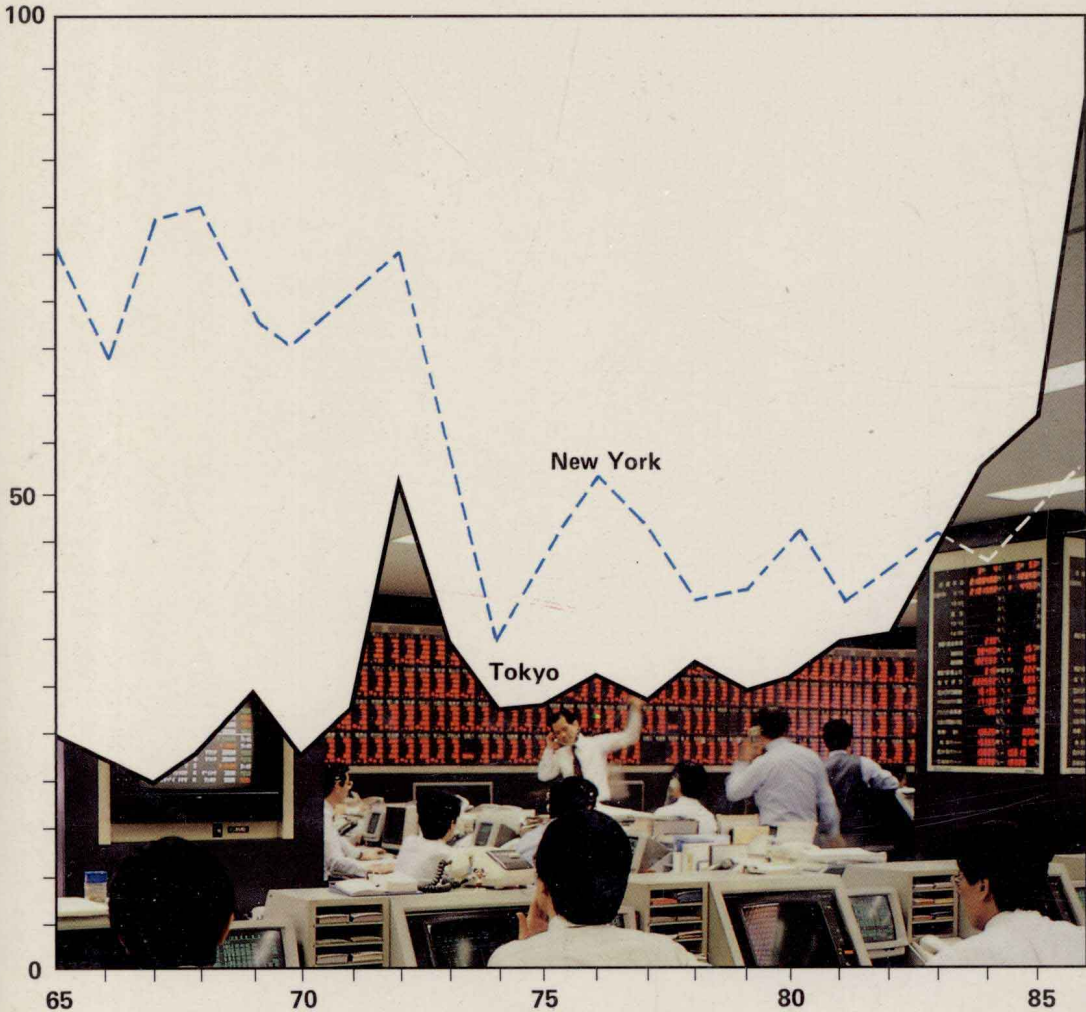


# JAPAN'S SECURITIES MARKETS A PRACTITIONER'S GUIDE

*Takeji Yamashita*



*Stock Market capitalisation/nominal GNP*

# **Japan's Securities Markets A Practitioner's Guide**

**Takeji Yamashita**

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# Preface

Let me tell you the story of a fictitious (but representative) character who has worked for a major Japanese securities house in Tokyo for more than three decades. His name is Taro, a popular first name, and he was born in 1930, the beginning of the Great Depression. Japan was no exception and experienced serious recession and unemployment on an unprecedented scale. The stock price index halved in just over a year. Taro's father, the third son of a farmer, had been forced to move to the city (and unemployment) because in those days it was only the first son who was eligible to inherit his father's property. It was a time when the German word 'lumpen' was first heard in Japan. Into such a poor environment was Taro born.

When Taro entered primary school, Japan was on a quasi-wartime footing. His father found work in a factory, saved money and bought government bonds little by little. Father continued buying bonds during Taro's secondary school days (ie World War II days). In fact, he and his co-workers were obliged to as a means of financing the war. There was no secondary market in the current sense where such bonds could be freely sold. The public just bought such bonds allotted for long-term holding. Being patriotic, father never thought of selling them.

It was 1945. The war was over. If Taro had been born a few years earlier, he might have been killed in the war. The bonds accumulated so assiduously over the years were worthless amidst rampant post-war inflation. The family, like most others, lived at bare subsistence level. Father knew he would have little to leave Taro, so he endeavoured to give him a good education and managed to push him through university.

After graduating, Taro joined a securities house as his school record was not good enough for him to be accepted by a bank or one of the major manufacturing companies. Five years later, he married, but not without obstacles. Taro's future father-in-law was none too pleased at the match saying he did not want to give his beloved daughter away to a mere *kabuya* worker, a contemptuous remark reflecting the low social status of those who worked for securities houses. It was a time when bankers and major manufacturers were in the limelight and attracted the elite. Nevertheless, Taro won the day and the newly-weds went to Kyushu via the beautiful Seto Inland Sea for their honeymoon. At that time, no one thought of a honeymoon overseas and there was no knowing that 15–20 years later Kyushu would be nicknamed 'silicon island'.

In the following year, 1961, Taro's first son, Ken, was born, which coincided with a stock market peak reflecting *Iwato* prosperity. In 1965, a

second son was born, and named Johji. Though just one year after the Olympic games in Tokyo, it was the bottom of a serious recession specifically named the 'securities recession'. In the four years to the bottom the stock market declined 44% and two organisations set up through the cooperation of banks, securities houses and the authorities to mop up excess shares had little effect. Taro's company too was in a critical situation, but luckily it weathered the crisis.

Taro had good reason for naming his two sons Ken and Johji (the latter which can be pronounced George). For Taro, the USA was the shining superpower. Imported American movies were so glamorous. Like many, Taro longed to visit the USA, but knew it was almost impossible. However, he dreamed that his two sons would go there, which explains his naming them Ken and Johji.

Around the time Johji entered primary school, what kind of Japan had Taro and his contemporaries built for their sons like Ken and Johji? The answer: a mammoth economy boasting the second largest GNP in the free world, something which Taro would never have thought possible just a few years previously.

Taro's pay had increased and likewise his savings. As a professional, he held a small amount of shares, and, although the secondary market for bonds was virtually non-existent, he had been obliged to buy some telephone bonds when he applied for a telephone to be installed. No one could have foreseen that two decades later the issuer of these telephone bonds, NTT, would change from being a semi-governmental organ to a private company due to the government's privatisation policy, and that its stock price would hit ¥3 million a share.

The stock market was in the midst of a huge bull market and heading toward a peak in January 1973. This was the height which signalled a change in Japan's economy into one of an entirely different structure.

Every coin has two sides, good and bad. The Seto Inland Sea, once the setting for a beautiful honeymoon cruise, became very polluted. Environmental pollution became a big problem. Then, two sudden oil price hikes assaulted Japan and other parts of the world during the 1970s. The Tokyo market was severely hit. All companies, including Taro's, made desperate efforts to rationalise. Oil consumption was curtailed. Pollution was reduced.

In the spring of 1988, Johji graduated from university with a good record and joined a major securities house. Unlike Taro's days, to join a major securities house was now as tough as entering a major bank. When Ken, four years earlier, had asked his father whether he should choose a securities house or a bank, Taro told him that in a bank he would be able to get along if he did not make any big mistakes while in a securities house he would have to fight for big scores without worrying about making mistakes. He added that Ken would have to choose that which suited his personality. Ken chose a bank, but in the ensuing years found that it too was very competitive, unlike in his father's days.

Now at the end of his working life, what does Taro have to bequeath to his children who have embarked upon their careers – the answer now is the world's largest creditor nation, a dazzling financial mammoth, which no Japanese had ever dreamt of. The Tokyo Stock Exchange has become the world's largest, exceeding the New York Stock Exchange in market capitalisation – compared with less than 5% of the latter when Taro married.

When Taro's grandchildren graduate in the 2010s, what kind of Japan and financial community will they inherit from Ken and Johji? This will depend entirely upon Ken and Johji.



To Bernard Grace, who has lived in Tokyo for about 20 years, I am deeply indebted for the time- and energy-consuming task of reviewing my manuscript and making it acceptable to English-speaking readers. Not only that but he was also kind enough to add several comments to fill the perception gap between Japanese and Western society. While Japan has been a big importer of information from the West, it has remained a relatively small exporter of information. Also, though many of us have often been urged to express our thoughts in languages other than Japanese, the effort has been mostly in vain. I was indeed lucky that I could work with Bernard Grace.

My debt to Makiko Ganaha is also great. She uncomplainingly typed the whole manuscript, not once but several times.

To all my colleagues, senior and junior, comprising economists, analysts, and quants in Daiwa Securities Research Institute and specialists in Daiwa Securities, my thanks. They were so generous in supplying me with data and information and also explanations.

To the authors of publications and articles shown at the end of this book I also owe thanks.

Takeji Yamashita  
Tokyo  
May 1988

# Glossary

ADB	Asian Development Bank
ADRs	American depositary receipts
BAs	bankers' acceptances
CBs	convertible bonds
CDs	certificates of deposit
CP	commerical paper
<i>daimyo</i>	lords in feudal times
EAFE	Europe, Australia, and the Far East – an index compiled by <i>Morgan Stanley Capital International Perspective</i>
EC	European Community
EPS	earnings per share
FBs	financing bills
G-5	Group of Five
<i>gensaki</i>	bond transactions with repurchase or resale agreements (detailed in Chapter 8)
GNP	gross national product
IQ	intelligent, as in IQ building
<i>Iwato</i>	see Chapter 4, footnote 22
<i>Izanagi</i>	see Chapter 4, footnote 22
<i>Jimmu</i>	see Chapter 4, footnote 22
JOM	Japan Offshore Market
KDD	Kokusai Denshin Denwa – Japan's international telephone service company
<i>kingaishin</i>	fund trusts
LIFFE	London International Financial Futures Exchange
M and A	mergers and acquisitions
MMCs	money market certificates
MMFs	money market funds
MPT	modern portfolio theory
NICs	newly-industralising countries
Norinchukin	The Central Cooperative Bank for Agriculture and Forestry
NTT	Nippon Telegraph and Telephone
OA	office automation
OECD	Organization for Economic Co-operation and Development
OTC	over-the-counter
PBR	price–book value
P/E	price–earnings ratio

RMB	ren min bi – currency used in the People's Republic of China
ROE	return on equity
<i>saitori</i>	intermediary members of stock exchanges in Japan
<i>samurai</i>	warriors in feudal times
SEC(US)	Securities and Exchange Commission
Shoko Chukin	Central Bank for Commercial and Industrial Cooperatives
TBs	Treasury bills (US)
TEPCO	Tokyo Electric Power Co
<i>tokkin</i>	specified money trusts with trust banks
TOPIX	Tokyo Stock Exchange Stock Price Index
VTRs	video tape recorders
<i>zaibatsu</i>	see Chapter 3, footnote 3
<i>zai-teku</i>	portfolio investments



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# 1

## Japan's securitisation and deregulation

### Tokyo as No 1

Japan's securities and capital markets have expanded tremendously in recent years. The first half of 1987 saw the Tokyo Stock Exchange ousting the New York Stock Exchange to become number one world-wide in terms of equity market capitalisation and trading volume. Also in early 1987, total transactions in Japanese government bonds exceeded US primary dealers' transactions in US government securities. Furthermore, since 1985 Japan has been the largest net creditor nation mainly due to Japanese investors' active foreign portfolio investments which showed a 77% year-to-year increase in the amount outstanding in 1986. Since July 1986, trading in Japanese government bond futures on the Tokyo market has exceeded trading in US Treasury bond futures on the Chicago Board of Trade. By the end of 1987, foreign stocks listed on the Tokyo Stock Exchange numbered 88, a more than fourfold increase from 21 in 1985 (Table 1.1), and foreign securities firms and bank-related securities arms having branches or representative offices in Tokyo numbered 171 (44 branches and 127 representative offices) as of the end of 1987 compared with only 104 in 1984 (ten branches and 94 representative offices). The number 171 is impressive compared to 123 for London and 65 for New York.<sup>1</sup>

Propelled by moves toward Japan being a more international, information-oriented society as well as the ever-increasing importance of Tokyo as an international financial market in the era of 24-hour global trading, Tokyo will likely become the world's most important metropolis, at least for the financial and business community, in the twenty-first century. As a consequence, demand for office space is enormous and office rents and land prices have skyrocketed. Major Japanese and foreign securities firms and banks are generally located in an area around Tokyo Station called the 'Tokyo Triangle' (bounded by Otemachi, Kabutocho and

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<sup>1</sup> For the London figure, *The Banker*, November 1987; no breakdown by branch or representative office. For New York, *Institutional Investor*, September 1987; broken down into one investment bank, 12 securities firms, 44 subsidiaries, seven representative offices, and one branch office. The small figure for New York is understandable in view of the fact that one-quarter of the 171 representative or branch offices of foreign securities firms and bank-related securities companies in Tokyo are US firms.