

Special Dialogue

The Securities Business of the Future and Innovation

It is said that FinTech will change financial industry practices from now on. In order to explore opportunities within the securities industry in the future, Daiwa Securities Group has, for example, invested in the venture capital firm, WiL, LLC (WiL), located in Silicon Valley, the creative hub for state-of-the-art technologies. Gen Isayama, CEO of WiL, and Toshihiro Matsui, COO of Daiwa Securities Group Inc., exchanged opinions on the future of the securities industry.

FinTech, the Great Business Opportunity

It is said that the rise of FinTech will greatly change the way business is conducted by financial institutions or the methods of interaction between people and money. What is going on in society now, and how will the world change in the years to come?

Isayama: From our point of view, FinTech is not simply something to be talked about, but in a broad sense, a new technology that will have a tremendous impact on society. A characteristic of technology is that it does not develop linearly and spread sequentially. Even if technologies are separately in existence, a set will at a certain point in time satisfy the requirements for social insertion and suddenly manifest itself. It is difficult to predict when this will happen. Artificial intelligence and machine learning are not in themselves new, having been studied in academia for a long time. When certain conditions, such as faster telecommunication and improved semiconductor performance, are met, they are rapidly implemented in society. As a result, even the intellectual work performed

by humans can be replaced by software and robots, and it is becoming a force for promoting social efficiency at a furious pace. Amid these major trends, the concept of connecting these technologies and finance is represented by the word FinTech.

In the same way as other industries, the financial industry has also automated a range of services and lowered costs by means of new technologies, and the impact this is having on the management of financial institutions is becoming ever greater. In extreme terms, startups that commence financial services with new technology may be more competitive than traditional financial institutions that hold existing cost structures. Of course the reality is not that simple. Finance is a regulated industry and, above all, relationships of trust with clients are the biggest factor in the business, so the industry will not be immediately replaced by a startup that has just come into the financial industry. However, considering that large-scale cost cuts are already being carried out at financial institutions, including in the United States, the managements of Japanese financial institutions also need to reconsider their cost structures.

Toshihiro Matsui

Deputy President and COO
Daiwa Securities Group Inc.



Gen Isayama

CEO
WiL, LLC



Matsui: Daiwa Securities Group stands on the side of the challenger in the sense that we do not possess a big legacy system in the settlement field. Moreover, due to the advances in technology that have resulted in the automation of simple tasks, in terms of being able to transfer the valuable time of our talented employees to more productive work, I think that FinTech will have a positive impact from the perspective of our Group's costs.

Having internally established a Business Reform and Productivity Improvement Committee, we are conducting a thorough review of current operations to create the time to perform higher value-added tasks.

Isayama: Another important aspect of technological development is to create better services and new revenue-earning opportunities through new technologies. For example, if technologies such as ICO* become more widespread as a means of procuring funds, Daiwa Securities Group needs to consider the commercialization of new capital financing that utilizes ICOs. In accordance with the changes that technology brings to society, I think that it will come down to companies discussing improvements to their organizational structures.

Matsui: It does not mean that I am not convinced that ICOs will grow into an important means of procuring funds, but at least that possibility cannot be ignored, and I think that it will be impossible for us not to respond at all. We will invest certain management resources in this field, and we will not rule out the possibility of conducting ICOs ourselves.

Isayama: I think that the most important thing is to make the choice as to whether to feel such things as this kind of change or facing competition as a threat or an opportunity. In the United States, you often hear people use the phrase "your choice," but how you ascertain the impact of things is only each person's choice. In Japan, European and U.S. IT companies, such as Google and Apple, are often spoken about in negative terms as a threat, but considering the influence that they have exerted on Japanese society, I regard the current situation, in the run-up to the full-fledged implementation of FinTech, as presenting a very interesting opportunity. It seems that we are reaching the stage where maintaining the status quo would be the worst option.

Matsui: My favorite saying is that of the professional *shogi* player, Yoshiharu Habu: "I'm not optimistic, much less pessimistic, just downright calm." This leads us to your stance on choice. Changes in the situation always have threat and opportunity sides to them, and it is important for managers to identify them without being biased toward either. You have to see both sides to see how to take measures against tough situations and how to grab opportunities. There are many people who say that Japanese tend to be biased toward negative thinking and are not good at positive thinking, but I would like to voice a different opinion to the trend that only supports optimism. However, having been thoroughly anxious, there is no doubt there will be no next development unless you take the necessary risks.

* Initial Coin Offering: A kind of fund raising method by which a company issues a token similar to a stock certificate in a virtual currency and procures business funds such as a virtual currency from investors.

The Future Role of Financial Services

In an era when all industries are being automated, will the *raison d'être* of financial services requiring human intervention continue in the future?

Isayama: Nowadays, in what is said to be an era in which people are living for 100 years, the Japanese traditional life model of "saving by working hard and living on your pension after retirement" is becoming impractical. It is a time when life after retirement can prove difficult without asset management. However, there are not many people who are fully aware of such a change. Despite the ever greater role and significance of financial services for individuals, in Japan the awareness that "money is something you earn through working" remains strong and, compared with the West, I think that financial literacy with regard to individual financial transactions and asset management remains low. A major role for financial institutions is the imparting of financial knowledge and educational activities.

Matsui: I think that it is not always true that the financial literacy of Japanese is low when compared with other countries. Mathematics grades are high even among the leading industrialized countries. However, successful investment experience is decidedly lacking. In that sense, I feel that consulting sales will increase in importance going forward.



Gen Isayama

Co-founder and CEO of WiL, LLC

Born in 1973 and originally from Tokyo. In 1997, after graduating from The University of Tokyo, he joined The Industrial Bank of Japan (currently Mizuho Financial Group). After working at the major U.S. venture capital firm DCM, he founded WiL in 2013.

Isayama: With regard to corporate business, companies need to grow globally in order to survive, and the importance of cross-border projects will increase. The M&A business in Europe and the United States, which Daiwa Securities Group is promoting by leveraging its global network, holds great hopes for Japanese companies.

Matsui: The influence of the Corporate Governance Code and the Stewardship Code is gradually becoming more widespread, and the behavior of Japanese companies is beginning to change. Many Private Equity funds are seizing the opportunities presented by the change in the behavior of Japanese companies and are strengthening their bases in Japan. It is also true that our company has strengthened its global M&A network with the aim of meeting the changing needs of Japanese companies. On the other hand, the market size of cross-border M&A per year is ¥1.6 trillion between Japan and Europe, ¥2.3 trillion between Japan and the United States, and ¥35.0 trillion between Europe and the United States*¹. We aim to improve our profitability by providing M&A services globally to clients around the world, not just for Japanese companies.

Isayama: From my experiences in having seen many venture firms, I feel that vulnerability in the back office is their biggest weakness. Venture firms with limited capital tend to neglect middle and back offices because they give priority to hiring employees who easily produce results, such as sales staff and engineers, which can also be a contributory factor in losses in corporate value. Avoiding the situation where the number of venture firms in Japan does not increase going forward, in this regard too, financial institutions, including securities firms, will play a major role, and you will need to actively discover business opportunities to support back office functions in venture firms.

There is also the phenomenon that the value of face-to-face services are said to increase as tasks become more automated. Daiwa Securities Group has the wealth of human capital cultivated up to now and the ability to directly seek out customer needs. In the case of providing just conventional products and services, however, the value of face-to-face services will go down. While cutting business costs, it is important to shift employees to higher value-added projects.

Matsui: In comparison with companies in the West, I think that Japanese companies are good at shifting employees. In general, the method of hiring in a form in which all employees are generalists enables reorganization by dynamically shifting and relocating personnel. In European and U.S. financial institutions, the shifting of personnel between retail and wholesale divisions is almost never undertaken, but at our Group this is conducted in a flexible manner. For example, utilizing the knowledge they have built up at our company, employees in the IB*² Division are able to work not only in the middle and back offices of venture companies but also in other fields, such as in investment or in management advisory services. Not limited to the IB Division, employees in every department of our company have a range of possibilities. For that reason, we are able to respond flexibly in effectively utilizing personnel in accordance with management efficiency. I think that Daiwa Securities Group has survived for 116 years because of its history of having flexibly responded to change. I feel that this flexibility is our strength.

*1 Thomson Reuters Full Year 2017 Mergers & Acquisitions Review

*2 Investment Banking



Innovative Minds

Is it possible for companies to intentionally bring about innovation by their own resolve?

Matsui: Mr. Isayama, you are always saying that there is not enough “fertile ground for innovation” in Japan, but what do you sense is needed to bring about innovation in Daiwa Securities Group?

Isayama: As the term “innovation” refers to the value added by chemical reactions that thus far have never happened, there will eventually be large parts left over that cannot be explained by logic or processes. That is to say that, inevitably, there is always uncertainty and risk involved in innovation. Since the decision making of large Japanese corporations involves a mechanism based on the premise that everyone will be logically persuaded by an approval document, I think that the culture makes it difficult for innovation to take place. What forms the basis of innovation is not an idea upon which the majority is in agreement, but rather an idea with value that is not apparent and of the kind to which everyone is opposed. For example, when Mercari arrived on the scene, services such as Yahoo! Auction and eBay already existed in the CtoC market. Looked at with common sense, it appeared that there was no opportunity in an area where first movers were already present, but Mercari restricted their services only to smartphones, and succeeded by thoroughly bringing about improvements in each user’s experience, thereby surprising society. Even though it might seem to be a low-feasibility idea, the ability to judge and say “let’s give it a try” is important. In the end, since the amount of enthusiasm the decision makers had was important, I think that there was no science involved in this case.

Matsui: Sometimes it is necessary to ignore the voices from the outfield. However, allocating a budget must bring with it responsibility. Although the majority are opposed, the person who drafted the budget in earnest intends to win. However, with regard to projects to which the majority are opposed, under what criteria do you think management should issue a GO order?

Isayama: Put simply, the key is whether or not to allocate budgets taking into account such factors as buffers and discretion. In the United States, there are companies that grant employees who have ideas a certain amount of discretion in terms of their R&D expenses. Even in Japan, there are systems in place, including in corporate venture capital, but actually I think the approval document culture is fraught with problems. In the case of the German company SAP, they established a subsidiary in Silicon Valley and started a new business that later grew into a companywide majority.

Matsui: In the case of IBM and others, however, instead of innovation occurring in-house, it seems as if portfolio managers repeatedly sold and acquired businesses and rapidly changed IBM’s business portfolio. There are doubts as to whether large corporations in the United States are necessarily innovative.

Isayama: Certainly, many excellent businesses of such companies as Google, Facebook and Apple have started out with acquisitions. We should not simply look at such companies as “having acquired new technologies and markets through M&A.” As a common point among these companies, we should focus on the accumulation of enormous amounts of R&D and the liberal climate that made these acquisitions possible.



Matsui: Daiwa Securities Group is also beginning a variety of initiatives to explore new business sectors. We are collaborating with companies in many different types of industries and with securities businesses, including the capital and business alliance with KDDI announced in February 2018. I think that the one purpose of these acquisitions is to obtain technology. Also, from now on, I think there will be less fear toward the cannibalization of existing businesses and new businesses, and the importance of not sparing investment to bring about innovation in the securities industry will increase. Daiwa Securities Group was also greatly affected at the time of the emergence of Internet securities whose operational costs are dramatically low. However, in times when much lower costs are required from now on, there is a possibility that Internet securities with an existing management fee system may be in a disadvantageous position. Rather, it may be our Group that devises the new securities services in the years to come.

Isayama: If the first step was creating an organization that can try new ideas, the second step would be creating a mechanism that allows you to quickly judge when to cut your losses when it fails. Japanese companies tend to increase losses because they are indecisive regarding opting out of projects once started, and this causes them not to make subsequent investments. Whether these two steps can be successfully introduced into the organization or not will be the next agenda.

To directly connect the sense of crisis as to how the company will survive with innovation, the senior management of the organization should proactively take care of risk-takers in the company. As a result, new ideas will be ambitiously proposed and they can put in place a culture that is capable of quickly making decisions on

withdrawals from projects.

Soon after WiL was founded, when there was no historical track record of business, I received such encouraging words from Daiwa Securities Group as “we were an organization that supports the seeds of change from behind.” Actually, through our communications, I have on many occasions seen the bold and swift decision making of management, which is clearly an indication to try new things. CEO Nakata and other members of Daiwa’s management team have an extremely open and liberal way of thinking. Daiwa Securities Group already possesses the culture that will bring innovative ideas to fruition, and I think that by having more exchanges with outside people like us, the original functions at your disposal will become more active.

Matsui: Actually, in the process of drafting new projects as an executive officer in charge of corporate planning, there were many occasions where I felt that our decision making on investment is faster than other companies. CEO Nakata says that “Innovation is the best result granted only to those who have repeatedly had many failures.” I am convinced that we will be able to bring about more original Daiwa innovation than ever before.

Isayama: Stanford University, which is sacred ground for engineers, is located in Silicon Valley. The area has also seen an accumulation of radar and semiconductor technologies since the old days. This history has become a magnetic force for attracting innovative talent. It was not artificially created by an administration, but is a culture that was naturally grown over time. So it runs against the argument for making the same thing in Japan. Instead, I think Japanese companies should actually visit Silicon Valley, learn its culture and use it well. Next month,* Daiwa Securities Group will conduct an Executive Management Committee meeting in Silicon Valley, and I believe this is extremely meaningful.

* From the time of dialogue

Matsui: I hope that the top management team will come up with implications for corporate management through company visits and on-site workshops in Silicon Valley, a rapidly changing city producing cutting-edge technologies and startups. Mr. Isayama, you will also be attending that Executive Management Committee meeting. In a more open environment, I am looking forward to seeing a new form of discussion that differs from the conventional. The times have become more interesting.

