

Inspiring Economic Dynamism within Japan

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On July 23, 2014, we had the privilege of hearing Takeshi Niinami, chairman of the board of Lawson, and soon to be CEO of Suntory Holdings, speak about the third arrow of abenomics. We thank the Japan Society for allowing us to participate in this event. **The Third Arrow: Most Critical Part of Abenomics** WisdomTree has been excited about Abenomics since its genesis in November of 2012. We believe that markets have responded well to the progress made on the first two arrows—namely decisive monetary policy and increases in fiscal spending. However, the third arrow, which encompasses the structural reforms that are central to Japanese Prime Minister Shinzo Abe's growth strategies, is both the most controversial and the most difficult to execute. Mr. Niinami's insights were of great interest. **Who is Takeshi Niinami?** Mr. Niinami's curriculum vitae (CV) is impressive. Most recently, he has been leading Lawson, a company operating nearly 12,000 convenience stores in Japan. Additionally, Mr. Niinami has been involved in the Industrial Competitiveness Council and has been an advisor to Prime Minister Abe. His greatest involvement was in agriculture and health care, and that is where many of his remarks were centered. The timing of Mr. Niinami's appointment to head Suntory Holdings, a Japanese firm that until now has always been led by a member of its founding family, is also interesting. Suntory's move to bring in a CEO from outside its firm is an important one to be aware of in the broader evolution of Abenomics. **Restoring Economic Dynamism** A critical theme of the talk was the importance of restoring Japan's economic dynamism. In a deflationary environment, the cost of failure is quite high. As a result, businesses don't invest. CEOs and other important company leaders don't gain experience doing business and executing on innovation—they become very skilled at cutting costs. Mr. Niinami emphasized that cutting costs is not the same thing as running a business and making sound investments. He also recalled a conversation he had had with a Harvard Business School classmate who is currently in the private equity industry. His friend had asked a Japanese CEO about his company's subsidiaries. The particular company had approximately 1,000 subsidiaries, and Mr. Niinami's friend was asking which of those the CEO considered to be within the firm's core business. The response from the CEO: They're all within our core business. Mr. Niinami's conclusion: CEOs and senior-level management at firms—many of whom attained their positions of influence by virtue of their cost-cutting proficiency—need to change. It needs to become easier for entrepreneurs to start businesses, and for businesses to fail. It is through this process, which Mr. Niinami repeatedly referred to as economic dynamism, that resources are ultimately allocated more efficiently and Japanese firms become more "investor friendly" over time. **Thoughts on Agriculture** On the topic of agriculture, Mr. Niinami did not mince words: reform of the Japanese agricultural industry, which has been government controlled for more than 40 years, is hard. The critical transition is to shift from many small farms operated by single farmers or families to larger professional operations. As a result, greater economies of scale could have the potential to be achieved and new entrants with experience in running

large rice-growing operations could be attractive. When asked about ultimate catalysts for change, Mr. Niinami pointed out that the average age of a rice farmer in Japan was 70 years. At some point, retirement would occur and this, in combination with aggressive policies from the government, could lead to new ways that Japanese rice growers operate. **Thoughts on Health Care** Mr. Niinami's big point on health care was the focus on preventive medicine, something that he said had never previously been encouraged in Japan at the government level. Mr. Niinami cited that approximately 9% of total payroll in Japan is paid to social security—if longevity continues to increase and people's health in the latter years of their lives is poor, costs have the potential to skyrocket. **Conclusion: Putting Japan on "Global Equal Footing"** Mr. Niinami repeatedly said throughout the talk that one goal of Abenomics is to put Japan on a more "global equal footing." In essence, Japan needs to solve the issues hindering competitiveness on the global stage, which include the stubbornly strong yen, deflation, high energy costs, high corporate taxes, high environmental costs and inflexible labor markets. While Mr. Niinami did not address all of these factors during his talk, he conveyed a distinct sense of confidence that the third arrow of Abenomics has strong potential, and we look forward to seeing the policies implemented over time.

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