Why Japan Could Be The Next U.S. IPO Hotbed

By: Drew Bernstein

When most investors think about Japan, they imagine large blue-chip companies, ultra-low interest rates, and an economy slowly fading from a global industrial powerhouse to an also-ran. After all, the Nikkei 225 logged 15 years of decline from its bubble-era peak in 1989, shedding 75% of its value along the way. Japan recently slipped behind Germany to become the fourth-largest economy in the world, the Wall Street Journal reported.

I was surprised, therefore, to recently be invited to a conference held in Tokyo by the NASDAQ stock market about how Japanese companies could list on Wall Street. I have known the NASDAQ's Vice Chair, Bob McCooey, for decades, and he usually has an excellent nose for the next big trend in the global capital markets. I came away from my visit to Japan convinced that this region of Asia is not as financially sleepy and conservative as people might think.

The companies in attendance appeared to be very interested in the global visibility that a listing on Wall Street could provide them. The dealmakers at the conference all claimed to have growing pipelines of Japanese issuers that are either preparing to register with the Securities and Exchange Commission or actively considering it.

Putting Japan Back On The Map

What accounts for the surge in interest?

A combination of ratcheting geopolitical tensions between the U.S. and China and an uptick in innovation in Japan's economy have led global fund managers to drive up the price of Japanese equities and put the country back on investors' radar.

“We have seen a big shift in fund allocations in APAC where institutional investors have been looking hard at non-China regions, with Japan as a major beneficiary of that,” said Enna Weng, managing director of the investment bank Freedom Group. She has personally vetted more than 30 Japanese private companies in the past year and is in active discussions with half a dozen.

“From the company side, there’s an appreciation that for certain sectors and stories, they may be able to attract a better valuation and liquidity by listing in the U.S. than they would get domestically,” Weng said.

Weng noted that biotech companies with a solid pipeline of FDA candidates are particularly attractive. “They find that U.S. institutions are more experienced with valuing pre-revenue life science stories, with a platform that will reward companies as they release clinical data and hit critical development milestones," she said.

On the investor side, the fact that Berkshire Hathaway’sBerkshire Hathaway 0.0%Warren Buffett has scored big returns from his Japanese investments that led other institutions to pile in. As the established names become more crowded, fund managers are open to considering the next potential breakout story.

That said, so far, the Japanese issuers listed on NASDAQ have been smaller and have struggled to attract the attention of analysts and institutional investors. One reason is that, in contrast with many other Asian countries, Japan’s domestic stock market is relatively active. There were 97 IPOs on the Tokyo Stock Exchange in 2023, SPG Global reported.

According to Koji Ishikawa, who leads the capital markets practice for Greenberg Traurig in Japan, until recently, local investment bankers would say that a U.S. listing was for companies too small to qualify for the Tokyo Stock Exchange. However, he notes that attitudes among local venture capitalists are changing rapidly. In addition to life science, he said that new materials, green energy, AI, and robotics are all sectors that might look seriously at the U.S. as an alternative.

“We are at the dawn of U.S. listings for Japanese startups, like the Japanese players who tried to make it in Major League Baseball," Ishikawa said. "There have been a dozen talented players who tried to make it in America, but we only remember a few: Nomo, Ichiro, and Ohtani. I am sure that the Shohei Ohtani of startups is coming to the U.S. capital markets in the near future.”

In some sense, the looming demographic cliff is forcing Japan to accelerate the pace of innovation and break free of established big corporate culture. The country is expected to have a labor shortage of 11 million people by 2040, The Financial Times reported. The older-than-65 crowd already makes up 30% of the population. As just one illustration, only 12% of Japanese construction workers are younger than 29, while 36% are older than 55.

To maintain its status as a high-income nation and its vaunted service culture, Japan likely has no alternative but to invest heavily in robotics and AI. With strong technical education and world-class, highly automated manufacturing, Japan is probably best positioned to address the crisis of a rapidly aging and shrinking workforce that will transform North Asia's economies in the coming two decades.

In contrast with Silicon Valley's myth of the rebellious garage founder genius, Japan's approach to innovation stresses cooperation between startups, the government, and large corporations. The Japanese government's J-Startup initiative has already produced 20 unicorn companies with valuations of more than $1 billion and it aims to spawn 100 new unicorns and 10,000 startups by 2027.

The Long Road To Wall Street

How many of these Japanese startups will become the next Google or NVIDIA?

Ishikawa, who works with companies that list domestically and overseas, said that listing on the NASDAQ or NYSE makes sense if companies have global products or address global markets, if their competitors are global, and if they need to attract global talent.

As Japan ages, its retail investor base is becoming increasingly more risk-averse and less likely to embrace the next buzzy tech or life science IPO, which has led younger management teams to expand the aperture on where to list.

However, one obstacle is that few local investment banks, accounting firms, and law firms are familiar with the U.S. listing process.

Weng opined that language may be a barrier for some of the management teams she speaks with. "Unless you invest in an UN-quality employee who is financially literate, you will lose the nuances of the story, and it becomes impossible to capture the fund manager’s attention,” she explained.

Weng added that, compared to China, Japanese management teams tend to be unsophisticated about the global capital markets and they lack the same ecosystem of advisors to prepare and package the story.

“They don’t have the internal resources or local financial advisors to get them ‘camera ready,' " she said. "In this sense, China, for all the geopolitical tensions, is 20 years ahead. But on the other hand, the financials you receive from a Japanese company, whether historical or projections, are likely to be much more conservative and substantive.”

Innovative companies with the courage to go global, eager to cooperate with the government and large corporates, and providing conservative financials. After a few days in Tokyo, the new Japanese model started sounding pretty good.

Now they just need their version of Ohtani to put them on the map.