Everyone knows the extraordinary success story that is Japan. All of you here today will know that the Japanese equity market represents nearly half the world’s stock market capitalisation outside the United States, that Japan is now the world’s largest creditor nation and that Japan’s share of international banking business now exceeds that of any other country, including the United States.

You know this because there is a substantial chance that the car in your garage is Japanese. There is a near certainty that your camera, your video tape recorder, your sound equipment (including your new compact disk player), your electronic typewriter and your microwave oven were all developed and assembled in Japan. It is also increasingly probable that some of the ladies here will be using Japanese cosmetics and will have Japanese designer clothes in their wardrobes.

I have not provided you with the normal list of awesome economic statistics about Japanese trade surpluses and the size of the Japanese equity market and so on that tends to go with this sort of talk. I don’t want to just talk about what Japan has done or Japan today: I also want to talk about why it has done it, where it is going, what new trends, both economic and social, are developing in Japan and why any prudent investor, institutional or individual, should allocate a very sensible proportion of their portfolio to the Japanese capital markets.

It is just over one hundred years since Commodore Perry released Japan from the shackles, if one likes to call them that, of a closed, insular and feudal society. Perry’s arrival saw the overthrow of the Shogunate of the House of Tokugawa and the Emperor restored to the constitutional position which he always had but had not occupied for some 800 years — Japanese history has a recurring thematic quality about it.

The Meiji era had begun and with it, the development of modern Japan. I wonder now, with the benefit of hindsight, whether the United States government would have been quite so keen to have been the catalyst of Japan’s awakening.

Japan is a series of naturally inhospitable extremely mountainous islands upon which live 125 million people with no natural resources to speak of. When in 1868 it opened its doors to the world, the prospects must have seemed very bleak indeed: its major exports initially were silk and eggs. From these humble beginnings, Japan’s industry has moved from being imitative of other people’s products to the position it now occupies on the world stage, where some of its companies and products are for consumers an essential part of their well-being: Sony, Matsushita, Sharp, National Panasonic, Honda, Yamaha, Nissan, Toyota, Canon, Nikon, Asahi Pentax: the list could go on and on — and it does.

What, then, has taken Japan from being a backward society to one of the two foremost industrial nations in the free world in less than 120 years — and that 120 years interspersed in World War II by the total devastation of the country’s economy and its population?

There are perhaps two principal features that have contributed to Japan’s success: one is the legendary work ethic of its people; the second has been the commitment they have made at different stages in their development to research and to the future in order to ensure that their technology is as up-to-date as possible and that they are the lowest-cost producers. This could be called a collective conscious desire to innovate at all costs.

Since 1868, Japan has moved its emphasis of production from silk and eggs to the heavy industries which were the technology industries of their time — steel, chemicals, and shipbuilding — through the consumer industries of the 1970’s to the space age technology of today: microchips, lasers and optical
fibres. Future investment profits in Japan, I believe, will come in part from those areas targeted for future growth by the Japanese: aerospace and earth sciences (for instance, satellite — born sensors and laser-ranging equipment), life sciences (such as bio-engineering), robotics, new materials (such as specialist ceramics) and information systems, (including fifth-generation and superfast computers).

The possibility that in 20 years, Japanese corporations will be competing head to head in completely new industries with such technological giants as Boeing or the Hughes Aircraft Corporation is not a pipe dream.

The largest Japanese companies are now spending considerably more on research and development in relation to total sales than their United States equivalents. Whereas previously Japan established an edge over its competitors first through economies of scale and then through superior manufacturing methods, in the 1990's its relative success will be assured through an increasing technological advantage.

In the last two decades, we know that Japan has risen to dominate consumer products such as television, cameras and video tape recorders. But take a sector such as industrial machinery: once the preserve of industrial Britain, America's rust belt and Germany's Ruhr. Such diverse areas as machine tools, printing machines and robotics are fast becoming Japanese dominated. In the semi conductor industry penetration of the United States domestic market has led to company after company surrendering market share to fiercely competitively priced Far Eastern products. The same product targeting process which gave Japan such leadership in shipbuilding and steel in the 1960's and led to its success in the manufacture of consumer goods in the 1970's and 1980's is now giving it a greater influence in a wide spectrum of industrial spheres.

This is because Japan has been utterly ruthless in the application of new technology, and has as a result seen off many of the Western worlds formost industrial companies because Japan's acceptance of the microchip and other such devices has gone far beyond that of any other Western nation. The collective wisdom of the Japanese people is that they must continue to innovate to survive. They have been pre-eminently successful in this quest, and the result of this has been that they have built up a very large trade surplus with the Western world. Estimates for the surplus this year vary between US$50-100 billion. Already this surplus is being used to develop their financial activities by building up both direct and portfolio investments overseas. Japanese stockbroking firms are already among the world's largest. Tokyo is well on the way to becoming the third financial centre of the world, and this has major implications for the City of London, New York and the traditional financial pecking order of the Western world.

Japan's massive trade surplus has led to a concerted international effort since the Group of Five meeting last September to push up the value of the Yen. I read from time to time in the newspapers that the strength of the Yen will impact severely on the Japanese economy; I wonder if this will be so; Japan's market share in many products is such that there is no suitable or available alternative manufacturer. Japan dominates colour television production, VTR production, audio and video tape production: all are capital intensive industries, and cannot, in the short term be duplicated. Profit margins will be eroded in these areas but the dominance of Japan will not be. The other side of the coin is that because of the strength of the Yen Japanese companies are being forced down the road of further innovation and research. These new innovations will take time to show through, but long term, my belief is that they will only serve to strengthen Japan's competitive position.

Let me give you an example. There is a company-Tamron-which produces 8mm lenses for Sony. When the Yen strengthened, Sony told Tamron that they must reduce the cost of this product by 30-40 per cent. The effect of this was to cause Tamron to look at their methods of production. In the initial review, they were able to reduce costs by 35 per cent, by moving from outside metal assembly to an in-house plastic injection moulding system. However, there were still two parts involved. After the next production modification, however, Tamron were able to manufacture the assembly as one piece by investing in new production equipment. The effect has been to cut the overall cost of the assembly by around 60 per cent. Can you think of a company in this country that could do the same? The pressure, therefore, of a very strong Yen has forced Tamron, and is forcing many others, to become even more innovative to reduce costs and remain competitive. In the longer term this innovation will cause further problems for industry in the rest of the world, who have not had the same pressure to innovate as the Japanese.

The other way that the Japanese are combatting the strength of their currency is by investing in manufacturing plants outside Japan in the major markets that they are competing in. In this way, in the long term, the strength of the Yen will not impact so severely on the exporting companies, and will allow them to retain their market share.
Many potential foreign investors in Japan are also concerned about the impact of additional trade restrictions on Japan which would constrain its export ability. Interestingly, Japan is less reliant on exports for its economic well-being than is generally recognised. Less than 15 per cent of Japan’s Gross National Product is derived from exports; this compares with 27 per cent for the United Kingdom and 30 per cent for West Germany.

Japan itself has long recognised the dangers of overseas protectionism to its trading activities. Already almost half of Japan’s exports are in some form constrained by imposed or “voluntary” quotas and tariffs. For this reason, in addition to currency considerations, Japan has committed itself to a massive direct investment in overseas manufacturing plants. By the early 1990s, for example, the Japanese will have the capacity to assemble 1,300,000 cars a year on American soil. This should be in addition to the 2,000,000 cars presently imported direct from Japan. Only half of the content of the US-built Japanese cars will actually be of North-American origin; high added value items, such as engines and transmissions will be mainly imported from Japan.

The same syndrome will affect Japanese consumer durables and other manufactured goods. It is much less easy to discriminate against components than against identifiable “big ticket” items (indeed, it will be undesirable to discriminate against such imports when local employment has come to depend on them).

So, over the next decade, Japan will steadily move overseas a large part of its assembly industries, whilst retaining for domestic production the higher added value components and devices. All this fits in very neatly with Japan’s need in the next two decades to employ more efficiently a work force which will be shrinking as a percentage of the total population. Japan’s population is ageing far more rapidly than any other nation: this demographic change is opening up a completely new dimension to the investment scene in Japan: I expect to see the emergence of companies catering for healthcare in the home and retirement communities.

Japanese pharmaceutical companies with effective drugs in such therapeutic categories as anti-cancer, cardiovascular disease and anti-arthritis will also be prime beneficiaries. Already now, Japan, with a population half that of the United States, spends the same amount in US dollar terms on drugs.

What else is happening in Japan that makes it an attractive area to invest in? Is the success of Japan causing a change in the aspirations of the population? The work ethic is still there, but the Japanese are demanding for themselves a better standard of living. This is being reflected in eating-out, for instance, where three or four years ago, only one per cent of consumer spending went on eating-out; currently this has risen to around the four per cent level, and it is possible that it could rise to thirteen per cent of consumer expenditure, which is the figure for the United States, sometime in the next fifteen years.

Another change that we are noticing in Japan is that women are demanding what their counterparts in the Western world have aspired to for some time — fashionable clothing and better facilities in the home, which in turn is bringing about the emergence of new industries, such as home improvement centres and mail order companies. The Japanese leisure industry is also increasing in importance, reflecting changing lifestyles, while at the same time more people are taking their holidays abroad — the strength of the Yen obviously encourages this.

Concurrently with this change in consumer attitudes and preferences, the Japanese government is responding to overseas political pressure by seeking to promote the propensity to spend and domestic economic growth: this is being done through various fiscal stimuli, infrastructural improvements in such areas as transportation and water-treatment (this in turn has implications for research and innovation), a tax reform package and the denationalisation or privatisation of such entities as Japan National Railways, the Tobacco and Salt Monopoly and Japan Airlines.

Not least of these will be the partial sale in a few months, of the presently wholly Government-owned Nippon Telephone and Telegraph (NTT). This issue promises to be the largest ever seen in Japan and will, in essence, mirror that of British Telecom (BT) which recently took place in the UK except that NTT is three times the size of BT. BT’s successful floatation was noted with considerable interest by the Japanese authorities. The publicity which attended the launch of BT should be as nothing compared to the concerted and orchestrated promotion which will precede the listing of NTT in Tokyo. Both the Japanese Government and the massive sales machines of the leading securities houses will have an identity of interest in ensuring that the issue is a roaring success. Foreigners are unlikely to be invited to participate in this lucrative placing, but they will most certainly be encouraged to buy the shares in the secondary market. A great deal of “face”, money and ambition is tied up in the NTT issue,
and the huge liquidity which characterises the Japanese economy at present will be mobilised to ensure its success.

Let me sum up: it is obvious that Japan has come a very long way in a very short period of time. It is now a far more mature economy than that of 20 years ago, but the desire to innovate which has characterised Japan continues; this means for investors that tremendous investment opportunities will continue to be available if properly researched. It also means that the Japanese population will become wealthier and this, in turn, means that they will have new aspirations to be catered for — which will create new products and new markets.

- The work ethic continues;

- The desire to innovate and invest in the future remains;
- Japan has low inflation and low interest rates;
- Japan is a major beneficiary of reduced oil prices;
- Japan has an economy which is experiencing increasing domestic demand;
- Japan has a strong currency.

In this regard, it is interesting to note that the Yen has never been re-denominated and is exactly the same unit of currency that has prevailed since the Meiji restoration. Would you care to guess what the Yen/US dollar exchange rate was before World War II? Would 500 Yen suit your book or 5000? or 50 Yen? Well that is what is was: 50 Yen. And is it not likely that is the direction in which it is heading back over the next few years?