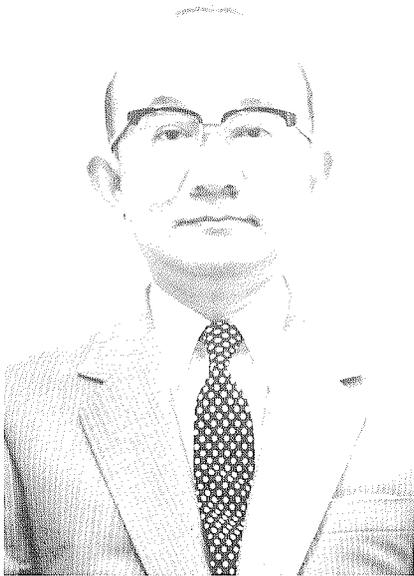


A GE OF THE SPECIALIST

BOOM FOR JAPANESE ANALYSTS



by GENTARO YURA

Major factors affecting the development of the securities industry in Japan have revolutionised the role and functions of the country's securities analysts.

Recent economic theories maintain that financial intermediaries play a vital role in providing professional financial services, particularly the compilation and dissemination of information about various types of financial assets, in addition to the more traditional role of credit substitution and transformation. In a similar way, a security analyst plays a very important role as an intermediary of information between issuers of securities and investors in the securities market.

Given the nature of marketable securities, it is rather easy for an information gap to arise between the seller (i.e. issuer) and the buyer (investor) concerning the quality of the product — the so-called asymmetry of information between the parties concerned. Hence, under the modern securities exchange system, full and timely disclosure is required of an issuer of securities who wishes to raise funds from the market, so that investors can make rational investment decisions. However, in practice, as the activities of corporations have become more complex, so has the corporate information which is disclosed, and an investor finds it more difficult to fully appreciate it. Even if an investor has sophisticated analytical capabilities, he may find it too time-consuming and costly to collect all information available and analyse it by himself. Herein lies the need and rationale for a specialist who monitors information provided by an issuer on a

continuous basis, who also processes it and gives some evaluation, thereby making it easier for investors to understand. That specialist is the security analyst.

The information a security analyst has to collect, analyse and evaluate is quite diverse, ranging from data about individual companies and their securities, the industry that a particular company is associated with, to macro-economic information such as economic activity in general or monetary trends. Furthermore, as investors and investment instruments become more diversified, together with the increasing scale of investments, portfolio analysis becomes more vital to identify that optimal combination of investment instruments that meets the specific investment objectives and risk-tolerance of a particular investor. This has been promoting the specialisation of security analysts into research analysis, portfolio management, and investment advice.

At any rate, as security analysts (in the broad sense of the term) go through the investment decision-making process which involves analysis, evaluation and application, they facilitate the channelling of investment funds into the most favourable companies or industries, thereby contributing to the efficient distribution of capital through the

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securities market. This, I believe, is the fundamental role of security analysts in promoting the growth of the securities market.

The relationship between the market and the analysts goes in both directions, in that the growth of the market itself increases the need for more sophisticated services on the part of security analysts and also expands the business opportunities for analysts.

In Japan, security analysis as such has been conducted for quite a long time, particularly by the research departments of securities firms. My own association, the Security Analysts Association of Japan, was established 25 years ago in 1962. However, it was not until a few years ago that the profession of security analysis came to attract attention from the public at large and that the investment-related industry in general started to emphasise security analysis in earnest. Evidencing this increased interest are our examination figures. Our examinations started 10 years ago, and in each of the first five years the number of applicants averaged about 1,400, but alone this year the number is 15,000, an increase of more than 10-fold. Also, members, including corporate members, now stand at about 2,500, 2.5 times more than 10 years ago.

There are three major factors behind this growth of the profession of security analysts. First, the securities market has grown rapidly and its weight in the overall financial market has increased. Until the mid-1970s, during Japan's high economic growth period, funds were channelled through bank loans and the securities market was no more than a secondary player.

However, since the mid-1970s, especially the second half of the 1980s, open markets, in particular securities markets, have shown spectacular growth, resulting in the so-called securitisation of finance. The reasons for this change are: (1) Japan's budget deficit and

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massive issuance of government bonds promoted the growth of the bond market, where rates are determined by the market; (2) as economic growth slowed down, investment in financial assets has come to be preferred over investment in real assets; and (3) the growth of electronics and financial deregulation has given rise to financial innovation, particularly in the securities market, where a multitude of new financial products and new modes of financial transactions have been developed. I believe other countries have seen similar developments to a certain extent, but in Japan, because the loan market had been dominant for such a long time, the impact of these changes has been much greater.

The loan market is essentially a privately-negotiated market involving specific lenders and clients. Lending banks, which are intermediaries themselves, have to determine the credit-worthiness of borrowers. In contrast, in public markets, as I mentioned at the outset, full-time information intermediaries are required between issuers and the many and unspecific investors, and this is where security analysts come into the picture.

The second factor behind the growth of the profession of security analysts has to do with the growth of institutional investors. In Japan, as in other nations,

as more and more financial assets are being accumulated, institutional investors such as pension funds, trust banks, life insurance companies and investment trusts have quickly grown to account for the majority of securities transactions. And, in line with these developments, investment advisory services, a new form of investment-related services, have also grown at a rapid pace.

Quite naturally, as the size of funds invested by institutional investors becomes larger, there will be a greater need for more sophisticated investment information and portfolio management techniques. As a result, because institutional investors are enhancing their own in-house analytical capabilities, securities firms and investment advisory companies are being forced to recognise the need to upgrade their own analytical capabilities.

In recent years, the fact that our association has witnessed a sharp rise in both membership and the number of participants in our educational programs as well as the greater variety of industry backgrounds of members, is a reflection of the greater need on the part of institutional investors to develop their own analysts and also on the part of securities firms to provide highly qualified analysts to meet the more sophisticated needs of institutional investors.

The third factor is the globalisation of securities markets. International capital flows have become active since the world moved to the floating exchange-rate system. This, in turn, has prompted the opening of national financial markets and the more rapid spread of financial innovation worldwide. Securities markets themselves are becoming more and more integrated to form a global entity.

Such liberalised capital flows and the globalisation of markets inevitably leads to the expansion of the activities of analysts. Japanese analysts must not only

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be able to provide foreign investors with useful and convincing investment information about the Japanese market, but also gather and analyse information about specific foreign securities and overseas markets. By so doing, Japanese analysts will find themselves more and more in competition with security analysts in other countries.

I believe this will act as a positive stimulus to improve the overall quality of Japanese analysts. In fact, the tremendous growth of analysts the past few years in Japan seems to be partly a result of the globalisation of securities markets. I believe that for the Tokyo market to become a real international financial centre, we need more analysts equipped with the capabilities that are required of a truly global investment manager.

As I have described so far, the situation in Japan clearly shows that parallel with the rapid growth of the securities market, the status and role of

unique characteristics. However, if one takes a somewhat longer view, and given the overall trend of market developments, there is no doubt that the growing number of market participants is creating a broader supply-and-demand base, which will ultimately lead to prices being largely determined by intrinsic investment value. Money flows are becoming more globalised and cross national borders freely. When the gathering and analysis of information is expanded to a global scale, and when there is a very active flow of information, the flow of money will follow suit, and market price formation will be averaged out globally.

When this happens, the Japanese stock price levels will be determined by fundamental factors such as the growth of Japan's economy, or earnings forecasts of a particular industry or a company. Hence, through discharging their role as information intermediaries, which I described earlier, security analysts will

And, if an analyst is to evaluate a multinational company or a foreign company, he must be versed in the accounting rules and practices of different countries. Also, in the area of portfolio management for institutional investors who invest a large amount of funds, the use of new instruments to control risks as well as add value, such as options and futures contracts, and also the application of quantitative analytical tools incorporating the most recent investment theories, will become increasingly important.

There is no doubt that the scope and level of expertise and techniques required of an analyst today is far greater and more sophisticated than 10 years ago. At the same time, because of the rapid progress of globalisation, the need for commonality in our body of professional knowledge and techniques is becoming dramatically evident.

To help analysts keep abreast of the ever-changing theories and practices, the Japan association gives top priority to upgrading and updating various educational programs. In response to the globalisation of financial markets, analyst societies in various countries have embarked on a common approach for the international standardisation and harmonisation of educational programs. This is a very welcome move toward improving the abilities of analysts on a global scale.

A further challenge is the raising of professional ethics and the establishment of professional standards. It goes without saying that because the very nature of securities analysis entails predictions of future earnings and risks, it is therefore uncertain by definition. Additionally, it involves products with violent price volatility. Because of this, to qualify as a true professional, it is vital for an analyst to be able to maintain a high degree of mutual trust with the investor, who is his client.

To achieve this, an analyst must exercise stronger self-discipline to achieve a high level of professional conduct worthy of the profession. The Security Analysts Association of Japan recently established standards of professional conduct, requiring compliance on the part of its members.

Knowledge and techniques as well as integrity are the two important pillars of our profession. And, as long as our efforts continue to strengthen them, I believe that the future for analysts will be extremely bright. □

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analysts has also steadily risen. Today, security analysis is attracting talented young people because it is a challenging profession with great prospects.

I should mention that in the past, a good many people believed there was no use or, at best, only very limited use for analysts. I must admit that some people still think like this. Their reasoning is more practical in nature in that they maintain that in the Japanese market, price formation, particularly of stocks, is determined not by fundamental investment value but by a uniquely Japanese supply-and-demand relationship and that if one follows the advice of rigorous analysis, one tends to underperform. Their insistence that there is no need for analysts is based upon a notion which is completely opposite to the efficient market hypothesis.

I do not deny that the market and price formation in Japan have some

contribute to the efficient use of capital on a global scale. Perhaps my view is too optimistic, but I firmly believe that analysts will continue to play an important role in the context of the dynamic development of financial markets.

Of course, analysts themselves must meet various challenges in order to satisfy the growing needs and expectations from the marketplace and elevate the status of the profession.

Because the activities of corporations are becoming more diversified and internationalised, analysts must be equipped with the knowledge and techniques to collect, screen and properly analyse much more information than ever before. For example, to evaluate the growth potential of a company, an analyst needs not only accounting information regarding the financial strength of the company, but also an understanding of its products and technology involved.