With 24-hour trading becoming a reality, the rush of listings of foreign companies is expected to continue this year.

The number of foreign securities companies entering the Japanese market also has increased sharply, from around 10 at the end of 1985 to about 30 at the end of 1986. We welcome their coming, because one characteristic of the securities industry is that the pie always grows bigger as the number of market participants increases, resulting in bigger earnings for

each company. In order to keep abreast of the diversifying needs of Japanese institutional investors and individual clients, Japanese securities companies must be able to offer a large variety of financial products, both domestic and foreign. The participation of foreign securities dealers in the Japanese market helps broaden the range of financial products offered.

As regards the turf problem—the so-called “fence” between banks and securities houses spelled out in Article 65 of the Securities and Exchange Law, I feel it is better for the banking and securities businesses to remain separate as they are today. If any institution possessed both the indirect financing functions of a bank and the direct financing functions of a securities firm, it would monopolize financing, and lead to the undesirable evil of business companies in need of funds falling under the institution's control. If direct financing and indirect financing are kept separate, business corporations can benefit from the balance of power between banking institutions and securities companies. This is a far better state of affairs for Japanese industry.

Although the deregulation and internationalization of Japan's capital market have advanced significantly, there remain many areas for improvement. Recently, the Securities and Exchange Council discussed problem areas and submitted a set of recommendations to the Finance Minister. It is difficult to change overnight financial practices that have prevailed for the more than 100 years since the Meiji Restoration of 1868. However, deregulation and internationalization will almost certainly be accelerated even further through the concerted efforts of the government and the private sector.

Already bond futures trading has become a reality, and stock futures trading is now under study. The Investment Consulting Business Law was promulgated in March 1986, and April will see the appearance of investment consulting firms entrusted with full powers to conduct investment services to satisfy the needs of clients, both in and outside Japan.

In Japan, 17% of the population, as many as 20 million individuals, hold corporate stock. Only the U.S. surpasses Japan in the number of individual shareholders. If institutional investors' transactions are included, stock turnover in Japan exceeds the aggregate turnover of 10 EC countries. Now that the Japanese securities market has grown to such a mammoth scale, securities companies will continue to contribute to the quantitative expansion of Japan's financial and capital markets. ●