Is the Tokyo Market on the Decline?

By Sakamoto Sakae

The "hollowing out" of Tokyo's capital and financial markets have been the focus of recent articles in Japanese newspapers. Explanations for this phenomenon include higher transaction-related taxes compared to Hong Kong, Singapore, and other Asian markets, as well as London, New York, and other Western markets, high rents, personnel expenses, and other office maintenance costs, and the difficulty of creating new products due to an excess of bureaucratic regulations regarding financial products. Financial services comprise one of Japan's important industry sectors and concerned parties have a strong sense of impending doom.

On August 24, the U.K. investment trust firm, Foreign & Colonial, announced that it was relinquishing its seat on the Tokyo Stock Exchange (TSE) and withdrawing from the Tokyo market. The company explained that "maintaining a seat was too costly" and "in the six years since listing on the Tokyo exchange only a small number of Japanese investors had purchased the company's stocks." Since the beginning of the year, 13 firms, including Abbott Laboratories, the U.S. pharmaceuticals manufacturer, and Eastman Kodak, the American photographic film maker, have left the TSE. Colonial's withdrawal brings the number to fourteen.

According to the TSE, the apex of foreign firm listing on the exchange was 127 at the end of 1991, the height of the "bubble" economy. However, in the midst of the subsequent collapse of the bubble and the ensuing securities slump, foreign firms abandoned Tokyo one after another, with the number declining to 95 by the end of August this year. In every case the explanation for leaving echoed Colonial's, with the high cost of maintaining a TSE seat being the main reason given.

According to securities industry sources, fees for translation of financial statements and other information for investors make up the largest part of the annual ¥15 to ¥20 million cost of maintaining TSE membership. Because this documentation is of an official nature, it must be checked by certified public accountants and others who charge expensive fees, leading to higher costs. The Ministry of Finance (MOF) is at pains to find a way of dealing with this problem since the use of foreign languages for disclosure materials that Japanese investors review is hardly acceptable.

Easing TSE membership criteria for foreign firms

Even so, administrative authorities are not idly standing by. The MOF has instructed the TSE to study incentives and means of retaining foreign firms, a symbol of the Tokyo market's internationalization. As noted above, there are as yet no workable retention plans and abolishing membership guidelines for foreign firms is the leading incentive under consideration.

According to the TSE, under the current guidelines foreign firms are required to meet rigorous membership standards, including net assets in excess of ¥100 billion and annual profits of ¥20 billion for the previous three years. Because the official screening standards are ¥10 billion and ¥2 billion, respectively, when joining the exchange the TSE says that the guidelines restrict seats to foreign companies that are in fact blue chips, thus "protecting" ordinary Japanese investors. According to informed sources, the TSE is considering abolishing these restrictions and virtually lowering membership criteria to one-tenth the current amounts.

Tangible relaxation of TSE membership criteria is meant to draw Asian firms to the Tokyo market. A TSE executive says, "We want to put a stop to the hollowing out of the foreign division by opening a way for Asian firms to raise capital on the Tokyo market." This means that rather than dealing with Western companies which can procure funds on their own countries' markets, they will work with high growth Asian firms whose demand for capital is flourishing, attempting to turn the TSE into an Asian capital procurement center.

This posture of stressing Asia represents an awareness that the U.S. is one step ahead in attracting Chinese companies. Last year China's Shanghai Petrochemical obtained a listing on the New York Stock Exchange in the form of American depository receipts (ADR), the first time Chinese stocks had been listed on an American market. The Japanese securities industry was shocked that a Chinese company would bypass the Tokyo market and go to New York. The measures to ease membership criteria now being studied by the TSE are apparently linked to a strategy to regain lost ground.

Japanese stocks gain ground in London

Western firms that belonged to the TSE are fleeing Tokyo while Asian companies bypass Tokyo to raise capital in New York. This in itself is a serious matter for the Tokyo market, but Japanese stocks have recently been trading briskly on the London market.

According to a study by a major securities firm, last year's volume of Japanese stock transactions on the London market was the highest ever, standing at £114.6 billion (around ¥19 trillion). The figure for the first six months of this year alone reached £89.7 billion (around ¥14.2 trillion) and it is certain that this year's results will be broadly higher than that of last year. The trading volume on the TSE for the same period was only around ¥103.6 trillion. Calculated with these figures, the Japanese stock transaction volume in London was equivalent to 15% of Tokyo trades.

According to one source, "In addition to the securities transaction tax incurred

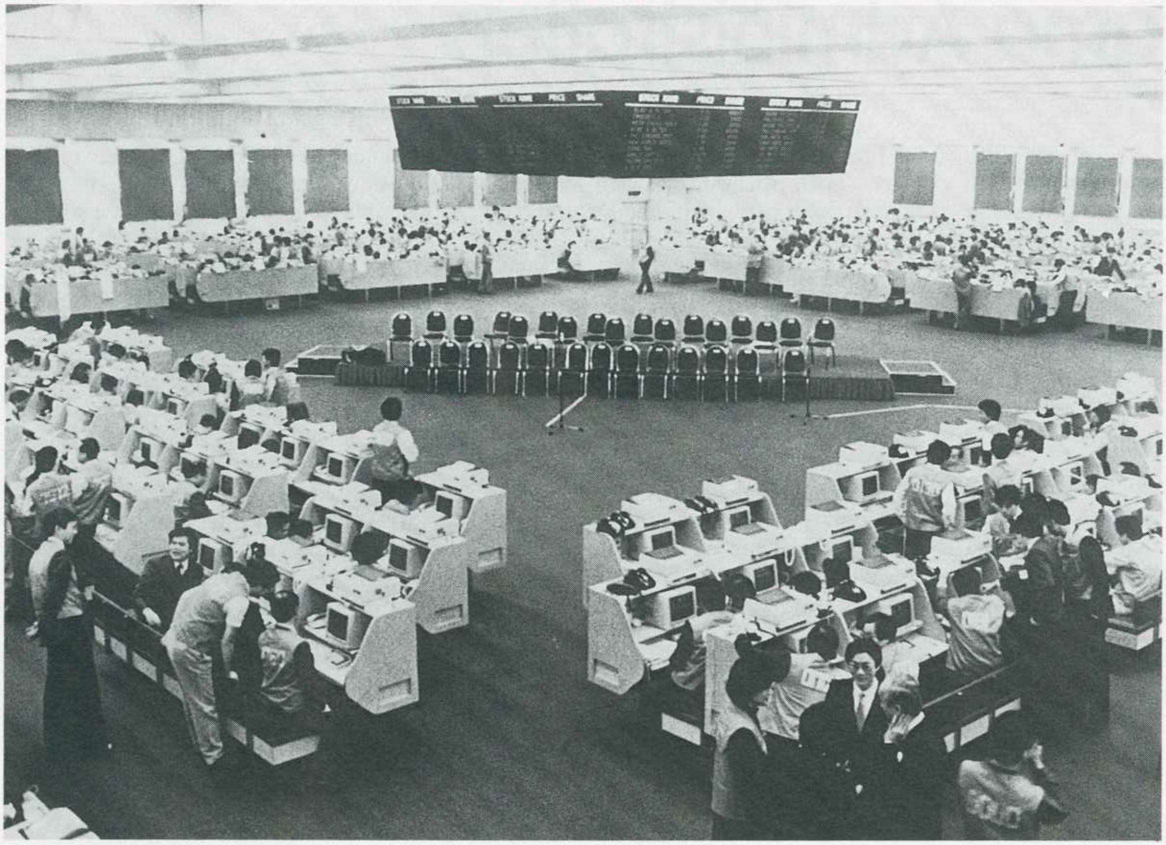

Photo: Kyodo News Service

Hong Kong's Unified Stock Exchange, which began operations in 1986, has grown so rapidly that it shows signs of overtaking the Tokyo Stock Exchange.

when stocks are sold, commissions paid to securities companies are higher in Japan—the cost of trading in Tokyo is more than double that of London," and this is behind the shift to London.

According to a top executive at a major securities firm, the securities industry has pressed the MOF to abolish the securities transaction tax (0.3% of sale proceeds) and this year they have emphasized avoidance of the "hollowing out" of the Tokyo market as the main reason for forcefully demanding abolition of the tax. However, since the MOF has been sounding alarms over declining tax receipts, the executive does not think that the securities industry's request will be easily accepted. Whether the revenue authorities' or securities administrative authorities' judgment prevails, attention is now focused on the bargaining between the MOF Tax Bureau and the Securities Bureau.

Appeal of Hong Kong and Singapore markets

A report on issues concerning international financial transactions completed in early June by a group of experts from the Council on Foreign Exchange and Other Transactions (an advisory panel to the finance minister) offers a detailed picture of the financial market's decline. In a report entitled "The Integration of Japan's Domestic and External Economies and International Financial Transactions" the council offers the following comments:

"Recently, new growth has also been seen in various Asian countries' financial markets in conjunction with rapid economic development, and with China's reform and liberalization policies in the background Hong Kong has been strengthening financing functions directed at China while Singapore has been actively developing financial derivative products as an advanced international financial market in Asia. Further, both are starting to play a role as bond flotation markets through the issuance of "dragon" bonds (Eurobonds issued on Asian markets and listed on multiple exchanges).

"Products that duplicate those handled on Japan's market and competition between the markets has recently been noted and some foreign financial organizations which supervised all Asian markets from Japan have begun transferring those functions from Japan to Hong Kong and Singapore.

Differences in personnel, non-personnel, and other management costs are also behind this move and some people are of the opinion that the relative appeal of both the Hong Kong and Singapore markets is increasing. Others also believe that commissions, the tax system, and other transaction costs in Japan are additional reasons."

The tone is subdued because this is an official report, but the point is that, if left as it is, Tokyo's market functions will end up being transferred to Hong Kong and Singapore. Will Tokyo continue to be the core Asian market, or will the center move to Hong Kong or Singapore? JJTI

Sakamoto Sakae is an economic news editor at Jiji Press news agency. He specializes in such fields as finance and international economic affairs.