What Kind of Companies Are Withdrawing?: The Case of the Japanese Online Securities Industry

Ayako TAKAI

Abstract: A survey of 70 companies that had entered Japan’s online securities industry in its early stages showed that the number of these companies had shrunk dramatically to 56 companies by September 2003, following a series of market withdrawals that began in 2001. At first glance, this may appear to be a weeding out through a severe competition for survival. However, the reason for these withdrawals was not distress; in actuality troubles for these companies grew after they withdrew from the market. It is true that four out of the six (67%) foreign firms ceased operations and withdrew, but, in contrast, none of the 22 domestic financial firms halted operations, however, their numbers shrunk by nine (41%) due to mergers. In other words, at the very least Japan’s online securities industry in its early stages did not experience a culling due to distress as is implicitly assumed, but rather numbers were reduced due to other mechanisms such as financial restructuring in a very short period of time before the companies experienced distress.

[Note: The rest of the text includes the author's affiliation, a version presented at an event, and copyright notice.]
Introduction

Starting in the latter half of the 1990s, the spread of the internet provided significant opportunities to various businesses around the world. Among these, financial businesses had a high level of user-friendliness because of their also being an agglomeration of information, and advances in information technology allowed them to make startling strides as internet businesses in Japan and elsewhere. The securities industry in particular, within a few short years of starting online transactions in earnest in 1999, saw growth that took companies from startups to their current sizes.

However, as the market quickly grew in this manner, starting in 2001 a series of companies announced their withdrawal from the market. Firms numbered 67 in March of 2001, a high point, and this number shrank dramatically to 55 by September 2003. While some studies have investigated company success factors in regard to competition at the inception of the online securities industry (e.g., Applegate, Umezawa, Ladge, & Egawa, 2003; Takai, 2006) no research has focused on companies that have withdrawn from the industry, nor the factors in their doing so.

The Ohlson O-score (Ohlson, 1980), Altman Z-score (Altman, 1968) and other bankruptcy forecasting metrics for “distress” are known to have a strong impact on the withdrawal of companies at the nascent stage of an industry (Daily, McDougall, Covin, & Dalton, 2002; Dowell, Shackell, & Stuart, 2011). In Japan as well, the Ohlson O-score is thought to be an excellent fit (e.g., Inoue, 1999). However, of 77 companies that entered the online securities business from
1996 to 2004, the Ohlson O-score for predicting bankruptcy\(^1\) was calculated for the 44 for which their securities reports were available, and as shown in Table 1, the average value of the Ohlson O-score for companies that withdrew from the online securities business and those firms that survived in that business show no significant differences. In other words, companies did not withdraw because they were distressed. This paper identifies the factors that caused the withdrawal of companies from the online securities industry even as the industry was starting up.

### History of the Industry and Withdrawals

The history of online securities in Japan began with the entry of Daiwa Securities into the market in April 1996. In less than a year, major players Nikko Securities, Nomura Securities, and several other industry stalwarts had followed suit, with almost twenty companies becoming involved in online securities within two years.

There was a series of deregulations known as “Japan’s Big Bang” at that time, dramatically changing the competitive landscape in the online securities industry. First, in December 1998 the “licensing system” for securities firms changed to a “registration system”. This caused firms to utilize the internet, the use of which was becoming

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\(^1\) This is calculated as follows (Ohlson, 1980). Distress = \(-1.32 - 0.407 \times \text{SIZE} + 6.03 \times \text{TLTA} - 1.43 \times \text{WCTA} + 0.08 \times \text{CLCA} - 2.37 \times \text{NIT A} - 1.83 \times \text{FUTL} + 0.29 \times \text{INTWO} - 1.72 \times \text{OENEG} - 0.52 \times \text{CHIN}\)
widespread, and a shift to an online securities business which made it possible for companies to enter the industry even with relatively few investment resources. Many firms from overseas and other industries entered the market in rapid succession (Takai, 2004, 2006).

Second was the full liberalization of stock commission fees in October 1999. Until that time, these fees were set by law, but with this change securities firms were free to set fees as they saw fit. The rule of competition that “the only difference in securities firms is their size” was fundamentally altered.

The spread of the internet coincided exactly with this time of change in systems. As a result, while there were 34 companies in the online securities industry in September 1999, only six months later, in March 2000, that number had exploded to 51, peaking with one-fourth of Japanese securities firms entering this market. Companies competing therein made announcements on an almost daily basis, reducing fees and expanding product lineups, and providing a variety of new information services. Competition grew fierce. Though the shift to online marketplaces had plateaued at only 1.17%, the online securities market as of September 2003 was approximately 18% of the total financial market, and had grown to more than half of individual transactions. It was threatening to disintermediate the retail channel that had accounted for most of the business until that point. However, that rapid growth also saw mergers in, and withdrawals from, the online securities industry, and the number of companies in the industry, declined dramatically from 67 in March 2001, the peak, to 55 in September 2003 (Figure 1).2

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2 In the seventeen years between 1997, when Yamaichi Securities went bankrupt, and the end of 2013, there were approximately 220 withdrawals of domestic securities firms due to voluntary discontinuations, business transfers, and mergers, with the number of new companies entering the market about the same. In addition, existing securities firms also saw dominant shareholders sell their holdings and companies takeovers by
What kind of companies are withdrawing?

Many companies left this new market, even as it grew rapidly, though the companies that entered and the companies that withdrew were not necessarily the same types of firms withdrawing in the same way.

Companies entering the online securities business can be divided into several categories based on their size and how they were formed. As to how they were formed, there are five categories: “foreign capital securities,” “internet specialized,” “local securities,” “bank group securities,” and “other”. In terms of size, there are major firms

other industries aiming to enter the market, leading to a striking turnover of securities firms that were controlling shareholders (Nikami, 2015).

**Figure 1.** Number of competitors and total number of accounts (online trading)

*Source: Japan Securities Dealers Association “Result of an investigation about Internet trading” and IR data of each company.*
(the big three), semi-major firms, medium firms, and small firms. Categories for both company formation and size can be illustrated in matrix form, as shown in Figure 2.

Though there were market entries from all five of these company formation categories, withdrawals in this period consisted only of companies belonging to the four categories other than “internet

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3 Around the year 2000, the focus of this paper, the term “big three” securities firms referred to Nomura Securities, Daiwa Securities, and Nikko Securities. However, none of the five categories for company formation apply to these firms, and none of them has withdrawn from the online securities market.
What kind of companies are withdrawing?

Table 3. List of withdrawing companies

<table>
<thead>
<tr>
<th>Number of withdrawing companies</th>
<th>Company name</th>
<th>Entry of online trading</th>
<th>suspension of online trading</th>
<th>merger</th>
<th>Category of securities company</th>
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<tbody>
<tr>
<td></td>
<td>Charles Schwab Tokio Marine Securities</td>
<td>Apr-2000</td>
<td>Feb-2002</td>
<td></td>
<td>foreign capital securities</td>
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<td>Wit Capital Securities</td>
<td>May-2000</td>
<td>Apr-2001</td>
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<td>Societe Generale Securities</td>
<td>Feb-2000</td>
<td>Nov-2001</td>
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<td>foreign capital securities</td>
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<td></td>
<td>Hinode Securities</td>
<td>Mar-1999</td>
<td>Dec-2002</td>
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<td>local securities</td>
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<td></td>
<td>Dojima Kanto Securities</td>
<td>Apr-1999</td>
<td>Mar-2001</td>
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<td>local securities</td>
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<td></td>
<td>Nihon Global Securities</td>
<td>Jun-1999</td>
<td>Jul-2003</td>
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<td>local securities</td>
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<td></td>
<td>Marufuku Securities</td>
<td>Apr-2000</td>
<td>Dec-2002</td>
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<td>local securities</td>
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<td></td>
<td>Ishiyoshi Securities</td>
<td>Jan-2001</td>
<td>Nov-2002</td>
<td></td>
<td>local securities</td>
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<td></td>
<td>Star Futures Securities</td>
<td>Feb-2000</td>
<td>Apr-2002</td>
<td></td>
<td>others</td>
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<td></td>
<td>Global Net Trade Securities</td>
<td>Jun-2000</td>
<td>Dec-2001</td>
<td></td>
<td>others</td>
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<td>Imagawa Securities</td>
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<td>Apr-1999</td>
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<td>Wako Securities</td>
<td>Feb-1998</td>
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<td>Hiraoka Securities</td>
<td>Nov-1999</td>
<td>Sep-2002</td>
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<td>local securities</td>
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<td></td>
<td>Internet Trade Securities</td>
<td>Apr-2000</td>
<td>Mar-2001</td>
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<td>bank group securities</td>
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<td></td>
<td>Tokai Maruman Securities</td>
<td>Feb-1998</td>
<td>Sep-2000</td>
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<td>bank group securities</td>
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<td></td>
<td>Meiko National Securities</td>
<td>Apr-1998</td>
<td>Mar-2003</td>
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<td>bank group securities</td>
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<td>Taiheiyo Securities</td>
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<td>Apr-2000</td>
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<td>bank group securities</td>
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<td>Towa Securities</td>
<td>Sep-1998</td>
<td>Apr-2000</td>
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<td>bank group securities</td>
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<td></td>
<td>Dai-ichi Securities</td>
<td>May-1999</td>
<td>Apr-2000</td>
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<td>bank group securities</td>
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<td></td>
<td>Tokio Mitsubishi Personal Securities</td>
<td>Jul-1999</td>
<td>Sep-2002</td>
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<td>bank group securities</td>
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<td></td>
<td>Saison Securities</td>
<td>Apr-2000</td>
<td>Apr-2001</td>
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<td>bank group securities</td>
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<td></td>
<td>E-wing Securities</td>
<td>Apr-2000</td>
<td>Apr-2001</td>
<td></td>
<td>bank group securities</td>
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</tbody>
</table>

specialized”: “foreign capital securities,” “local securities,” “bank group securities,” and “other” (Tables 2 and 3).

What follows is an examination of the characteristics of each of these categories, as well as what kind of companies withdrew from the market and how they did so.

Withdrawal of Foreign Capital Securities

Foreign securities firms were differentiated from domestic securities firms in the Securities and Exchange Act, and those

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4 Previously, the Securities and Exchange Act differentiated these firms from domestic securities firms, but they were combined with domestic firms as of the Revised Financial Instruments and Exchange Act. There are many companies in the wholesale side of the financial industry, such as
companies that entered the online securities business were primarily engaged in investment banking. Because of the shift by securities firms to a “registration system” in 1998 as part of the financial big bang, these firms entered the online securities industry in Japan on their own or by establishing joint-ventures.

Among these, the firm that got the most attention was the largest in the US online securities market, Charles Schwab, which formed a joint-venture with Tokio Marine Securities and others in April 2000 to enter the Japanese market. However, because preparing for “substantial sales” was time-consuming, they actually entered the market the following year, in 2001. This was referred to with the historical metaphor of “Black Ships entering Japan’s securities industry,” though two years after entering the market, and less than a year after kicking off full-fledged sales, they withdrew from the market. Others, such as major French securities firms BNP Paribas and Societe Generale likewise entered the market in 2000, though “domestic rivals waged a war to gain customers in October 1999, when stock brokerage commissions were fully liberalized. By the time Charles Schwab had entered the market, the major players had already been decided.”

“In any case, from the time internet transaction began in earnest these companies were late to the game. The ugly competition to gain customers did not allow them to increase their accounts as they planned, and they were forced to withdraw.” In other words, these companies did not “expand” their customer base for securities transactions in Japan as much as they expected, and once they found out there was little pie left over for them, they opted to withdraw from the Japan market without even putting up a fight.

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Withdrawal of Bank Group Securities

After the economic bubble burst in 1991, failures in Japan’s financial system could not be hidden, and the city banks that had ruled the roost were forced to restructure in a series of mergers.

In 1996, Mitsubishi Bank merged with the Bank of Tokyo forming the Bank of Tokyo-Mitsubishi, Ltd. This was followed by the merger of Sumitomo Mitsui Banking Corporation merger in 2001 and the UFJ Bank Limited and Mizuho Bank, Ltd. merger in 2002. The system of thirteen city banks that had been maintained had shrunk to five.

Restructuring occurred in various banking-related firms in concert with these mergers, and accelerated among bank group securities companies. For example, Sanwa Bank merged with keiretsu firms Taiheiyo Securities, Towa Securities, Universal Securities, and Dai-ichi Securities, forming Tsubasa Securities Co., Ltd. in 2000. Only Towa Securities had been in the Sanwa Bank keiretsu, with Taiheiyo Securities being in the Yamaichi Securities keiretsu, Dai-ichi Securities in the Long-Term Credit Bank of Japan keiretsu, and Universal Securities in the Daiwa Securities keiretsu, though it had come under the Sanwa Bank umbrella by 1999.7 When Sanwa Bank discussed the merits of integration as “merging keiretsu securities firms and solidifying their position in securities sales through retail,” 8 Taiheiyo Securities chairman and president Jun'ichi Yoshino held out hope for subsidiaries to see the impact of mergers, emphasizing, “by joining the Sanwa Bank Group we will strengthen our products and brand. We can go head-to-head with the large firms without having to reduce our fees.”9

In addition to the perspective of “cleaning up of parent companies,”

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the lifting of a ban on brokering of financial products that was part of the financial big bang had an enormous impact on systemic reform of securities sales.\textsuperscript{10} In other words, banks entering into brokerage agreements with subsidiaries enabled them to take over the creation of securities accounts for bank customers and to meet the needs of those customers for handling securities. From the standpoint of the securities company subsidiaries, this had the same impact of bank retail stores becoming additional sales channels.

Because of these factors, mergers within the same financial groups saw the birth of SMBC Friend Securities Co., Ltd.; Mitsubishi Securities Co., Ltd.; Nikko Beans, Inc.; and Kabu.com Securities Co., Ltd. Mergers outside of the same group included that of Saison Securities, in the Credit Saison keiretsu, with Monex, Inc.; Tokai Maruman, in the Tokai Bank keiretsu, and Tokyo Securities, in the Asahi keiretsu, with Monex, Inc., becoming Tokai Tokyo Securities.

This restructuring resulted in nine of the 22 actual banking companies (41\%) that entered the online securities business disappearing due to mergers.

Withdrawal of Local Securities

Local securities are those small securities firms that primarily work with individual investors in a local area. Iwai Securities, Marusan Securities, and other such companies saw opportunity in the online securities market, and a series of them entered the market prior to the liberalization of fees. There were also many that entered the online securities market once it took off. As a result, companies

\textsuperscript{10} This ban was lifted on April 1, 2004, though prior to that, on June 21, 2002, the “2002 Basic Policies for Economic Fiscal Management and Structural Reform” (the second outline of policies) was created by Japan Economic and Financial Advisory Council gave the lifting of this ban as a direction.
entering the online securities business in this category numbered the most, at thirty.

Among these, Ichiyoshi Securities entered the market late, in January 2001, and withdrew from the market in October 2002. The reason given for their withdrawal was sluggishness, with “a few more than 2,000 accounts, of which no more than 500 are active”. As well, fixed costs for systems and server maintenance costs were perhaps too high for the company.

The greatest impact of liberalization from the financial big bang was felt by small- and medium-sized securities firms that had no value add strategy or serious low-cost strategy. One local securities firm stated its position as “too many employees to become a discount broker with many employees, and not able to provide advice and information like the large firms.” This firm thus decided to make a bet on acquiring suburban and local customers. Battling it out in urban areas or over the internet requires setting fees lower than large or specialized firms. Putting human resources primarily in local areas enabled this company to avoid low fees.

The aforementioned Ichiyoshi Securities is a medium-sized firm similar to Iwai Cosmo Securities, Marusan Securities, or Mito Securities. These types of local securities firms were able to maintain sales as long as they treated their local customer base well.

There have also been mergers where a firm had a small and narrow customer base, and the firm opted for a merger while they were still an attractive company. For example, Hiraoka Securities, based in the Kansai region of Japan, merged with Aizawa Securities, based in the Kanto region. Aizawa Securities had 206 retail stores compared to seven for Hiraoka Securities, thus after the merger the combined company was named Aizawa Securities to reduce the expenses of

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having to change signage, and so on. 13 At the same time, the company added “complex” format stores, with one on the first floor of a building near the Nanba subway station for both face-to-face transactions and internet transactions. 14 Thus, six (20%) local securities firms ceased operations in the online securities business, and three (10%) merged. This is a high percentage that withdrew in order to maintain their customer base.

Withdrawal of Other Securities

The “other” category refers to companies that are unlike traditional securities firms. Star Futures Securities, a futures-oriented securities firm that withdrew from the online securities business, and Global Net Trade Securities, a member of the Hikari Tsushin Inc. group that rapidly expanded its mobile business, both withdrew without appearing to have carried out any business.

Conclusion

We have examined withdrawals in four categories. “Japan’s Big Bang” perfectly coincided with the widespread adoption of the internet, and companies were faced with the decision to withdraw from the online securities market for various reasons, without even being distressed, and in a very short period of time. A very high percentage of these withdrawals were due to such factors as “mergers with parent companies” for “bank group securities” firms, “a strategy to focus on local customers” for “local securities” firms, and “mergers with other capable, similar firms”.

What kind of companies are withdrawing?

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References


