

Japan: Yes, this time is different

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“This time is different.” These are four very dangerous words. I am bullish on Japan and I certainly have a hard time making my case. The legacy of Japan’s lost decades is incredibly strong. Being a Japan optimist, I often get a similar reaction to the one that hard-core Elvis fans must get when they insist “the King is still alive.” However, unlike the King of Rock’n’Roll, the Japanese economy is very much alive. In fact, there is plenty of hard empirical evidence that Japan has not just changed but has what it takes to become an economic powerhouse and the envy of the world in terms of economic sustainability.

So what’s different this time? Why won’t Japan slide back into another lost decade? Because the following four fundamental forces have changed from negative to positive:

1) The ownership structure of corporate Japan has changed from a closed, insider-based system to an open and competitive system

In economics, ownership is key. Equity ownership dictates the very basis of power for all the essential corporate decisions—financial, strategic and human capital. Ownership defines corporate culture. Twenty years ago, more than half of the equity ownership of Japan Inc. was tied-up in “mochiai” cross-shareholdings. Now this is down to less than five percent.

This breakdown of Japan’s “keiretsu” ownership structure is why I am the bullish on Japan. The old Japan Inc. was a system of insider capitalism that incentivises bad economic decision making—group banks kept lending to group companies not on the basis of economic merit but for the sake of maintaining relationships and supply-chain group companies were forced into utter dependence on the conglomerates and their banks that owned them, allowing de-facto zero price power and no room for competitive diversification or independence. Imagine your company was built using your brother in-law as a supplier. Cutting him off when a more efficient and better supplier emerged would be basically impossible and incentivising him to change his ways would take time and raise both capital and opportunity costs.

In finance, the “mochiai” cross-shareholdings fuelled a debt-bubble and then kept “zombie” companies alive for much longer than their economic worth warranted. In management, this enforced a “closed fortress” corporate culture of rule-followers and “yes man” salarymen who, in the case of failure, had nowhere else to go—the other fortresses were not open to you.

In contrast, today, corporate Japan has liberated itself from the group-ownership straightjacket, and has turned from a membership-only closed club to an open-for-business structure. The recent Toshiba case proves the point: the old Japan Inc. would have gone out of its way to keep Toshiba in the group, thus keeping Toshiba’s assets hostage to continued in-group control. Instead, Toshiba’s ownership has fundamentally changed. Outside capital has come in, the assets are being strategically re-focused on core-competence. The unthinkable has happened: asset sales, spin-offs, outside directors and outside

management. While Toshiba is a dramatic case, we are now seeing many examples of economically rational change in corporate strategies across all industries.

Make no mistake—Japan's new openness is made possible by the removal of the cross-shareholdings structure. Japan Inc. has turned from being closed and insider-focused to being open for not just business but open for new strategic partnerships, open-source innovation and letting core-competence assets sweat like never before. Yes, it is different this time.

2) Japan is in a demographic sweet-spot and a new middle class will rise

Japan is now in a demographic sweet-spot. In fact, I predict Japan will be the only advanced economy that achieves the ultimate goal sought by policy makers—a new middleclass will rise in Japan over the coming three to five years.

The numbers speak for themselves: yes, the absolute number of people in the total workforce—all people between 15-65 years old—has been falling by about half-a-percent over the past two years; but against this, employment has been rising steadily at a rate of around 1.5 percent. So the drag from falling population numbers has been more than offset by a rise in the number of people participating in employment and economic life.

As the supply of labour shrinks, companies are offering better terms of employment and higher pay. But it is not just about higher wages. It is the total package of employment conditions that makes the difference between taking a job or staying at home—job security, career development, work-life balance, etc.

The positive changes have already started. Companies are now creating net full-time jobs, a complete reversal from what we saw during the previous 20 years—between 1995 and 2015, Japan Inc. was a net destroyer of full-time jobs, part-time jobs were the only jobs created, which pushed up part-time employment from 20 percent to almost 40 percent of total employment. About two years ago this started to change and in 2017, more than half of all new jobs created are full-time ones. Many leading companies have begun to re-hire part-time employees on a full-time basis.

The importance of the change in the quality of job creation—full-time rather than part-time—cannot be emphasised enough. It's at the core of any virtuous economic cycle—incomes are not just higher, but predictable, which allows leverage and credit. A virtuous labour market cycle feeds a more virtuous and stable society. For example, household formation and marriage rates are now rising again. Yes, it's different: In Japan, the current young generation are poised to be better off than their parents.

3) Public policy has changed from political instability and ad-hocism to stability and pro-growth consistency

Between 1990 and 2012, Japan had one of the most unstable political leadership regimes in modern history. In contrast, today's Japan has become a bastion of political stability. Prime Minister Shinzo Abe will celebrate the fifth anniversary of his rule this month and, more importantly, the recent election result has raised the odds of Team Abe staying in power for the foreseeable future. This is good news for all of

us in the private sector—whether we identify as entrepreneurs, business leaders, investors, consumers, pensioners, or a combination thereof.

Of course, you may agree or disagree with some of Abe's policies, but actually it is the predictability and consistency of policy that is often more important than the content. Flip-flopping is the worst that can happen. The less entrepreneurs and business leaders can trust what the tax laws or the investment rules or energy policy or the labour laws or health care costs are likely to look like in a couple of years, the more cautious they are going to become. Just as Japan's political stability in the 1960s, '70s and '80s was important to her economic success, the trap of political instability and regime uncertainty was a huge negative factor cutting down corporate spirits and the private sector's willingness to take risks and invest for the future.

Whether you like Team Abe or not, they do have a consistent track record of being pro-business and pro-growth. No question that more could be done to promote entrepreneurship and growth, but the basic direction is now constructive. Specifically, a premature tightening of policy is now unlikely. Where the 1990-2012 period was marked by repetitive "stop-go-stop" monetary and fiscal boom-bust cycles, Team Abe is keeping a steady course of modest fiscal and monetary support. In turn, this creates ideal conditions for the private sector to develop not just stable growth but escape velocity. Yes, this time is different.

4) Japan's ruling elite is now united in its goal of re-claiming Japan's status as a Tier-One nation

Corporate ownership changes and political stability are the deep structural change that has taken place, but perhaps most importantly the motivation and ambition of Japan's ruling elite has found a new focus. Simply put, the rise of China from a developing economy to a global competitor has focused their minds like nothing else during the past decades. No, Japan does not want to become an economic colony of China. Prime Minister Abe, in a speech to the US Congress, stressed the urgency for fundamental change in Japan's economic structure as "TINA—There Is No Alternative."

In my 30-some years in business, I have not seen the ruling elites—politicians, technocrats, corporate or social thought leaders, be they young or old—as united as they are today in their eagerness to re-claim Japan's status as an undisputed Tier-One nation. While the past decades were marked by defeatism and fatalism, today's Japan is marked by ambition, confidence and a newfound idealism. Japan wants to be Japan, not America and not China.

Nobody knows yet what the new Japan will look like, but make no mistake that a new Japan is being created. Yes, this time is different—be bullish Japan.

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