An Insider's View of Japan & Financial Services

A Candid Interview with Atsushi Yoshikawa**

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July 2018

Over the last 40 years, Atsushi Yoshikawa has led and managed companies across the world for the Nomura Group, spanning businesses in Asset Management, Investment Banking and Real Estate. In a candid personal interview, he shares his views on Japan - a country revered as the harbinger of innovation, yet struggling as an economy for decades - and on the future of financial services.

What is the real problem causing economic paralysis in Japan that's lasted for decades?

Japan's development model since World War 2 was based on a government-led economic expansion, where the government decided the areas in which to invest, rather than letting the market decide. This model was championed by the Ministry of Economy, Trade and Industry (formerly the Ministry of International Trade and Industry), and it worked well in the boom years. After the bust, the post-war business and growth model of Japan collapsed, and no one knew what the new business and growth model of the country should be. In fact, the Government continued to spend public money to try to revitalize the old economy and provide tax incentives to spur consumption. As a result, it kept zombie companies alive, which led to the huge government debt problem of today.

Now perhaps with Prime Minister Abe's leadership there is hope. Abe-san has been great in his leadership of developing Abenomics and in foreign policy. He is a leader who is willing to discuss one-on-one with many global leaders. Forming the free trade agreement, "TPP 11", even as the US declined to participate, is a good example of his leadership. The fact that he has remained in his position for more than 5 years, and won the election three times, is a refreshing change. Japan in general, and especially the business sector, is very proud of his achievements so far.

But the very serious problem in Japan is one of demographics. There is a shortage of young people, and the current young generation in Japan was born when Japan had almost peaked out. Their life has been good, relatively speaking, because they haven't had to fight to survive. Actually, the mild deflation period was not a bad environment for middle class people who preferred to have a stable lifestyle. As a result, most of the current young generation don't feel the need to work hard, as the previous generation did when they were building Japan. Most of them have a job if they want it, but that is not always because they are smart and hardworking, it's just because of the shortage of human capital. And if you compare them to their peers in other countries in Asia, and other parts of the world, I am afraid to say, their generation is falling behind. If this continues, Japan will continue to be in decline.

If you were the Japan PM for a day, what policy would you implement first?

This is a time for the Japan to officially change immigration policy and welcome smart and hardworking foreign people. It is for the benefit of Japan to welcome foreigners. Nowadays you see many tourists, and foreign people working in shops, factories and farms. And Japanese people have got used to seeing foreign people in society. People in Japan now realize that without foreign workers, day-to-day life in Japan would become very difficult. There are over 2 million foreigners working in Japan today as a job trainee or on a student status, as the work permit regulations are not clear. We must change our immigration policy and make immigration rules and regulations clear so that more and more qualified foreign people feel comfortable living and working in Japan.

Would that be the fix for the Japanese economy?

It will help supporting the economy in two ways. A shortage of workforce has become serious issue in many industries, such as construction, retail, nursing care, and many service sectors. The foreign workforce will fill these gaps. Also, foreigners may provide the necessary pressure on young Japanese people, enough to make them feel threatened that they need to work hard, if they want to find good jobs. However Japanese economy has many complicated problems. On the macro-economic front, although we are finally starting to see some inflationary pressures in the US, and we hope this spreads to other parts of the world, CPI remains very low in Japan. BOJ is left with a very limited policy mix and is far from beginning any normalization process in their monetary policy. On the other hand, large Japanese companies have gained more momentum by improving their corporate governance standards, making tough decisions to focus only on what they are good at and to cut cost. Over the last five years they have made a lot of effort to improve efficiency and ROEs. Hopefully this trend will continue, and the deflation period in Japan is finally behind us

What is your view on China?

China will continue to grow even though it will be at a slower pace than before, there is little doubt about that. Asia will be more and more influenced by China. There will be countries who will be comfortable with this, and others who will not. Japan has to learn how to live with China. One of Japan’s advantage is that it is a free and democratic country. People like that as a place to visit, work and live with their family. And because of the US-Japan defense treaty, we have safety. But there are also parallels between Japan and China. Debt levels of both countries are inflated, and poor governance has led to bad investments. That caused a bust in Japan before, and poses a risk to China going forward.

Japan has been a dominant player in most industries like manufacturing and electronics, but has never really had a dominating position in financial services on a global stage. Why?

Ever since WW2, the Ministry of Finance (MOF) in Japan has controlled every product and service that any financial services institution could offer. There was virtually no freedom given to banks to initiate a new product or business service without consulting with the MOF. So, there was no real effort by individual financial services companies to be innovative, until they were faced with the so-called “Japanese Financial Big Bang” in 1996. Soon after the Big Bang, many big foreign firms entered the Japanese domestic market with global expertise and services, and this was a wake-up call for Japanese financial services companies to seek survival strategies of their own.

That's interesting. As a young engineer working for Suzuki in the 1980s, I was amazed by the culture in Japanese companies, and couldn't help thinking that this was crucial to their huge successes. Why wasn't this followed in Financial Services firms?

It is not possible to generalize company cultures across industries in Japan. There are multiple categories of cultures even among the manufacturing sector. Companies such as Toyota and Komatsu who have made tremendous effort and successfully produced world class excellent products, could define their own global philosophies such as 'The Toyota Way' and 'The Komatsu Way' based on their strong Japanese culture. When they went abroad, they tried to replicate these philosophies as it made them successful in Japan. Initially they had Japanese expats running their operations and training local staff in the factories abroad. Today, they have a layer of local management who have a good understanding of their corporate culture, and at the same time are willing to introduce global good business practices into their headquarters. This has worked very well for them

Other companies like Takeda Pharma, Fujifilm, Asahi Breweries, and financial firms like Tokio Marine & Fire and even Nomura, have enjoyed a very strong domestic business, but realized that the domestic business was not growing and needed to expand overseas. They have done in two ways. First, they tried to do it by themselves. But they found their products and services were not competitive enough in local markets outside Japan, and it would take a lot of time in creating a stable local management team with a cohesive cultural background. Then they chose an alternative route, which was to buy local companies, even at a premium, and continue to use the existing management team of the acquired company. I expect large Japanese companies to follow this route in the future to grow their overseas business and subsequently create a corporate culture as they become successful.

Having said that, I think there is a growing understanding around the world that corporations should not be run solely for the benefit of shareholders, but also for the benefit of employees, communities, the environment and the future generation. This is namely ESG put into good practice. Many Japanese companies with a long and proven track record, have values which put the customer's interest first, which creates a win-win outcome for all stakeholders. I hope that some Japanese companies will become known as excellent examples of the leading ESG companies.

The Asset Management business is under stress on fees and performance. If you had to design an asset management business today from scratch, what would you do?

There is a structural problem with the active asset management business. If you are a good performing asset manager, you will attract more assets. But alpha can only be generated over a limited capacity. So as you become more successful and your assets under management grow, your performance tends to deteriorate. Additionally, information is available widely and quickly today, and the edge that an active manager used to have in generating alpha diminishes quickly today as financial markets have become more efficient. In other words, active asset management is a good business for the founder and early-stage investors, but it's hard to maintain it as a sustainable business once AUM reaches capacity limits.

Entering a passive business is also very difficult today. Two or three big companies dominate this space, and the tight margins make the barriers to entry quite high.

Does that mean there is no opportunity left in the asset management business?
I think the ESG concept is a very powerful theme for all investors. But it seems to me that there isn't a really good product in this space yet. If a large-capacity, long-term, ESG-based financial product could be created, it is likely to have tremendous benefits for investors, the asset management companies, and contribute in making the world a better place in the long run.

The other under-explored area is asset allocation and asset-liability management for pension funds and retirement assets. The science of allocation is still very much rear-view mirror looking, as participants still largely formulate their strategic asset allocation based on long term historical price movements, and then try and change it every six months or so. If one can come up with a better allocation methodology which is truly forward looking, then there will be a large asset pool pursuing this strategy. I think that a multi-asset class investment skill today is far more valuable than a single asset class portfolio management.

What about Investment Banking? Is that a good business for the future?
Investment banking has been squeezed quite dramatically with the requirement of higher capital by regulators, at the same time spreads have narrowed. As a result, consolidation has continued to happen. At Nomura, we realized this. As a consequence, we moved our global equity execution business into a single execution platform called Instinet, which is owned by Nomura.

In fixed income, it is very difficult to differentiate services just by trading, under a low volatility environment. Now markets have become more volatile, and spreads are likely to widen, so the brokerage business is expected to come back. Investors at the end of the day want to talk to someone who is knowledgeable about markets activities, so the role of brokers will always be there.

The underwriting and corporate advisory business should steadily grow too, as cash is abundant, and geopolitical uncertainty continues to rise in the world.

Softbank has a unique model which is successful. Can there be more Softbanks in Japan?
Softbank is unique because Mr Masayoshi Son is so smart and daring in investing into technology companies. It is so difficult for someone to replicate that model.

What advice would you give to the younger generation who is studying today?
The most important thing for young people is to know is that digital and AI technology is extremely important. Everyone doesn't need to be able to write code or program, but you must know how to improve a business process using the most updated technologies. This is true no matter what kind of job you go into.

Singapore shares a lot of similarities with Japan, in terms of demographics and rapid wealth creation. What policies should Singapore follow, to avoid the abyss that Japan has fallen into?
Singapore was lucky to have a great leader in Mr. Lee Kuan Yew, and he was smart enough to surround himself with talented people. Singapore's transformation was a miracle, which doesn't happen very often in world history – Singaporeans should understand that. There will always be people in less advanced countries who are hungrier, work harder and smarter, etc., so resting on your laurels is a dangerous attitude. Singaporeans cannot rest and close themselves to foreigners, they need to embrace talent – local and foreign – and keep working hard. I think the Singapore government has been studying the successes and failures of Japan in the post war period very carefully, and I am still fairly bullish on Singapore's future.

** **Atsushi Yoshikawa** is a Distinguished Visiting Fellow at NUS Business School, and hosted by the Centre for Asset Management Research & Investments (CAMRI). Mr Yoshikawa currently serves as Chairman of the Board, Nomura Real Estate Holdings. He was appointed Advisor of Nomura Securities in April 2016. Prior to his current role, he served as President and Group COO of Nomura Holdings from August 2012 to March 2016. He also served as CEO of Nomura's Wholesale division from August 2012 to March 2014. Since joining Nomura in 1978, Mr Yoshikawa has held key positions across a number of the firm's businesses, including Retail, Equity Sales, Investment Banking, and Asset Management. He served as CEO of Nomura's Asset Management division and as President and CEO of Nomura Asset Management, Japan's leading asset management firm, from April 2008 to June 2011. In addition to his broad business background, Mr Yoshikawa has extensive international experience having spent nearly 20 years outside Japan in Singapore, Hong Kong, and New York, including his experience as President and CEO of Nomura Holding America. This has given him a unique insight into the firm's international operations and global client base. Mr Yoshikawa graduated from the University of Tokyo with a BA in Economics and received an MBA from the National University of Singapore. He received the NUS Business School Eminent Business Alumni Award in 2014.