

Mr. Kichiro Takao, President Nikko Securities Inc.

December 23, 1997 Born in Osaka

March, 1958 Graduated from Wakayama University

April, 1958 Entered Nikko Securities Inc.

December, 1982 Board Member

November, 1985 Executive Director

August, 1988 Senior Executive Director

May, 1990 Vice President

June, 1991- Present President

Corporate philosophy and strategy of Nikko Securities Inc.

The industry of securities has been in the severe condition after the collapse of economic bubble. However, it's going to move as a strong spring to aim to develop the industry while it seeks for the way of new risk management. We had an interview with Mr. Kichiro Takao, President of Nikko Securities, a leading company of the security industry which creates such movement and deal with new management. This interview was edited and added some contents based on a lecture of "Securities Management" for graduate and university students of Faculty of Business Administration at Kobe University this April. We asked the top management of Nikko Securities to have the lecture as lesson of the beginning of this year. Mr. Takao, President joined there for the first of this lecture and clearly talked about the history of securities industry in Japan, the position in the current Japanese economy, what the industry aimed at and strategy of Nikko Securities to pursue in that condition. We asked him to place it on this top interview because his lecture was very popular and good theme of the current times.

Introduction

Everybody generally thinks it difficult to understand securities business however we always can listen to today's stock price and exchange rate at the last part of news program and say it's largely involved in the economy. This is evidence that the stock market plays a big role in the economy. In some ways, I think people in charge of securities business are going to play a bigger role and function there. Today, I would like to talk about the role, function of securities industry necessary for structural reform and corporate policy of Nikko Securities while looking back on the history of security industry.

Before the main topic, I'd like to simply introduce myself. I graduated from Wakayama University in 1958 and entered Nikko Securities Inc. It's been three years since I became President. I worked in the Sales Dept. for 21 years except for the three years and for 12 years in the head office. It's the proportion of two to one. I was just a general student and crazy about playing baseball in my school days. When I entered this company,

the Japanese economy was in the severe times around 1958, the 33rd year of the Showa or chronic recession and it didn't improve for a long time. I was doing an employment activity at that time but the condition was similar to the present times.

There were few listed companies at that time. It was good 20% of graduates could enter in the listed company. I entered the company without being aware of what securities company was and what I would do there.

I will simply explain a little about Nikko Securities. It was established in July, 1918, the 7th year of the Taisho and had been 75 years last year since then. The security industry is said to be very young but our company has seventy-five-year-old history.

We have about 15,000 employees in the whole group this April and about 11,700 only in the Nikko Securities which come in the second in the major four securities companies therefore the major four companies have this scale. The average age in Nikko Securities is 31 years and 11 months old which is comparatively younger compared to other industries.

The capital is ¥123.11 billion at the end of March in 1994. Own capital is ¥800 billion and comes in the third in the four companies. Compared to the main securities company in the world, Merrill Lynch is ¥460 billion, Solomon Brothers, ¥430 billion, Goldman Sachs, ¥370 billion and Morgan Stanley ¥320 billion. These four companies are said to have large capital. Compared to the main company, commercial bank has considerably more capital of about ¥2.1 trillion which is more than double as much as ours. When we looked at other companies, there are 15 companies which capital exceeds ¥800 billion such as NTT, Toyota, Matsushita, Nissan, Hitachi, Sony, Tokyo Electric Power, Toshiba and Kansai Electric Power.

We have 126 domestic branches and 27 overseas offices in 20 countries. I think the four security companies also have the same scale. We have ¥32 trillion in deposits and come in the third among the four companies. Compared to that of commercial bank, the First Kangyo Bank has about ¥39 trillion, Mitsubishi bank ¥37 trillion. Seen from the viewpoint of financial assets that we have deposit from customers, we maintain a decent level among those banks.

We have several groups including the main body and will talk about main things of them. We have an investment trust management company in charge of fund management, Nikko Securities Investment Trust Management Co., Ltd. Its net asset is ¥8.7272 trillion at the end of March in 1994 and comes in the second in the industry. Compared to other industries, deposit balance of the top local bank is about ¥8.5 trillion therefore the asset is almost the same level as that of the top local bank.

We also have two investment advisory companies, Nikko International Capital Management and American company of Wells Fargo, Nikko Investment Advisors where we invest half of its capital. The former contract asset is about ¥1.6 trillion and the latter one is about ¥680 billion. The total assets are ¥2.3 trillion and come

in the third in the industry. In addition, the contract assets of joint venture Welse Fargo are ¥17 trillion including all overseas groups. When we see this figure, we can know how large the overseas market is.

We also have think tank of Nikko Research Center(hereafter described as NRC) some staff members of this NRC have been transferred as a professor of Kyusyu, Hokkaido and Nagasaki Universities and I'm very proud that NRC has fairly great level and it comes in the second as think tank of securities following NRI according to the evaluation by investors.

In addition to that, we have Nikko Capital which invests in venture and starts a trust bank last October according to the financial system reform and Nikko Trust and Banking (Corporation) is also one of our group companies.

This is a profile of Nikko Securities and Nikko Securities Group. I'm talking about today's main topic about securities industry argument, how the Japanese securities market structure changes, history of Nikko Securities and Corporate strategy of Nikko Securities.

Securities Industrial Argument

Securities Industry provides intermediation service of funding and fund management. It gathers, analyzes information and evaluation and provides professional knowledge including know-how for customers as an intermediation organization in the industry.

Securities market divides into two, Issue market and Secondary market.(See figure 1.) In addition, the issue market is divided to the issue side to issue securities and the investor side to acquire it. In the issue market, issuer is nation or public institution or various companies. Meanwhile, investor has two kinds, corporate and private investors. Securities companies do underwriting stock and sell it to investors as distributor.

Each investor doesn't continue to have stock acquired in the issue market, sells or purchases it for each reason in the securities or over-the-counter market which decides the price of securities and formalized the other secondary market. The securities company for example is in charge of stock brokerage dealing with buy or sell order of stock to the market, and dealing business to buy or sell public corporation bond and securities for investor's response which aren't listed on the stock exchange but often traded.

These works on the issue and secondary market are the basic structure for securities business. We have various jobs on such business and can divide into the following three jobs if I explain them in detail.

(1) Make financial products(securities business as manufacturer)

The first job is to make financial products. These financial products have several products such as single product of government bonds, corporation's stock or bond. We play roles of giving issuer advice about the market to issue product type of what securities are issued or decision of price and interests while understanding investor's needs and conditions of secondary market.

We combine such many single products with other products to make new products. Please see Figure 2. There are various products from warrant to stock and bond here. Products are lined in the order of high risk and return from the right above to the left below. For example, warrant has high risk but receive high return. On the contrary, bond has low risk but is difficult to get high return.

From such product combination, we will get new products such as stock investment trust and public and corporate bond in investment trusts like MMF and Chance.

We can deal with various needs from the side of investor by the combination of products such as professional fund management to solve insufficient knowledge or management of small-lot securities. In addition, it sometimes becomes difficult to issue high-risk product because there are fewer people to accept. However, such products combination enables to minimize investors risk and issue it in some cases therefore, we can deal with both needs of investors and issuer.

The one more job for us is to make new product such as securitized paper. This is a future business for us. For example, we collect bond of non bank as soon as possible to improve its financial institution and ask someone to buy this bond and sell them as securities to general public. We'll considerably do such business actively in the future. We start to think such new business and product as a big market.

Simply compared securities company to bank, bank receives deposit, lends it and is the world of mass. Meanwhile, we issue and distribute securities therefore we can create various products according to customer's needs. In such ways, our business is extremely innovative. When we look at examples in other countries, it's not too much to say that securities business takes the leadership in financial reform and I think this business will also be very interesting job in the future.

MMF (Money Market fund) mainly focused on extremely short term corporation bond and started to be sold in the U.S. in 1971 . It caused to be a large flow of deposit from bank and focused on this MMF. This also accelerated financial deregulation. Now that it accounts for 3.3% of private financial asset, it becomes something familiar to us. This is one of the innovative examples.

We Nikko Securities developed new product of "Chance" in January, 1991. This is a product mainly managed

by public corporation bond and we keep fund in three periods of three month, six month and a year now. We reached the level to keep ¥1.7 trillion only for three years. The scale of ¥1.7 trillion comes in around the 46th among 129 banks compared to deposit balance of domestic local bank throughout all areas in Japan. If we catch investor's needs precisely, we can have opportunity that this level of fund might increase only for three years. In some ways, I can say our business is very innovative industry.

(2) Sell information (Securities business as information industry)

Then, we have securities business to sell information as information industry. Everybody can understand it well. For example, all information such as interests, fluctuation of exchange rate and economic information, political and social situation, movement of inflation relate to the stock market. The stock market can be exactly said as economic epitome. Therefore, all economic phenomena in the world are evaluated as the price through the market. In such point, we always live under tension every day.

When I worked in the securities company for three years and felt when joining in the class union that we had respective different talks because it took several years to start working. At that time, I thought the securities company was the closest in the world which varied every hour and day. The securities business is exactly such place. That's why everybody says it's very severe business or there are many things to study but I think it's very challenging place in some ways.

Such information moves when they are forecasted, so it's too late even if we do action after an incident. We forecast a situation and do action before it happens. After something occurs for example as a result spread expands or a risk occurs. I feel this is very interesting. Because of this, we have to gather or analyze various kinds of information such as economy, interests and exchange rate as an economist.

One more thing we have to do is to know each of corporate information such as how A directs to develop its management and how the accounting result of this fiscal year becomes. It's also important to fulfill analyst's function to analyzes these information and sell it.

There are various ways to sell information. For example, Matsushita listed on a stock market in the postwar period in May, 1949. If we bought 1,000 stocks and invested ¥64,000 at that time, what do you think how much would be? If we kept it until now, it would exceed ¥300 million now. Ito-Yokado listed on the stock exchange in September, 1972 if we bought 1,000 stocks at that time and the price was ¥1.4 million, it would be ¥67.91 million now.

To sell investors information means that we forecast the future condition, analyze and evaluate information. It means we recommend a brand to investor but it dominates a large part of our jobs.

Throughout such information, we will receive charge for services. The charge can be said as consideration for information analysis and evaluation. Therefore we aggressively make an investment. We have about 220 analysts in our think tank of NRC and 20 staff members in charge of providing information to private customers, so a person per 25 members with comprehensive work will work as an analyst or economist. We will fulfill, strengthen this field and prepare for training so that all employees can get a license of analyst.

In relating to this issue, we also have a problem to establish information system. The expenses relating to our computer system in March of the fiscal term of 2003 was about ¥40 billion. We use half of this to analyze or provide information.

(3) Sell knowledge (Securities business as consulting)

We sell knowledge as well as sell information. We have knowledge about management and procurement. We will give investors advice of appropriate fund and management based on various product knowledge, investment know-how as portfolio manager.

In the procurement side, as I said before, we will support them what products and market they should choose in the global development as advice of procurement. We give advice the way of procurement according to characteristics of fund such as corporate growth level or the way using procurement fund for new business or repayment to borrow. We also help fund-raising of government, state-dominated financial institution or overseas companies especially we considerably developed our business in China, ASEAN and Central and South America last year.

(4) Necessary human resources on securities business

Next I'm talking about necessary human resources on securities business. As is often said that securities business is intellectual fighting sports, when we hear a word of fighting sports, we imagine physical strength but it means intellectual part of fighting sports. Therefore, we need a lot of knowledge, ability enthusiasm and vitality.

We will know the result of service that we provide through the price of securities soon on this business. In such ways, there is a severe part that the result of service is required soon.

At the same time, since there are various customer needs, we have to wide range of activity to meet various needs.

The more difficult thing is that we will complete our job every deal although bank continues to do business with companies for a long time. We finish the relationships with companies basically only once, so this is very unstable and competitive job. Therefore, regardless of age and experience, people with young vitality especially people who have strong sensitivity can fulfill their ability in this industry. We basically think young people develop the field of new product and business. I mean it's meaningful to do something beyond their experience.

Therefore, since this business is very promising in the future, more and more banks establish their subsidiary to enter this industry. Our status is going up year by year on the background of such condition of the industry. When I see the Wall Street in the U.S. although the market between the U.S. and Japan are different, the income of securities seems to exceed that of banks. I think maybe securities business will be more competitive as the innovative industry and give market more returns.

The focus point is that various people who work in banks strongly tend to change their job to securities business which we've never thought before.

In order to respond to these conditions, we want to promote to develop or cultivate human resources, we introduced our original training system and established training school which was different corporation on April 1. According to the changes of the times, we want to focus on such training and education.

2. Changes of security market in Japan and history of Nikko Securities

I'd like to talk about the second topic of how the structure of Japanese securities market changes and history of Nikko Securities. Japanese Meiji government took initiative in establishing the Tokyo Stock Exchange for the purpose of strengthen the basic of financial infrastructure and the modern stock company system in 1878, the 11th year of the Meiji era. I mean the government started bureaucrat-led secondary market. The process of this establishment largely influenced on the way of developing stock market. In the Western country, issue market and secondary market formalized its securities market but Japanese security market developed mainly in the secondary market which caused to have strong meaning of speculative place. Due to the easing of regulation, the issue market was gradually established like advanced countries after 1975 and the times came that it functioned as main part of securities market.

The essence of security business is in the risk management. If we have a lot of regulation, we can't manage risk and control it. We can't have such means due to regulation. We've been in such condition in our history since the security market was opened. The regulation has finally been eased recently therefore we can have free wheeling thinking and developed our business. I mean we can fulfill our innovative ability.

We were considerably criticized three years ago due to stock trading, which resulted from the fact that both issuer and investor had few awareness of self-responsibility. We expect that this leads to establish market and we'll make efforts to it.

(1) Recovery of securities in the 1945s, the 20th year of the Showa

In the 1945s, the 20th year of the Show era, full-scale securities business was popularized, which resulted from stock release, democratic movement of securities and Zaibatsu dissolution. As you can understand it when seeing a document of total market value of the main world stock exchange.(See figure 3.) The U.S. market becomes the top, Japan, the second and England, the third.

Japan introduces American style financial system. Securities firm adopts direct finance and bank adopts indirect finance. Because they separate their function respectively and divided the rule clearly, we can say the security market expanded.

On the contrary, there is European style(German style) financial system. This was called universal banking and bank started to take responsibility for all fields. In such advanced France, Germany, the reason that the security market reached only this level was because it reflected to how the market started up there.

(2) Times of stock and trust in the 1955s, the 30th year of the Showa

It was the time that the stock market was popularized in the 1955s. On one hand, people started to have their own full-fledged financial asset although they had few. People could have money as a result the stock market was also popularized. The birth of investment trust led to promote to expand the market. Please look at Figure 4. This shows the movement of investment trust.

I entered Nikko Securities in the 1955s, 30th year of the Showa. I was in charge of sales in the situation as if I kept going up and down rapidly by elevator. In this expansion period of securities industry(the whole domestic industry was in the same situation) I had increasingly volume of work and had to do as much work as several people had regardless of I liked it or not and couldn't help overworking on Sunday although I only took a day off on Sunday because there were few people including managerial levels at that time. I wouldn't help overworking until 9:00 or 10:00 at night on weekday because of the market expansion.

However, what I really felt in the period was how horrible our desires were. I was so scared of our desires because people changed a lot with money. They were really nice but if they had money, they would change a lot. I was taught it in the process of sales. What a real friend or reliable person was, I really learned it in the

hard way for the seven years since I entered this society.

In some points, I contacted a lot of customers during the time and made them grow myself. I still think so. I always asked myself what right thing was for the seven years. I think the answer is there's nothing correct rule and principle for this question. Therefore, whatever I do, it's important to go back to the basics and think it about again. I really felt like that.

The one more thing I worried during this time was I felt many times what I would become if I continued to work here because I suffered from volatility. However, I just thought I couldn't solve any problem if I thought negatively. This is what I felt in the period.

When people stand in a difficult situation, they always tend to be regretful when they look it back, they shouldn't have done that or they felt good to do it. However, if we do so, we'll be at a loss. I realized I couldn't do anything and couldn't go out from the problem if I struggled more. Therefore, I don't think too much about the results I'll reflect it if I have things to do so but I have no choice but to do if we think it too much. I learned it for this period.

(3) Establish the status of securities business in the 1965s, the 40th year of the Showa

Securities industry was in the severe recession in the 1965s, the 40th year of the Showa It was also the time that there was also a bad event that Yamacichi Securities took emergency finance with Bank of Japan. Securities firm changed from the registration system to licensing system. In this period, we really understood how important the security market or security business was. However it's very strange that new sprout of the times would rather come in the severe condition. The security market is still in the difficult condition but this recession that had never come for 30 years will breathe new life into the new times of security market.

In the 40th year of the Showa, 1965, I was in charge of various jobs in the Personnel and Planning Dept. When I looked back on it, our company established administrative system such as merit-pay system and evaluation system of branch in the period.

At the same time, I experienced president of branch office. The position was very interesting. I can decide what to do and can actually do action. In such ways, the top is the best position. I could learn how important I managed the whole group as well as I worked by myself. I think the ability to work well or not is also important but I learned various things as a proverb said "Work well, play well" and found how important I managed the whole branch through this experience at that time.

(4) Establish organic relationship between issue and secondary market in the 1975s, the 50th year of the Showa,

The issue market finally was established in the 1975s, the 50th year of the Showa and began to take full effect. Japan had a shortage of fund until 1965, the 40th year of the Showa and couldn't help taking fund allocation due to excessive demand over supply. It became in the time of financing surplus and had abundant fund. As a result, Japan stopped its low interest policy and market mechanism started to function through the oil crisis.

At the same time, Japanese economy changed from high economic growth to stable and general companies started to pursue rationality and efficiency of financial constitution. Such time just came that they didn't rely on loan but ran their business with their capital.

The long-term debt from bank was 40% until 1975, the 50th year of the Showa and the short-term debt was 33%. However, it decreased to 10% at the beginning of 1975, the 50th year of the Showa and the ratio of fund-raising by stock or corporate bond increased. At this point, the issue market began to function finally. A big secondary market was born in this period. Underwriting of long-term government bond was 6.8% at most in the whole market of 1975, the 50th year of the Showa but increased to 57% in 1993 which was considerably large figure.

At the same time, government bond increased to be issued a lot. Its balance is more than ¥180 trillion and we can say each citizen has debt of about 1.5 million in a way of national bond.

(5) New times of securities comes in the 1985s, the 60th year of the Showa,

In the 1985s, the 60th year of the Showa to the Heisei, direct finance was established. Fund-raising of Japanese companies including domestic and overseas issues reached ¥28 trillion. It means direct finance accelerated to expand qualitatively and quantitatively from the viewpoint of means of diversification of the fund-raising.

Outstanding issue increased at the same time. Finance outfit was diversified from the conventional spot deal of security to derivative trading such as introduction of future transaction and option which increasingly led to diversify securities market.

There was an illegal trading and panic of stock prices after 1989, the 1st year of the Heisei. Today, new time is coming. Private financial assets are increasing rapidly. For example, the total balance was ¥178 trillion in 1975 but it exceeds ¥1 quadrillion now. It was ¥1.5 million a person before but is over ¥8.6 million now.

There are needs that such fund circulates to the overseas market. Last year, a large amount of capital of

¥4.36 trillion was invested in the overseas market for a year on the Internet. We also have big business here. In addition to that, corporate investor's asset such as pension increases. In 1980, the 55th year of the Showa, pension assets were ¥50 trillion but became ¥190 trillion in March, 1999. It will cross the ¥300 trillion marks in 2000 on such condition. Our contract asset in the industry of financial advisor is still 1.9% and will become larger in the future. Therefore, I think we'll have considerably big business in the future.

3 Corporate strategies of Nikko Securities

(1) Securities market facing structure reform

I'd like to simply talk about corporate strategy of Nikko Security. Although I talked about various things, the structure of security market was growing rapidly now. I summarized what kind of changes it had again. One of the changes is globalization.

The market of HK has the same level as that of Germany and France. The market of HK, Singapore and Malaysia respectively expand to 3.5 to 6 times than before. However, the market of England, France and Germany became 1.3 to 1.5 times at most. There is a large market in Asia. Large amount of fund were invested from Europe and the U.S to these Asian markets.

The other changes are that financial system is largely changing from indirect finance to direct finance. In addition to structure change of securitization, other industries newly enter this market due to deregulation this year. All commercial banks will establish a subsidiary to enter securities business. Computerization also makes us change the relationship with customer which becomes power resource of financial innovation. Four structural reforms have finally started in the security market now.

(2) Corporate strategies to replace changes with a chance

In such environmental condition, what should we do? I mean we have to develop corporate strategy to replace such changes with a chance.

We have a business chance in changes. Furthermore, we have an environment that we can maximize our device because we have such corporate environment. Therefore, we have to implement four things to be a leading company in the future.

The first thing is the ability to manage a risk. We originally do business in a risk. That's why the ability to manage a risk is important. The second is the ability to combine product. This is a kind of skill or product strategy in our company. We have to think about such thing. The third is the ability to sell products. This is a

customer strategy to strengthen sales activity. The forth is after care. We call it "Market make". We need the ability of market make. We also can say financial strategy although it depends on the amount of equity.

The ability to manage a risk means to think how we manage customer's product and risk of our position and increase return. We'll be in a trouble if we take a risk by ourselves therefore we have to think about how we manage it. Only financial institution not only securities company but also bank and life insurance who can do this risk management can survive in the 21st century. That's why we have to strengthen the ability.

For product strategy, in order for us to continue to be a leading company, we always have to take a lead of others. It's important resource to get a new idea. We have to create and develop product with various things such as derivative and computer.

We're so afraid if everybody does the same thing, we have few return in our industry. One more feature of our industry is the term to gain excessive profitability is too short. Therefore, we always have to run. If we have price volatility, we have a business chance there. In such condition, we always have to think how to make attractive product. I mean we have infinite business chance in case of price fluctuation. Therefore we have to do our best in this field.

As things go, a leading company can get both customer and information therefore we'd like to do management to take this initiatives in the industry.

We started studying investment technology for seven or eight years ago. This is combined with computer and investment theory and manages a risk in scientific and subjective way. It's also used to develop products. We established an organization called "Investment Engineering Research Center" in NRC and placed another research center in San Francisco to promote studying various things with Dr. Willian Sharp as an advisor who got Nobel prize. We're pride of being in the front line of the industry. When I arranged our document, I was really surprised to know that we had 800 employees who majored in science and technology because we promoted such research. If we add people who don't major in science and technology but study mathematics to the figure, the total number will be over 800. We considerably make such strategic research.

For customer strategy, the most important thing is to think about how we improve customer satisfaction. I happened to find an article on Nikkei financial newspapers on January 4th that corporate investors had good evaluation for Nikko Securities and thought we're the most highly public and sound company in the industry. In our business, trust is the most important therefore the most important theme for us is how to improve customer's satisfaction to get their trust. We have to understand their needs in detail and how to deal with them well in our organization.

For financial strategy, the first thing we have to do is to expand net capital. I mean we can't do business in

the market without it. With acceleration of liberalization in the future, the tendency will be increasing. In such ways, we have to increase net capital. We strengthen the infrastructure to pursue how we expand more multiple and stable profitability including other fee businesses as well as intermediate business in the secondary market.

Finally, we have to take global strategy. We have to enhance our international presence mainly in the emerging market to survive in the 21st century. We can't survive if we do business only in Japan. In the U.S. and European market which has loose regulation, new product and business are produced one after another and developed across borders to other countries. Global uneven distribution of fund also brings about various businesses through the mediation of the fund flow. In order to keep the top player, we have to make commitments in the important global market.

Nikko Securities pursues localization of overseas branch. Branch leader and managerial level of people play active roles there because it's essential that they understand the market and customer very well in order to take root in each local area and develop business. We'd like to know each feature of the market clearly and develop business in the process of recycling fund from Japan to overseas, or from overseas to the domestic market in addition from overseas to overseas market. We have to create network of four bases of Tokyo, London, New York and Hong Kong and integrate each base on a horizontal basis as a securities company which maximizes individuality and independence.

Postscript

We'd like him to talk about the position of Nikko Securities and the development direction in the future. Securities business will be headed for difficult maneuvering from here on out with the management in new threat and opportunities of global competitor, market or new comer from other industries. He emphasized four strategic points of the ability of risk management, product strategy of skill, customer strategy of sales ability, financial strategy of aftercare and the importance of global strategy. In addition to his forecast and opinions, if you read other reader's opinions about this issue, you will deepen understanding the contents.