COLLECTIVE INTELLIGENCE

Japan's Asset Management Ecosystem: Advice for New Entrants

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Prime Minister of Japan Fumio Kishida is pushing to enhance the country's asset management industry by implementing a series of reforms including tax incentives. While there is a huge opportunity in the Japanese capital market, the new entrants should be aware of the nuanced local context and be equipped with the strategy to communicate effectively.

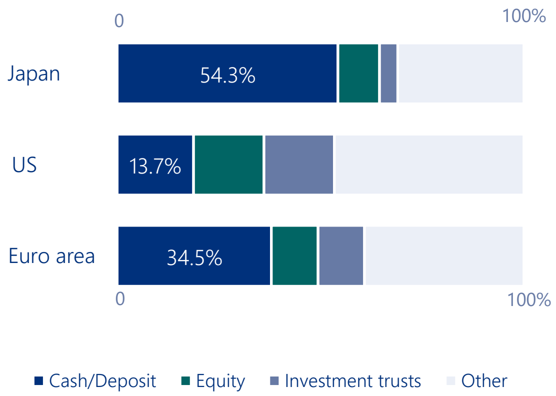
The opportunity

In June 2023, the Kishida administration unveiled its reform plan to develop asset management into a major industry in Japan. Announced as part of the annual economic policy outline, the reform is the most recent of many attempts over the years by the Japanese government to shift huge household financial assets from cash and conservative deposit-based savings – estimated at 1.1 quadrillion JPY (US$7.5 trillion) – to more value-accretive long-term investment tools.

What's in Kishida's reform plan?

- The proposal introduces several key enhancements to individual savings accounts to allow for higher annual contributions and significantly increases the maximum tax-exempt account holding size (reformed NISA (Nippon Individual Savings Account) program).
- The reform also expands the tax incentive for pension investments (iDeCo, DC plan reform).
- A new national agency to promote financial education is to be established and would promote the importance of long-term portfolio investment and financial literacy.
- The plan would also accelerate the effort to make it easy for foreign asset managers to launch business in Japan, including streamlining the registration process.

Strucutral change needed: inflation threatens cash and deposit savings which make up more than 50% of Japanese household financial assets



Source: Bank of Japan, Flow of Funds

Changing the structure and allocation of Japanese household financial assets is much needed; currently, 54.3% of Japanese household financial assets are held in cash and bank deposits, compared to 13.7% in the US and 34.5% in the Euro area. Considering the recent pickup in the inflation rate in Japan, as well as the increasing interest in investment among the younger generation, 1 quadrillion of JPY household cash and bank deposit is potentially well positioned to achieve more returns if moved to investment. This shift could bring significant opportunities for both domestic and foreign players in the financial market.

What's behind the push – and will this time be different?

Return on investment is critical for Japan's rapidly aging society, as evidenced by a 2020 Japanese Financial Services Agency (FSA) report that estimated a financial gap of up to 20 million JPY in the average Japanese household at retirement.

Successive Japanese administrations have sought to precipitate the shift from savings to investment. Indeed, Japan already has a developed asset management industry; however, the absence of a diverse ecosystem has stifled innovation and competition. The Kishida administration is hoping that inviting a fresh wave of experienced foreign asset managers into the market will shake things up. The effort by the FSA to enhance education and understanding of finance and investments is also key in laying the groundwork.

What companies need to know

Despite the sizeable opportunity and the big push by the Japanese government to welcome foreign players into the market, new entrants may face various challenges:

Navigating complex Japanese regulations. While taking an open and welcoming posture to foreign entrants, Japan's regulatory environment contains many layers of complexity. Foreign asset management firms will need to engage government agencies to help shape the development of the industry.

Defining channels. Most retail financial products in Japan, including ETFs, are sold by banks and security companies. Existing Japanese asset management firms are subsidiaries of those same institutions, meaning foreign firms may find it difficult to discover the right channel to sell their products. While many see opportunities to use technology to circumvent this challenge, the regulation in this area is nascent, and while young Japanese investors might be open to using such platforms, most of the wealth is held by older people.

Building trust. New entrants will need to invest in establishing their brand and building trust among retail investors in Japan, and it would be wise for such companies to forge partnerships with well-known local players. In addition, outside of a top tier of sophisticated investors, there is low awareness and understanding among Japanese retail investors of the different types of investment products and their benefits and risks, and Japanese investors are known for taking a very conservative and risk-averse approach. While the new agency established to promote financial literacy in Japan is intended to help address this challenge, it will also fall upon the industry itself to help.

Fighting competition. There is intense competition emerging among foreign asset management firms in Japan. Established foreign players are doubling down on and expanding their platforms in Japan while many new players seek to establish a foothold. This competition spans many areas including talent, partnerships and customer awareness.

How can companies thrive?

Brunswick Senior Advisor Ken Shibusawa, a member of the Council of New Form of Capitalism Realization established and presided by Prime Minister Kishida to produce these reforms, emphasized the importance of encouraging asset management in light of the dramatic structural shift in Japan's aging demography. This shift will have severe implications for the pension system and a smaller younger generation supporting the growing retired generations.

"All Japanese citizens, including children and the elderly, should be aware that they are the final asset owners and that they benefit from incomes earned," he said. "In this regard, the most important part of the message by the FSA is their emphasis on education about finance and investments, which will provide the foundations." In order for overseas entrants to be successful, "it is important to collaborate with local partners who understand the local context and can help map how to engage stakeholders."

To continue the conversation

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