It's time to leave home again
Michiyo Nakamoto

Expansion abroad highlights limited opportunities at home, writes Michiyo Nakamoto

Until recently, Japan seemed destined to become the Galapagos Islands of the financial world, isolated from global trends in banking, capital markets and high finance.

As western banks reaped billions from increasingly complicated financial techniques, Japanese banks and brokers, only just recovering from a decade of turmoil at home, were largely unable to take part in the fun.

One year into the global credit crisis, Japanese financial institutions are reaping the rewards of their forced seclusion. As western banks continue to reel from the fall-out of the US subprime debacle, Japan's re-invigorated banks and brokers are beginning to emerge from their hibernation and tiptoe back on to the global stage.

The recent sharp decline in valuations is providing an unprecedented opportunity to bolster Japanese strategies for global expansion and the country's institutions are once again going on the offensive.

Tokio Marine and Nichido, Japan's leading non-life insurance company, has spent more than $5.5bn to acquire Kiln, one of the largest agencies trading in the Lloyds insurance market, and Philadelphia, a US non-life insurance group, in quick succession.

Mizuho, the country's second largest bank, paid $1.2bn for a small stake in Merrill Lynch while SMFG paid £500m for a 2 per cent stake in Barclays. MUFG is poised to spend $3.5bn to take its stake in Union Bank of California to 100 per cent.

Nomura, Japan's largest broker, intends to make strategic acquisitions abroad with some of the Y600 bn (£3.1bn, €3.9bn, $5.5bn) it recently raised.

Outbound M&A so far this year has totalled $43.3bn -almost equal to the record $44.2bn in 2006, according to Thomson Reuters. "We are telling [Japanese companies] that this is a very good time to make acquisitions because they still have access to the capital markets, bank financing is available, there are few private equity buyers and, if you are talking about buying US assets, prices are attractive," says Yuichi Jimbo, head of investment banking at JP Morgan in Tokyo.

The rush to expand abroad is a positive sign that Japanese companies and financial institutions are once again set on becoming global operators.

But the trend also highlights the lack of attractive opportunities at home. Just a year ago, it was hoped that Japan's relatively underdeveloped financial markets might stage a comeback as the government adopted a slew of reforms aimed at encouraging a shift of household assets from savings to investment.

It drew up plans to boost the country's financial competitiveness, including new rules to encourage more funds to invest in Japan and reforms to lower the firewalls between banks and brokers.

Since then, however, the mood has become, if any-, thing, more downbeat. than before. Despite relatively buoyant corporate earnings, the Tokyo stock market was the worst performer among leading markets last year and was down 19. 2 per cent this year at the time this report went to press, this year.

Domestic institutional investors have shown little interest in increasing their exposure. "Only 17 per cent of investments by Japanese public pension funds is going into Japanese equities," says Tom Ito, co-head of investment banking at UBS in Tokyo.

Even the proverbial Mrs Watanabe has shunned opportunities at home in favour of foreign government bonds. Japanese households have as much as Y30,000bn in cash stashed under their mattresses, according to a the Bank of Japan. "There is underutilised money in the economy," says Toshimitsu Motegi, financial services minister.

Meanwhile, "international investors are disenchanted with Japan", says Scott McGlashan, who manages a £230m Japanese equities fund at JO Hambro Capital Management. The fundamental problem is that investing in Japan has failed to provide the kind of returns that investors, are looking for.

"The money management culture is not fully developed in Japan," says Takumi Shibata, deputy president and chief operating officer of Nomura.

Market valuations may look attractive, with almost a quarter of listed companies trading below book value, but this has not led to a surge of interest.

"As far as [foreign] strategic buyers are concerned, there is little interest in buying Japanese companies because there is limited growth and they are relatively low margin, compared Institutional investors are becoming more vocal in their demands for better returns with their international peers," says Mr Jimbo.

The situation is compounded by a regulatory environment that is not particularly conducive to investing.

The Financial Services Agency is making real efforts to boost Japan's standing as a financial centre. But other areas of regulation, particularly tax policy, have been out of synch with the government's purported aim to nurture a vibrant financial sector.

Not only is Japan's 40 per cent corporate tax rate a huge disincentive, the government's stance on triangular mergers - where the acquirer uses its shares, rather than cash - also hampers M&A activity.

"It is extremely ambiguous whether [capital gains] tax can be deferred in a Japanese triangular merger," says Hidehiro Utsumi, a corporate and tax partner at Allen & Overy.

"That is why out-in M&A is not growing. The legal environment has improved quite a lot but the tax environment has not," Mr Utsumi says.

"The Japanese system is aimed at taxing at the entrance. But I think the entrance should be kept open to allow M&A to grow and then they can tax the businesses after they make profits," he says.

Another issue is the shareholding reporting rule, which is too stringent for large asset managers, Mr Utsumi says. For funds that have several trillion yen in investments, "there is a view that they should lower their investment in Japan", he says. "Unless funds are allowed to invest more freely , the market won't improve."

Companies' moves to increase friendly cross-shareholdings and adopt anti-takeover defences have been a further disincentive.

Recently, there have been signs of a recognition that, unless Japan becomes a market where investors can expect reasonable returns, they will go elsewhere.

The Ministry of Economy, Trade and Industry, which only last year was considered a bastion of protectionism, has this year published revised guidelines for anti-takeover defence measures that are considerably more shareholder-friendly.

"It's a dramatic change from what came out in 2005," says Mr Ito at UBS.

"I think we will see changes in the attitude of Japanese companies and the courts."

Meanwhile, institutional investors are becoming more vocal in their demands for better returns, although they are increasingly doing so behind the scenes.

"What is clearly happening in Japan is publicly silent but, privately, determined institutional investors are becoming the mainstream," says Nomura's Mr Shibata.

Even companies are shifting their attitude in the face of persistent shareholder pressure.

In the past few years, Japanese companies have been buying back their shares and increasing dividends. Mere are paying attention to investor relations and engaging with their shareholders. But these changes are unlikely to transform Japan into a financial centre to rival New York and London, or even outshine Hong Kong and Singapore.

To be sure, "because of the strength and size of the economy, Tokyo will be an important financial centre in Asia", says Gregg Guyett, chief executive at JP Morgan in Tokyo. "I am optimistic, because I think that the people in the government are smart enough to recognise that Japan is going to crash if you can't get a return for all the people who are going to retire, and the easiest way to do that is to get returns on their financial investments," he says.

The changes that are taking place reflect a level of recognition that Japan needs a thriving financial sector to provide for its ageing society. But "the critical question is whether the country can build a national consensus around this", says Mr Shibata.

Fonte: Financial Times, London, September 12 2008, Caderno Especial Japan Banking, Finance & Investmnet, p. 1.