Japan's Big Four Go Global

By Masataka Maeda

Japan's big securities houses are rapidly going global. In the term ended September 1986, the four largest companies' overseas subsidiaries brought in profits of ¥83.3 billion (about $537 million at the rate of ¥155/$)—130% more than in the September 1985 term.

As Japan has become a creditor nation, Japanese investors have turned their sights worldwide (Fig. 1), and Japanese institutional investors' attitudes and actions now have a major impact on overseas securities markets. With the wealth of capital available in Japan, the big Japanese securities companies have spread their nets across the globe, making an unprecedented effort to hire capable overseas staff and to link them together with computerized telecommunications. The day is drawing inexorably nearer when there will be 24-hour trading in New York, Tokyo and London—and Japan's giant securities companies are determined to be part of it.

Primary dealers

In a move seen as symbolic of the pivotal role that Japanese securities firms have come to play in the U.S. market, the Federal Reserve Bank of New York designated Nomura International and Daiwa America primary dealers in December 1986. As a result, these two firms—the U.S. subsidiaries of Japan's number one and number two securities companies, respectively—are now authorized to buy and sell government securities in direct dealings with the New York Fed in its open market operations. Until then, the primary dealers had been an exclusive club of fewer than three dozen, primarily American, securities companies as members.

Yet their appointment was not unexpected. For years, Japan's big four securities companies—Nomura, Daiwa, Nikko and Yamaichi—had been saying that the rapid increase in Japanese institutional investors' purchases of overseas securities entitled them to primary dealer status. They have spent an astounding amount of energy on securing this recognition. For example, Nomura practically doubled the staffing at Nomura International—from 194 at the end of September 1985 to 370 at the end of September 1986. The other companies have been no less ambitious, Daiwa America boosting total staffing to 316 (from 118), Nikko International to 198 (from 109), and Yamaichi International America to 163 (from 72) over the same one-year period.

In addition to vastly expanding staffing, Nomura has also made a major effort to beef up its computer network. Just recently, its Nomura Computer Systems subsidiary set up a major computer center on New York's Staten Island—the first of any Japanese overseas subsidiary. The other three companies (Daiwa, Nikko and Yamaichi) have sent computer engineers to New York from Tokyo and are rapidly putting computer systems in place to better enable them to deal in U.S. government securities.

While this investment has paid off first for Nomura and Daiwa in their elevation to primary dealers, there are some observers of the Japanese financial scene who think that pay-off should have come even earlier. Asked about the delay, Nomura executives speculate that it was a political ploy by U.S. authorities to show their displeasure at the delay in enabling U.S. securities companies to become members of the Tokyo Stock Exchange and to pressure Japan to open its capital markets to greater foreign participation.

Clearly, Japanese securities companies have gotten too important for even the U.S. authorities or American securities companies to treat casually. Nikko and Yamaichi are also expected to qualify for primary dealer status in the next year or two, but this primary dealing is just one step on the road to globalization for Japan's big four securities companies.

Emphasis on Europe

On October 27, 1986, the London Stock Exchange overhauled and simplified its regulations in a dramatic package nicknamed the "Big Bang." Capital is becoming increasingly mobile and international, and capital markets everywhere are being liberalized and deregulated. Given this internationalization and intensifying competition, observers are predicting that the final shake-out will leave only a dozen or so total-service financial brokers. The Japanese companies intend to be among them.

As such, they are just as interested in the Euromarkets as they are in the United States. In 1983, Japanese companies raised a total of $5.1 billion with 63 issues in London and other Eurodollar markets. By 1985, this was up to $9.8 billion with 123 issues. Looking at the total Eurocapital market including German marks, Swiss francs and the rest, Japanese companies raised $11.3 billion with 287 issues in 1983 and $19.1 billion with 380 issues in 1985.

In addition to these issues by Japanese companies, the Japanese securities companies have also handled a wide range of foreign government and private-sector bond issues, as well as active foreign investment in Japanese stock. Their European business is booming. Just as they are beefing up their staffs in New York,

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they are also putting on more people in London. As of the end of September 1986, Nomura had 393 people there (an increase of 85 over the past year alone). Equivalent figures for the other big Japanese securities firms are 282 (up 127) for Daiwa, 237 (up 83) for Nikko and 164 (up 26) for Yamaichi (Fig. 2).

How well these companies will do in the London market depends on how successful they are in the bond-issuing market. Here, they will have to find a middle ground between the diverse needs of the issuers and the equally diverse requirements of investors. To do this, they have created a number of highly sophisticated and complex instruments involving, for example, currency and interest swaps. This is the proving ground for Japanese securities companies, and they have turned increasingly to people with scientific backgrounds who want to get into the market as "financial engineers."

Active though they are with overseas issues, these Japanese securities companies are not neglecting their home turf. In 1986, they unveiled a new system to computerize investing in Japanese stocks. Using this system, a modification of the London Exchange's SEAQ system for automated quotations, the Japanese securities companies show real-time quotations for both puts and calls for the leading Japanese issues, enabling European investors to sell to the highest bidder and buy from the lowest offerer. Another feature of the system is that it offers unlimited trading under a fee schedule quite different from the rate structure prevailing in Japan. As a result, increased trading through this system could easily develop into a precedent for the deregulation of commissions and fees in Japan as well.

In addition to their traditional securities operations, the big four are also moving into banking in London. Nomura, for example, obtained a license from the U.S. Treasury and started a local banking subsidiary in November 1986. Daiwa has also been licensed to start a local banking subsidiary in early 1987, and Nikko and Yamaichi are expected to follow suit soon. There are several reasons for the securities companies' interest in banking: (1) to raise capital cheaply directly from the interbank market, (2) to help corporate clients with capital procurement through direct lending as well as underwriting debenture issues and (3) to conduct foreign exchange operations on their own.

The big four securities companies already have local banking subsidiaries in Singapore and Amsterdam (Luxembourg in the case of Nikko), but Nikko executives are hoping that "with the addition of London, we will have the potential for truly global banking." Although Japanese domestic law, specifically Article 65 of the Securities and Exchange Law, clearly delineates between the activities allowed securities companies and those allowed banks, the securities companies are determined to gain the banking experience they need overseas to become total-service financial companies. At the same time, however, it should be noted that the big Japanese banks are responding in kind by setting up securities in London.


The IMAGE BANK: Photo by Ted Russell

Japan's securities giants are active traders on the New York Stock Exchange.

Overseas profits

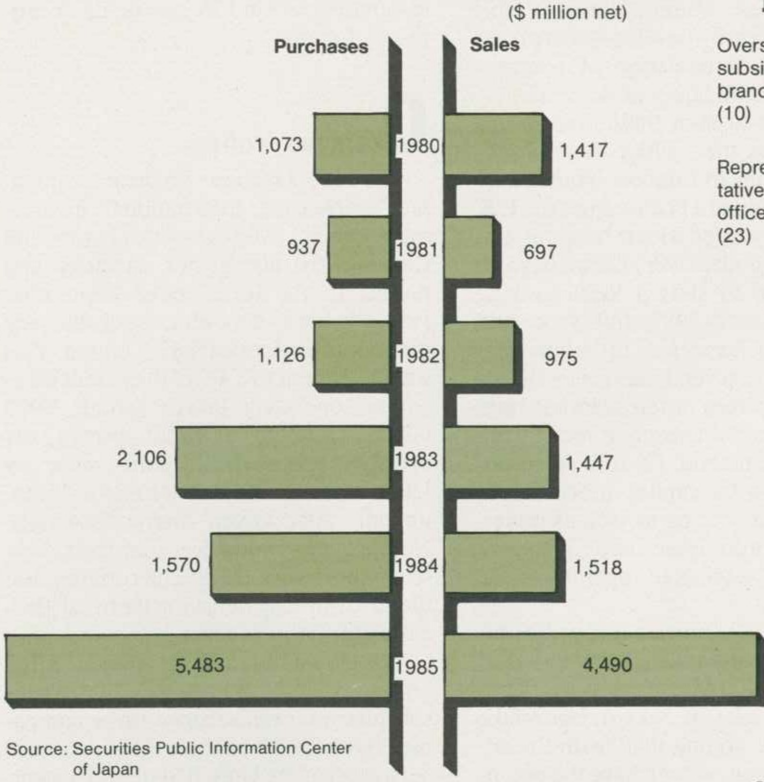
With the Japanese securities companies' increasing international involvement, their overseas subsidiaries are showing sharply higher earnings and profits. In the term ended September 1986, the big four's overseas subsidiaries' pretax profits totaled ¥83.3 billion. This was equivalent to 8.4% of the parent companies' operating profits (about ¥990 billion). Looking at profit growth, the overseas subsidiaries' profits were up 130%, while the parent companies' were up only 80%. Given this performance, Nomura and Daiwa feel that their overseas subsidiaries are off and running, and they are thinking of having them pay dividends in the next term.

The United States accounted for ¥10.7 billion, or 12.8%, of the big four's overseas subsidiaries' profits. Since these companies have 28.3% of their 3,696 overseas personnel in the United States, U.S. operations would seem to be proportionately overstaffed. However, this overstaffing was part of a conscious decision by the big four to concentrate people and capital in the United States to qualify for primary dealer status. There are also some securities companies that have purposely sacrificed profits (buying high and selling low) to expand the volume of treasury bonds handled.

Subsidiaries in the United Kingdom have accounted for ¥25 billion, or 30%, of the big four's overseas profits. Since 29.1% (1,076) of their overseas personnel are stationed in the U.K., people and profits would appear to be in equilibrium. Yet Nomura is the only one of the big four whose U.K. subsidiary is showing a trading profit, and all the rest are offsetting their losses with Japanese stock investment commissions, underwriting fees and the like. With the rapid expansion in the Euromarkets, there has been a sharp growth in the U.K. subsidiaries' in-house bond portfolios, and they are very vulnerable to changes in the market.

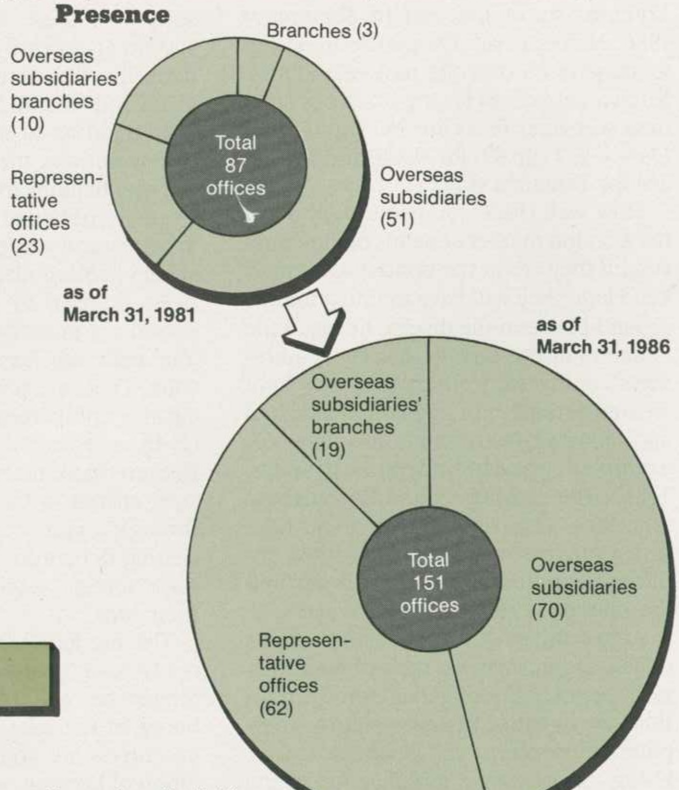
Outside of these two major overseas markets, subsidiaries in Hong Kong (where there is strong trading in Japanese stocks) account for ¥16.1 billion, or 19%, of the big four's overseas subsidiaries' total profits. Subsidiaries in Switzerland account for ¥9.8 billion, in Singapore ¥5.5 billion, in Amsterdam (Luxembourg in Nikko's case) ¥5.0 billion and in West Germany ¥4.7 billion.

Fig. 1 Japanese Investors' Trading in Foreign Stocks



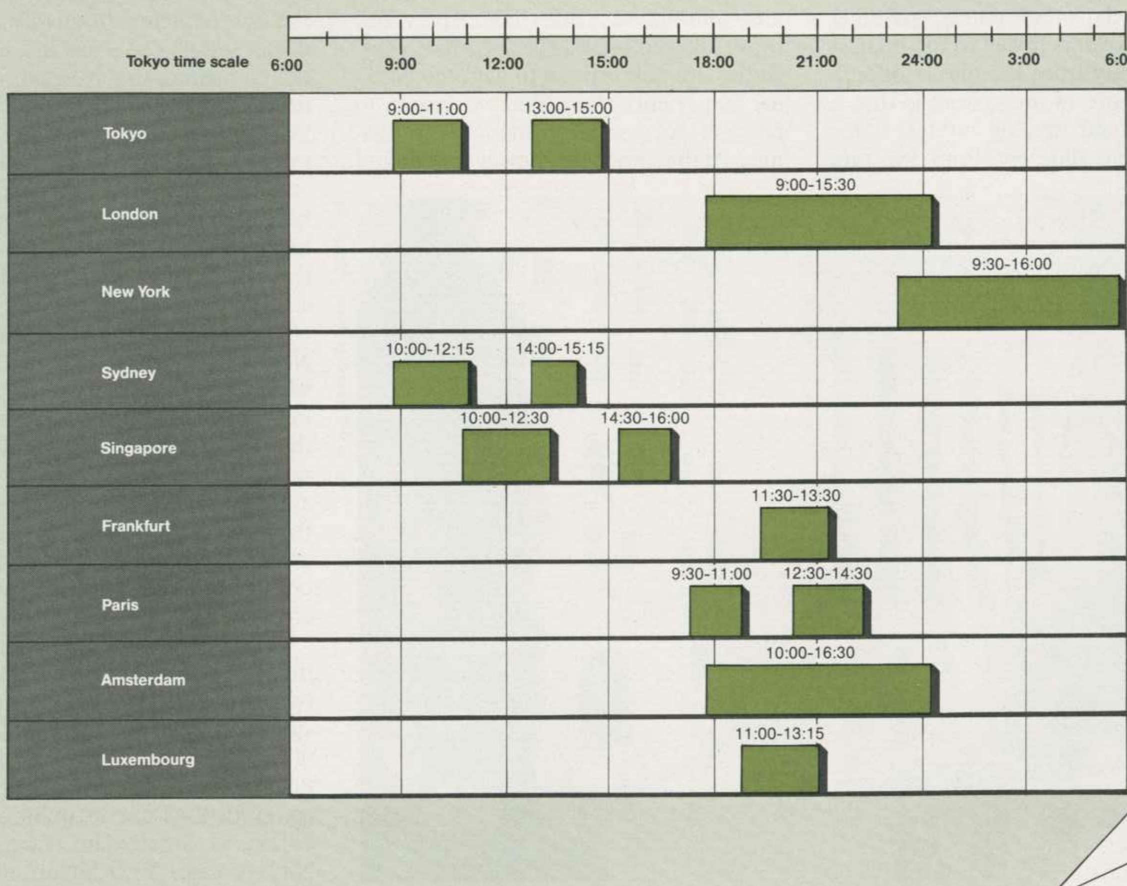
Source: Securities Public Information Center of Japan

Fig. 2 Japanese Securities Companies' Overseas Presence



Source: Securities Public Information Center of Japan

Fig. 3 Trading Times in Major Markets Worldwide (times by blocks are local times)



In addition, Nomura has subsidiaries in Bahrain, Australia and France; Nikko in Australia; and Yamaichi in Bahrain, Australia, France and Canada. However, none of these other overseas subsidiaries is very profitable. The big Japanese securities companies are also establishing branches and looking for business opportunities in Canada, Korea and elsewhere as these countries liberalize foreign participation in their securities markets.

Global accounting

Actually, it is only in the past few years that the securities companies' overseas subsidiaries have begun to show any profit at all, and the companies are not really set up yet to manage their overseas finances separately. As a result, it is easy for them to control their overseas subsidiaries' profits by, for example, manipulating the transfer prices for bonds underwritten overseas and sold in Japan. While the big four are moving toward introducing consolidated accounting principles, this is still in the formulative stage.

Once these accounting standards are decided on, it will be possible for London and Tokyo to work out a joint swap on bonds underwritten in New York, to sell them to institutional investors in Tokyo and Hong Kong and still to know exactly how much profit should accrue to each of the companies in the group. By the same token, it will also be possible to assign responsibility if the company's worldwide network is unable to sell out an issue underwritten by a particular unit. Nomura says that it wants to introduce these consolidated accounting principles "not only because the clear determination of responsibility and profitablility should give us a better picture of our operations but also to help motivate the overseas subsidiaries."

Although these accounting standards might seem minor in the overall international strategy context, it is the accumulation of little things like this that will ultimately give these companies the ability to be active players in the global 24-hour trading system (Fig. 3). A top Nomura executive thus characterizes his company's management as one of "system and power," explaining that getting all the necessary systems in place and operational will naturally give the company increased power in the global market.

Along with instituting new regulations and procedures, the securities companies are also moving forward with the prerequisite computerization for operational management and information processing. At present, the big four are working on their third-generation computer hookups, expected to be operational in another three or four years. The computerization of overseas operations is central to this effort, since it is an integral part of the move to global trading. The companies are rumored to be spending ¥100–150 billion (about $645–968 million) each on this third-generation computerization, with about a third of this likely to be invested at overseas subsidiaries.

Nomura, for example, is expected to build a computer center in suburban London like the one in New York. Daiwa is putting in IBM mainframes in New York and London and moving its Tokyo computer center to a new 11-story building that will be the hub of its international on-line computer network. Nikko is also hurrying with plans for large-scale computer centers in New York and London, and Yamaichi is currently reexamining its total computer organization preparatory to new moves.

Once completed, the big four securities companies' computer systems will be formidable information crunchers. New York will perform account information management on all client investors for government bonds and American stocks. London will do the account information management for European clients as well as handling information on the Eurobond markets and European stocks. And Tokyo, of course, will take care of the Japanese and other Asian markets. Thus Tokyo, New York and London will each be looking after information in its own area of responsibility—and all of their far-flung international branches and subsidiaries will be able to access any of these computer databases for investment information at any time.

Because the computers will be operational around the clock and around the globe, Tokyo and London will be able to access the New York computer for treasury bond and U.S. stock trading information and executions even when it is midnight in New York. At the same time, global trading means that the securities companies themselves will have to have the major U.S., Japanese and Euromarket bonds, stocks, bond futures, market index futures and other leading international investment instruments on hand so that they can deal smoothly with clients worldwide. Yet having a lot of paper on their own accounts exposes the companies to considerable risk should the markets decline, and analytical-minded young traders are now busily working out hedging systems to protect the companies against this risk.

Internationalizing home market

At the same time, the Japanese market is rapidly becoming more international. For one thing, more and more foreign companies are being listed on the Japanese exchanges; and Japanese companies and investors are becoming increasingly knowledgeable about trading in overseas stocks and bonds. In Tokyo alone, 1986 saw 31 new foreign companies listed on the Tokyo Stock Exchange, bringing the total to 52. Another 40–50 are expected to apply for and achieve listing in 1987. Beneficial though this is to the foreign companies in terms of exposure and market recognition, it also gives Japanese investors enhanced experience in dealing with foreign issues and highlights the Tokyo market's importance in international capital procurement.

The experience that securities companies are gaining with foreign stocks, both in Tokyo and overseas, has positioned them to make a strong play in investment trusts and investment consulting. Clearly hoping to take advantage of the increasing internationalization of Japanese investor portfolios, Japanese investment trust companies are expanding their offerings of foreign stock trust funds and building expertise with the assistance of foreign investment consultant companies. Conspicuous players in Tokyo, the big four securities companies' investment trust and investment consultant subsidiaries are now moving out into overseas markets on their own.

If there is a problem in the securities companies' efforts to go global, it is not in acquiring the necessary information hardware but in procuring the overseas personnel they need. At present, local hires account for 60–70% of the staffing at the New York and London subsidiaries, but the turnover is high. And because the better local dealers command salaries many times what Japanese in the same office are making at the same age with the same responsibilities, this is having an adverse impact on the traditional practice of lifelong employment and seniority-based rewards. There are some securities companies that have appointed locals to head departments where other locals work, and a number have even appointed local directors in an effort to boost morale. Overseas employees are also often sent to Tokyo for training. Assuming that the personnel problems can be overcome, it is very possible that the big Japanese securities companies will develop into truly international companies. ●