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AUSTRALIAN INVESTMENT IN JAPAN: LESSONS LEARNT

Introduction

The AJBCC and the JABCC are a bridge between our two business communities. They provide the opportunity for us to build strong corporate, government and personal relationships based on shared values and common economic interests.

It's great to see some of Japan's finest companies represented here today alongside many of our own corporate leaders in Australia.

I'd like to cover three areas in my presentation this morning.

Firstly, I'll acknowledge the importance and strength of the economic relationship that has been built between Australia and Japan and how this is now extending into specific developments in the Australian financial services market.

Secondly, I'll talk a little about who Challenger is and our own experience in doing business in Japan and the lessons we have learnt to be successful.

Finally, I'll talk about where I see opportunities in financial services developing in the future considering the economic and demographic trends impacting both of our nations.

This is an important point, particularly as Australia transitions to a more service-based economy.

In the same way that resources and commodities have propelled the economic relationship between Australia and Japan, I believe financial services is emerging as the new "super cycle," primarily driven by Australia's rapidly growing superannuation savings system

Japan-Australia economic relationship

First, I want to comment on the importance and strength of the economic relationship between Japan and Australia. There have been many chapters in Japan's economic relationship with Australia over the decades, whether in resources, shipping, manufacturing, retail, tourism and more recently and increasingly, financial services.

The signing of a Free Trade Agreement between both countries in 2014 was a very significant development. It provides duty-free or preferential access for 97 per cent of Australia's exports to Japan.

The FTA makes it far easier for Australian financial services companies to supply services which have previously been the domain of domestic Japanese institutions.

Another key step in financial services in June this year was implementation of the Asian Region Funds Passport scheme, which facilitates the cross-border marketing of managed funds.

While these changes have taken place just in the past two years, Japanese companies have demonstrated their interest in Australia's financial services sector through a series of investments and acquisitions dating back five years and more.

In 2010, Nikko Asset Management bought Tyndell Asset Management from Suncorp.

In 2011, Dai-ichi Life consolidated its move into Australia's financial sector with the takeover of Tower Australia Life (now TAL).

In 2012, Mitsubishi UFJ Financial Group formed a strategic alliance with AMP Capital Investors corner-stoned with a 15% equity interest.

And in the last week, Nippon Life concluded its acquisition of 80% of the MLC life insurance manufacturing business.

These transactions highlight the confidence Japan has in Australia's financial sector and the willingness for Japanese institutions to do business on our shores.

Challenger's experience in Japan

Of course, the investment or capital flows has not all been one way and Challenger is one example of that.

This takes me to the second theme I want to talk about.

In order to talk about our experience in doing business in Japan, which stretches back more than 10 years, I first need to tell you about our company.

Challenger is a life insurance company and asset manager whose vision is to provide our customers with financial security for retirement.

Supporting this vision are two core businesses.

Our asset management business is focused on the accumulation stage that builds the financial savings people need for their retirement.

Managing assets of over A$60 billion makes us one of the largest independent asset managers in Australia.

In our Life insurance business, we're focused on converting those savings at retirement to income, to ensure retirees can maintain their lifestyle sure in the knowledge they are protected from market, inflation and longevity risks.

We do this through a range of annuity products and we are the dominant issuer of annuities in Australia.

The capital we source from annuitants is invested in a diverse range of assets including fixed income, property and infrastructure.

Investment management is at the heart of Challenger and we have some of the most highly experienced people in the sector.

To meet our investment needs we invest globally. We source assets that provide long term dependable cash flows to match our obligations to our annuitants.

In this regard, Japan boasts some attractive assets, including property, with stable long-term incomes.

Challenger maintains a material Japanese property asset portfolio and has done so for many years, including acquiring or advising on investments in over 30 shopping centres. Not only have we sourced such assets for our Life company we have also acquired assets on behalf of Australian retail investors and European institutions.

Japan is attractive because it's a well-developed market, open to foreign capital enabling offshore investors to diversify their portfolio geographically.

Importantly, this 10 year experience has allowed us to develop business partnerships and personal relationships within Japan's financial services industry and to see the enormity of the potential opportunity to work with Japan's great financial services companies.

Lessons learned in Japan

Along the way, we have also learnt some important lessons about the business culture in Japan – lessons I think apply to any business in any industry.

The overarching point businesses need to grasp is that Japan requires a refreshing but what can be a fundamentally different mindset and approach. Let me provide a few examples of what I'm talking about.

Firstly, you need to take a long-term view in building relationships and most importantly stay the course.

You would normally expect to have ups and downs in markets. What made our journey different was that it included some of the biggest shocks to hit the global economy. This included the Financial Crisis or the Lehman Brothers shock in 2008, and the terrible Great East Japan Earthquake and tsunami in 2011.

Importantly, we remained committed to seeing things through, even in the face of these major disruptions, when others decided to exit the market. We greatly admired Japan's ability to face and solve these major challenges.

And today we're reaping the rewards of that perseverance.

Our approach to building relationships with Japan was tested and affirmed during the disruption of the Lehman Shock. As financial conditions and markets deteriorated rapidly, we spent many intense days in meetings with our partners looking for ways to effectively manage some difficult problems facing the listed vehicle we managed together. Resolving them required flexibility and give-and-take from both parties.

We came through this period with our relationship intact and even stronger. The effort both sides had put into communicating and building strong personal relationships during the good times helped us weather the storm in the tough times.

A second but related point is that success requires patience.

The Japanese business culture is built upon consensus. It's first and foremost and it takes time.

Decision timeframes reflect a different process. Most importantly, once consensus is reached, decisions are cast in stone.

A further point that we've learned is what I call "reasonableness". Partnerships are appropriately more akin to a marriage than a one-off transaction of convenience. And for any marriage to stand the test of time both sides need to be reasonable in their expectations. At least that's been my experience of married life.

Finally, you need to ensure your people have the right skills and personality to operate in an environment where respectful negotiation and patience is paramount and listening skills are as valuable as analytical skills.

In essence your team needs to have strong attention to detail, a real interest in other cultures, a commitment to long-term relationship building, Japanese language skills if possible and, of course, a willingness to embarrass themselves at Karaoke in the interest of 'the greater good'.

We have been very careful to make sure there is strong communication at the touch points between work teams at all levels of the partner organisations. In Challenger's case, this means across asset management, finance and accounting, legal services etc.

Many cross-border relationships falter because the relationship begins and ends with executive-level managers. Since the chain is only as strong as its weakest link, it's vital to choose relationship managers down to junior levels with the right skills and, give them the opportunity to regularly meet with their Japanese counterparts to make sure the relationship stays on track.

In summarising Challenger's experience in Japan, I would say for relationships to work, you need to quickly recognise the Japanese business culture is unique.

Accountability is key.

Patience is paramount.

And long term success rather than short term gains must be front of mind.

Opportunities for the future

Turning now to the final part of my talk – opportunities for the future.

Traditionally, many have looked at Australia's economy as one that relies on primary industry.

This is no longer the case.

Mining and agriculture have been the mainstay of Australia's economic progress for decades but alongside these industries we are now seeing a stronger service-based economy.

Earlier I referred to financial services as a future "super cycle" following the resources and commodities boom.

This super cycle will be powered by the sheer weight of money flowing through Australia's superannuation system.

The development of Australia's superannuation system has been one of the great success stories of this transition and one of our biggest achievements in the past two decades.

The superannuation savings pool is now worth more than A$2 trillion and is expected to reach almost $9 trillion in the next two decades.

Australia already has the fourth largest pension system in the world, behind the United States, Japan and the United Kingdom, despite being only the 13th biggest economy measured by GDP.

Much of this growth has been driven by the need to ensure financial sustainability for the ageing population.

The demographic factor has been evident in Japan for some time and is far more profound.

I'll expand on this point in a moment.

Australia's retirement wave

In Australia, we are now five years into a 20 year cycle where an entire generation of people will reach retirement age. And those new retirees will live longer than previous generations.

The number of Australians aged over 65 will double to 7 million over the next 40 years.

It's a worldwide phenomenon and more critical to Australia than most countries as, like Japan, we have among the longest life expectancies.

The average Australian born today is expected to live to 85 for women and 80 for men, according to the World Health Organisation.

That puts us near the top of the world rankings – fourth for women, with Japan at number one – and sixth for men.

However, if you have already made it through many of the trials of life to age 65, your life expectancy is even higher. In Australia, with future mortality improvements, it's an average 90 for women and 87 for men.

This is creating a major fiscal challenge.

Government has responded to this, by first encouraging, and now legislating for greater self-sufficiency in retirement.

Fortunately, the rapid build-up of superannuation assets that I spoke of just now is cushioning the impact.

Australia's move to a modern superannuation system in the 1990s was a shift from a defined benefit system, where corporations provided pensions, to a defined contribution world, where individuals take responsibility for providing for their own pensions, with government support.

That gives individuals much more control over their own pension. It also means they assume the underlying risks.

People take on the market risk to return premium investment outcomes.

They also take on the longevity risk of ensuring their pensions last throughout their lifetimes.

That means the lifestyles of retirees very directly rely on the skills of asset managers to manage these risks and generate retirement incomes.

The creation of Australia's superannuation system spurred the development of a large asset management industry whose skills and capability today not only meet the needs of Australian investors for domestic and offshore assets, but are also exported to foreign investors.

This point is particularly relevant for our financial services industry in the context of a future Australia-Japan economic relationship.

Both countries face similar demographic challenges albeit on a different scale and at a different stage in the cycle.

Japan's ageing population

I've talked about Australia's demographic challenge but let's pause for a moment to consider Japan's situation.

Japan's retirement system is exposed to a perfect wave of imperfect news relating to slow economic growth, negative interest rates and the ageing and contraction of its population.

Twenty-five percent of people in Japan are now aged 65 or over. By 2040, that ratio is estimated to rise to the historically unprecedented level of 36 per cent.

These trends put enormous pressures on Japan's social security system.

Not surprisingly, like Australia, self-sufficiency is important in Japan's retirement income system.

Unlike Australia, defined benefits pensions still account for the vast majority of the pension system – 96%.

And unlike Australia, it is fixed income assets rather than growth assets that dominate the pension system, accounting for 57% of pension assets. For Australia it is only 14%.

Japan has the highest allocation to bonds of any pension system in the world.

And while two, five and 10 year Japanese government bond yields – a traditional retirement income generator – are in negative territory, there is a diminishing incentive to invest this capital in the domestic market.

Ten of 11 banks surveyed by Bloomberg recently said portfolio rebalancing is necessary under the Bank of Japan's negative-rate policy, with eight saying they've already begun or are considering asset reallocation.

With this backdrop, there's a growing demand among Japanese retirees for higher return growth investments - equities, infrastructure and property and also foreign currency investments.

By way of example, the foreign currency annuity market is experiencing significant growth with Australian dollar annuities being one of the most popular. Indeed Japanese demand for Australian dollar annuities is multiples of the size of the domestic Australian market.

This highlights a key point.

When you compare the pensions systems of Australia and Japan what you see is a ying-yang effect where there's a great deal of synergy due to differing interest rate structures, asset allocation norms and capital versus income focus.

Australian asset managers have a highly developed capability in growth assets, like equities, property and infrastructure, where as Japan has a highly developed focus on fixed income. Australian interest rates are attractive for Japanese investors while Japan, being further through the retirement cycle has developed strong capability in income product development for retirees.

This bodes very well for co-operation between our countries and underscores the recent activity in financial services.

Conclusion

In conclusion, in talking today I've covered three areas. First, the strength of the economic relationship between Australia and Japan and how that relationship is growing in financial services. As Japan moves to mobilise capital and enhance its long term competitiveness, closer ties between our respective financial services systems are inevitable.

Second, I've spoken about what Challenger has learnt in Japan during a turbulent time in financial markets. Our experience has reaffirmed our belief in the importance of relationships built on accountability, patience and a focus on long term success rather than short term wins.

Finally, I've highlighted the future opportunities in financial services between Australia and Japan. As I've outlined, they provide a natural fit for each other.

The social economic reality of an ageing population that is so familiar in Japan is now occurring in Australia.

The size of the superannuation pool and the income needs of a rapidly growing number of retirees will power the new super cycle that I've spoken about.

Australia has a strong and stable financial system and depth of asset management capability along with the benefit of higher investment yields.

Japan has long experience of managing retirement income products on a large scale and a deeper market for investments that meet the needs of retirees.

Mutual collaboration will bring the benefits of new perspectives.

These complementary capabilities and demographic trends provide a huge opportunity for both Australia and Japan to extend their relationship in financial services.

Our two countries have a rich and long standing business relationship and a genuine commitment to advance this into the future.

Finally, and most importantly, whether retirees live in Australia or Japan, it's critical that their savings are managed in a way that ensures a comfortable retirement.

Greater collaboration between our financial services companies will help this happen.

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