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JAPAN OTC EQUITY FUND INC
Form N-30D
April 24, 2002

JAPAN

Smaller Capitalization

Fund, Inc.

ANNUAL REPORT

FEBRUARY 28, 2002

JAPAN SMALLER CAPITALIZATION FUND, INC.

April 18, 2002

To Our Shareholders:

We present the Annual Report of the Japan Smaller Capitalization Fund, Inc. (formerly Japan OTC Equity Fund, Inc.) (the "Fund") for the fiscal year ended February 28, 2002 (see reason for name change immediately following the President's letter). The Net Asset Value per share ("NAV") of the Fund decreased by 21.7% for the year, reflecting the overall weakness in the Japanese OTC stock market. The change in NAV represents the change in share price and the reinvestment of a \$0.08 per share long-term capital gain distribution paid on December 14, 2001. The closing market price of the Fund on February 28, 2002, on the New York Stock Exchange was \$5.53 representing a discount of 5.6% to the NAV of \$5.86. The net assets of the Fund amounted to \$92,815,469 on February 28, 2002.

The TOPIX, consisting of all companies listed on the Tokyo Stock Exchange (the "TSE") First Section, decreased by 31.6% and the Nikkei Average Index (a price weighted index of 225 leading stocks on the TSE) decreased by 31.1%, in United States dollar terms, for the year ended February 28, 2002. The Nikkei OTC Average Index (the "OTC Index"), a price-weighted index of the quotations of the OTC registered stocks, and the Index of the Japan Securities Dealers Association Quotation System (the "JASDAQ Index"), a capitalization-weighted index of all OTC stocks, decreased by 31.4% and 34.8%, respectively, in U.S. dollar terms, during the same period. The Japanese yen ("Yen") depreciated by 19.3% against the U.S. dollar during the year and played a negative role in the dollar-based performance of the various indices.

The Fund outperformed both the OTC Index and the JASDAQ Index by 9.7 percentage points and 13.1 percentage points, respectively, during the year. The negative results, mainly from the overweight position in the Electronics sector, were more than offset by the positive results from stock selection, especially in the Consumption and Infrastructure sectors, such as United Arrows Limited and Eneserve Corporation.

The NAV of the Fund declined by 11.7% for the quarter ended February 28, 2002. During the same period, the TOPIX and the Nikkei Average Index decreased by 15.0% and 12.9%, respectively, and the OTC Index and the JASDAQ Index also

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decreased by 16.3% and 15.3%, respectively, in U.S. dollar terms. For the quarter ended February 28, 2002, the Fund

outperformed the OTC Index and the JASDAQ Index by 4.6 percentage points and 3.6 percentage points, respectively. Positive results from the overweight position in technology stocks in the Electronics and Machinery sectors, such as UMC Japan and THK Co., Ltd. more than offset the negative impact of the underweight position in the Information/Systems sector.

The Portfolio

The Fund increased its equity exposure from 98.9% at November 30, 2001 to 99.3% at February 28, 2002. The Fund was diversified into 95 issues, of which 69 issues were OTC stocks, 19 were other smaller capitalization stocks and 7 were TSE First Section stocks, comprising 70.1%, 19.2% and 10.0% respectively, of net assets on February 28, 2002.

Japanese Economy and Stock Market Outlook

The OTC Index declined by 18.1% in local currency terms during the year ended February 28, 2002.

In addition to signs of economic retrenchment, growing disillusionment with policy inertia from the ruling Liberal Democratic Party compounded the market's depressed sentiment until mid-March 2001. However, the Japanese OTC stock market regained upward momentum in the latter half of March, after the Bank of Japan ("BOJ") effectively returned to a zero interest rate policy with a form of quantitative easing with an implicit inflation target that will remain in place at least until the Consumer Price Index has stabilized. In late April and early May, the Japanese OTC stock market extended the recovery in anticipation of structural reforms based on the policies outlined by the new Prime Minister Junichiro Koizumi and his cabinet. The OTC Index recovered to 1400 in early May.

However, cautious sentiment later returned due to the delay in clarifying the new government's intended policy measures. Continuing deterioration in domestic fundamentals, initially highlighted by the BOJ Tankan survey in July, and a series of poor industrial production figures weighed heavily on the market. A constant stream of profit warnings from technology companies worldwide also forced the OTC Index down. Furthermore, global stock markets suffered precipitous declines in the wake of the terrorist attacks on the World Trade Center and the Pentagon in September, 2001. The OTC Index approached 1000 immediately after the attacks, recording a new low for the year.

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Toward the end of calendar year 2001, the Japanese OTC stock market experienced a rebound, benefiting from an improvement in global sentiment amid further U.S. interest rate reductions, hopes of a recovery in the U.S. economy in 2002 based on encouraging retail sales figures, and rapid progress in the military campaign in Afghanistan. The Yen's depreciation also offered some support. The OTC Index recovered to nearly 1200 in early November, 2001.

However, the rebound quickly ended amid disappointing domestic news. Continued deterioration in economic fundamentals undermined the recovery while the delayed implementation of Prime Minister Koizumi's structural reforms weighed on the OTC Index. Moreover, Japanese equities became increasingly sensitive to credit risk after the downgrading of Japan's sovereign

domestic debt rating by Standard & Poor's in late November. In December, the default following the collapse of energy trading giant Enron Corp., and the bankruptcy of Aoki Construction, a mid-sized Japanese contractor, overshadowed the Japanese OTC stock market. The OTC Index continued to trade between 1100 and 1200 towards the end of February, 2002.

Outlook and Future Strategy

We have a cautiously optimistic view for the Japanese OTC stock market, despite the weak domestic macroeconomic figures, including consumer-related statistics. The recently announced anti-deflation policy package did not contain any concrete measures to encourage market participants. This was no surprise, since we had not expected the Koizumi cabinet to produce any decisive policy action. The slow progress of the Prime Minister's reform program, combined with the deflationary economic conditions, will likely prevent the market from achieving a sustainable recovery. However, we still expect the market to focus on some of the positive cyclical aspects of the economy in the short and medium term. Due to an improvement in inventory conditions and a U.S. economic recovery, we expect to see the cyclical turnaround among manufacturing industries, including export-oriented industries, to continue over the next quarters. Recent statistics, particularly from the U.S., suggest that the Japanese economy is bottoming out, which supports our view that a cyclical recovery is imminent. The Yen's depreciation trend will also aid the recovery in corporate earnings.

Difficult supply and demand conditions that have overshadowed the market for some time should be alleviated somewhat in the short-term. Activity relating to the unwinding of cross-shareholdings will tend to settle down through the latter part of March. In addition, tighter trading regulations governing short selling are expected to have a positive near-term market impact. Furthermore, the domestic public pension fund is expected to allocate money to the equity market in mid-March. Therefore, given these domestic factors and improved stability in the global stock markets, we expect the Japanese OTC stock market to trade with a firm bias in the near term.

One of the current focal points of our small capitalization stock selection looks at the ability of companies to withstand deflationary pressure. For example, we can still find a number of companies within the Consumption sector that have sufficient operational and cost competitiveness and have been gaining market share despite the severe competitive and deflationary conditions. Additionally, we are maintaining the portfolio's sensitivity to a cyclical turnaround with overweight positions in some Technology sector stocks. The deflationary trend in the domestic market will also justify the overweight position in this sector.

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We appreciate your continuing support of your Fund.

Sincerely,

Kazuhiko Hama
President

REASON FOR NAME CHANGE

The Securities and Exchange Commission adopted Rule 35d-1 (the "Rule") under the Investment Company Act of 1940 to address the use of certain broad categories of investment company names. The Rule requires a registered investment company ("RIC") with a name suggesting that the RIC focus on a particular type of investment or invests in a particular country, invest at least 80% of its assets in the type of investments suggested by its name, "under normal circumstances."

Accordingly, on February 19, 2002, the Fund's Board of Directors approved a new name for the Fund—Japan Smaller Capitalization Fund, Inc. The New York Stock Exchange ticker symbol remains "JOF". The name change did not require shareholder approval.

NEW NON-FUNDAMENTAL INVESTMENT OBJECTIVE AND POLICY

The Fund's Board of Directors approved a new non-fundamental investment objective and policy, whereby the Fund will, under normal circumstances, invest at least 80% of its total assets in smaller capitalization Japanese equity securities traded in the Japanese OTC market, Second Section of the Tokyo, Osaka and Nagoya Stock Exchanges, JASDAQ, Mothers, NASDAQ Japan, and other Japanese equity securities included in the indices determined by Nomura Asset Management U.S.A. Inc. ("NAM-U.S.A.") to be appropriate indices for smaller capitalization companies in Japan ("Smaller Capitalization Companies"). The new non-fundamental investment objective and policy did not require shareholder approval. The Fund's fundamental investment policy of investing at least 65% of its total assets in equity securities traded in the Japanese OTC stock market was not changed.

NEW MANAGEMENT AND INVESTMENT ADVISORY AGREEMENTS

A new Management Agreement between the Fund and NAM-U.S.A., and a new Investment Advisory Agreement between NAM-U.S.A. and Nomura Asset Management Co., Ltd. ("NAM") were approved by shareholders at their 2001 Annual Meeting held November 13, 2001. The new contracts allow NAM-U.S.A. to delegate security selection and order placement to NAM.

Mr. Masao Kurita of NAM is primarily responsible for day-to-day management of the portfolio of the Fund. Mr. Kurita has held such responsibilities for the Fund since November, 2001. Mr. Kurita was a Portfolio Manager—Japanese Equities with NAM from 1997 to 1999 and Senior Portfolio Manager—Japanese Equities with NAM from 1999 to present.

INTERNET WEBSITE

NAM-U.S.A. has established an Internet website which highlights history, investment philosophy and process and products, which includes the Fund. The Internet web address is www.nomura-asset.com. We invite you to view the

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Internet website.

JAPAN SMALLER CAPITALIZATION FUND, INC.

FUND HIGHLIGHTS-FEBRUARY 28, 2002

KEY STATISTICS

Net Assets	\$92,815,469
Net Asset Value per Share	\$5.86
Closing NYSE Market Price	\$5.53
Percentage Change in Net Asset Value per Share*+	(21.7%)
Percentage Change in NYSE Market Price*+	(18.6%)

MARKET INDICES

Percentage change in market indices:*		
	YEN	U.S. \$
	---	-----
TOPIX	(18.3%)	(31.6%)
Nikkei Average	(17.8%)	(31.1%)
JASDAQ	(22.2%)	(34.8%)
Nikkei OTC Average	(18.1%)	(31.4%)

*From March 1, 2001 through February 28, 2002.

+Reflects the percentage change in share price and reinvestment of long-term capital gain distribution.

ASSET ALLOCATION

Japanese Equities	
OTC Stocks	70.1%
Other Smaller Capitalization Stocks	19.2
TSE First Section Stocks	10.0
Cash and Cash Equivalents	0.5

Total Investments	99.8
Other Assets in Excess of Liabilities	0.2

Net Assets	100.0%
	=====

INDUSTRY DIVERSIFICATION

% of
Net Assets

Retail	19.2	Machinery and Machine Tools
Information and Software	12.9	Electric
Chemicals and Pharmaceuticals	10.4	Real Estate and Warehouse
Miscellaneous Manufacturing	8.2	Banks and Finance
Electronics	8.1	Restaurants
Services	7.7	Textiles and Apparel
Food Manufacturing	7.2	Automotive Equipment and Parts
Wholesale	4.1	Telecommunications

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TEN LARGEST EQUITY HOLDINGS BY MARKET VALUE

Security	Market Value
UMC Japan.....	\$3,311,69
Chiyoda Co., Ltd.	3,100,30
Cawachi Limited	2,824,91
Plenus Co., Ltd.	2,739,50
Yahoo Japan Corp.	2,477,77
T & K Toka Co., Ltd.	2,265,75
Kuroda Electric Co., Ltd.	2,172,02
Sanyo Electric Credit Co., Ltd.	2,112,19
Toys R Us-Japan, Ltd.	2,109,96
USS Co., Ltd.	1,898,57

JAPAN SMALLER CAPITALIZATION FUND, INC.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareholders
of Japan Smaller Capitalization Fund, Inc.

In our opinion, the accompanying statement of assets and liabilities, including the schedule of investments, and the related statements of operations and of changes in net assets and the financial highlights present fairly, in all material respects, the financial position of the Japan Smaller Capitalization Fund, Inc. (formerly known as Japan OTC Equity Fund, Inc.) (the "Fund") at February 28, 2002, the results of its operations for the year then ended, the changes in its net assets for each of the two years in the period then ended and the financial highlights for each of the five years in the period then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements and financial highlights (hereafter referred to as "financial statements") are the responsibility of the Fund's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these financial statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits, which included confirmation of securities at February 28, 2002 by correspondence with the custodian and brokers, provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP
New York New York
April 9, 2002

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SCHEDULE OF INVESTMENTS*
FEBRUARY 28, 2002

	Shares -----	Cost ----	Market Value -----
EQUITY SECURITIES			
Automotive Equipment and Parts			
Exedy Corporation	132,400	\$ 1,495,676	\$627,441
Automobile clutches			
Nippon Cable Systems Inc.....	115,000	1,054,173	849,659
Control cables			
SPK Corporation	45,600	590,497	323,296
Replacement parts			
Total Automotive Equipment and Parts		3,140,346	1,800,396
Banks and Finance			
Aiful Corporation	17,050	1,440,881	849,987
Consumer loans			
Sanyo Electric Credit Co., Ltd.	106,400	3,582,788	2,112,198
Finance			
Total Banks and Finance		5,023,669	2,962,185
Chemicals and Pharmaceuticals			
Arisawa Manufacturing Co., Ltd.	32,600	579,231	559,573
Glassfibers and insulating resins			

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS*-Continued

FEBRUARY 28, 2002

	Shares -----	Cost ----	Market Value -----
C. Uyemura & Co., Ltd.	99,000	\$ 2,078,276	\$ 1,292,959
Chemicals			
FP Corporation	22,500	956,479	621,292
Polystyrene and other synthetic resin foodware			
Konishi Co., Ltd.	127,800	1,423,557	1,049,144
Adhesives and construction sealants			
Mandom Corporation	78,000	1,090,432	1,018,113
Cosmetic products			
Matsumoto Yushi-Seiyaku Co., Ltd.	86,000	1,607,793	1,091,086
Analgesic anti-inflammatory agents			
Milbon Co., Ltd.	72,500	1,808,628	1,271,503
Hair-care products for beauty salons			
Shizuokagas Co., Ltd.	164,000	487,656	484,675

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Natural gas supplier			
T & K Toka Co., Ltd.	126,500	3,521,332	2,265,756
		-----	-----
Ink for printing			
Total Chemicals and Pharmaceuticals		13,553,384	9,654,101
		-----	-----
Electric			
Citizen Electronics Co., Ltd.	21,700	1,267,964	1,253,465
Electric parts			
Eneserve Corporation	45,500	1,129,756	1,412,590
Electric generation system for supermarkets			
Mirai Industry Co., Ltd.	116,000	1,777,000	683,906
		-----	-----
Plastic molded electric materials			
Total Electric		4,174,720	3,349,961
		-----	-----
Electronics			
Chiyoda Integre Co., Ltd.	59,900	843,825	474,301
Electronic components			
Cosel Co., Ltd.	59,000	1,698,071	893,839
Electrical machinery			
Digital Electronics Corp.	40,800	1,034,227	414,105
Electronic components			
Fuji Electric Industry Co., Ltd.	93,000	993,449	343,558
Electronic parts			
Fukuda Denshi Co.	39,000	961,762	849,883
Medical electronic equipment			
Japan CBM Corp.	60,100	1,134,621	484,406
Electronic calculators and watches			
Kuroda Electric Co., Ltd.	160,000	2,929,198	2,172,021
Trader			
Miyota Co., Ltd.	63,000	995,776	305,608
Watches, quartz oscillators and electronic image equipment			

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS*-Continued

FEBRUARY 28, 2002

	Shares	Cost	Market Value
	-----	----	-----
Nagano Keiki Co., Ltd.	54,890	\$ 1,006,320	\$ 618,560
Measuring instruments			
Nissho Electronics Corp.	43,000	1,430,395	500,616
Electronics parts distributor			
Roland Corporation	46,000	910,132	458,644
		-----	-----
Electronic keyboard for musical instruments			
Total Electronics		13,937,776	7,515,541
		-----	-----

Food Manufacturing

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Ariake Japan Co., Ltd.	32,300	739,366	954,573
Natural seasonings			
Iwatsuka Confectionary Co., Ltd.	71,800	692,781	535,841
Rice crackers			
Kakiyasu Honten Co., Ltd.	44,000	468,144	328,370
Processed meat products, fresh meats, and side dishes			
Origin Toshu Co., Ltd.	30,500	588,392	680,585
Delicatessen items and lunch boxes			
Ozeki Co., Ltd.	12,000	1,132,929	234,636
Supermarket chain			
Plenus Co., Ltd.	96,600	2,806,886	2,739,505
Japanese lunch-boxes			
Rals Co., Ltd.	114,000	1,606,660	535,990
Supermarket chain			
Yaizu Suisankagaku Industry Co., Ltd.	57,800	841,395	651,784
		-----	-----
Natural seasonings and dehydrated processed food materials			
Total Food Manufacturing		8,876,553	6,661,284
		-----	-----
Information and Software			
Argo Graphics Inc.	36,000	896,182	752,267
Computer aided design software			
CAC Corp.	89,000	1,846,372	1,118,519
Information technology services			
Celartem Technology Inc.+	31	368,928	691,742
Software development			
Fuji Soft ABC Inc.	13,300	836,138	396,037
Computer systems development			
Fujitsu Broad Solution & Consulting Inc.	44,500	1,794,921	361,991
Business application software			
Konami Computer Entertainment Tokyo, Inc.	121,600	1,556,516	1,506,444
Video games software			
UMC Japan	355	3,167,571	3,311,691
Semiconductor memory chips			
Real Vision Inc.+	196	734,202	886,421
Professional video technology			

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS*-Continued

FEBRUARY 28, 2002

	Shares	Cost	Market Value
	-----	----	-----
Trend Micro Inc.+	19,500	\$ 1,488,482	\$ 433,673
Computer software, anti-virus server			
Yahoo Japan Corp.+	63	11,237,066	2,477,779

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Internet services			
Total Information and Software		23,926,378	11,936,564
Machinery and Machine Tools			
Disco Corp.	15,500	1,151,460	838,651
Dicing saws for semiconductors			
Suruga Seiki Co., Ltd.	20,000	540,974	137,319
Industrial mechanical equipment			
THK Co., Ltd.	78,700	3,419,652	1,480,085
Linear motion systems for industrial machines			
Yushin Precision Equipment Co., Ltd.	41,600	2,017,235	968,633
Injection molding related machinery			
Total Machinery and Machine Tools		7,129,321	3,424,688
Miscellaneous Manufacturing			
Central Glass Co., Ltd.	336,000	1,759,202	1,652,480
Glass products			
Eidai Kako Co., Ltd.	144,000	1,085,863	413,747
Synthetic resin processed products			
Fuji Seal, Inc.	19,700	542,645	646,890
Packing materials			
Fujimi Inc.	64,700	1,951,160	1,062,279
Polishing materials for silicone wafers			
Hoden Seimitsu Kako Kenkyusho Co., Ltd.	62,000	1,015,688	289,190
Aluminum extruding molds			
Nichiha Corporation	194,600	1,739,791	1,716,610
Ceramic exterior walls and fiberboards			
Nippon Kodoshi Corp.	167,000	2,688,750	909,810
Paper and electric insulation			
Tomy Co., Ltd.	83,100	2,721,673	896,769
Toys			
Total Miscellaneous Manufacturing		13,504,772	7,587,775
Real Estate and Warehouse			
Nippon Kanzai Co., Ltd.	87,800	1,303,227	1,092,299
Comprehensive building maintenance			
Recrm Research Co., Ltd.+	1,050	1,302,300	1,786,633
Building management			
Riberesute Corporation	80	104,726	83,585
Sells residential and commercial buildings			
Total Real Estate and Warehouse		2,710,253	2,962,517

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS*-Continued

FEBRUARY 28, 2002

	Shares	Cost	Market Value
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Restaurants			
Saint Marc Co., Ltd.	48,700	\$ 1,377,590	\$ 1,192,104
Restaurants and bakery shop chain			
Saizeriya Co., Ltd.	25,400	1,021,560	834,061
Italian restaurant chain			
Watami Food Service Co., Ltd.	48,900	1,406,221	797,392
		-----	-----
Restaurant chain			
Total Restaurants		3,805,371	2,823,557
		-----	-----
Retail			
Cawachi Limited	54,700	3,052,774	2,824,911
Drug store chain			
Chiyoda Co., Ltd.	477,500	3,209,151	3,100,302
Specialty store chain			
Himaraya Co., Ltd.	200	2,504	381
Sporting goods			
Kyoto Kimono Yuzen Co., Ltd.	577	2,014,182	1,356,431
Japanese traditional kimonos			
Nissen Co., Ltd.	77,000	513,135	549,938
Mail-order business			
Otsuka Kagu, Ltd.	46,800	3,224,588	1,274,824
Furniture			
Prime Network Inc.	198	902,782	1,322,512
TV shopping business			
Toys R Us-Japan, Ltd.	131,500	3,750,692	2,109,967
Toy chain stores			
Uoriki Co., Ltd.	139,000	3,013,993	1,773,872
Fresh fish and sushi stores			
USS Co., Ltd.	60,000	1,428,555	1,898,578
Automobile auction			
Yamada Denki Co., Ltd.	27,100	2,053,113	1,638,196
		-----	-----
Consumer electronics			
Total Retail		23,165,469	17,849,912
		-----	-----
Services			
Arrk Corporation	11,000	376,840	394,045
Product testing			
Bellsystem 24, Inc.	3,100	1,015,540	1,002,911
Telemarketing			
Central Sports Co., Ltd.	66,100	768,084	411,907
Health and fitness clubs			
EPS Co., Ltd.	15	227,236	316,803
Clinical testing services			

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS*-Continued

FEBRUARY 28, 2002

	Shares	Cost	Market Value
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Future System Consulting Corporation	192	\$ 1,081,561	\$ 716,445
Information system and consulting services			
Sodexho Japan Co., Ltd.	157,000	3,331,323	738,162
Nursing home caterer			
N.I.C. Corporation	49,200	910,109	411,239
Human resources			
Toei Animation Co., Ltd.	12,000	634,388	616,142
Animated cartoon movies production			
Tow Co., Ltd.	214,500	1,653,845	1,744,879
Entertainment			
Weathernews Inc.	83,000	1,120,731	755,080
Custom weather forecasting services			
Total Services		11,119,657	7,107,613
Telecommunications			
Nippon Antenna Co., Ltd.	57,000	945,374	344,565
Communication related equipment			
Yozan Inc.+	279	1,138,532	249,860
Mobile telecommunication equipment			
Total Telecommunications		2,083,906	594,425
Textiles and Apparel			
United Arrows Limited	53,800	972,762	1,312,930
Casual clothes			
World Co., Ltd.	35,700	1,114,038	799,284
Fashion apparel			
Total Textiles and Apparel		2,086,800	2,112,214
Wholesale			
ArcLand Sakamoto Co., Ltd.	110,600	1,363,176	1,097,787
Home appliances			
C Two-Network Co., Ltd.	22,000	844,123	569,723
Processed foods			
Hakudo Co., Ltd.	91,000	418,420	414,269
Metal products			
Hakuto Co., Ltd.	112,800	1,945,846	1,077,533
Electric parts			
Shinwa Co., Ltd.	49,910	528,111	372,849
Industrial machinery			
Toba, Inc.	67,000	1,015,392	297,511
Trading company for control systems			
Total Wholesale		6,115,068	3,829,672
TOTAL INVESTMENTS IN EQUITY SECURITIES		144,353,443	92,172,405

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS*-Continued

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FEBRUARY 28, 2002

	Principal Amount -----	Cost -----	Market Value -----
INVESTMENTS IN SHORT-TERM SECURITIES			
State Street Bank and Trust Company, interest bearing call account 1.50% due 3/01/02	\$204,093	\$ 204,093	\$ 204,093
		-----	-----
TOTAL INVESTMENTS IN SHORT-TERM SECURITIES		204,093	204,093
		-----	-----
INVESTMENTS IN FOREIGN CURRENCY			
State Street Bank and Trust Company, 0.25% interest bearing call account		JPY 32,521,849	242,709

TOTAL INVESTMENTS IN FOREIGN CURRENCY		242,709	242,709
		-----	-----
TOTAL INVESTMENTS		144,800,245	92,619,207
		-----	-----
OTHER ASSET IN EXCESS OF LIABILITIES		(141,074)	196,262
		-----	-----
NET ASSETS		\$144,659,171	\$ 92,815,469
		=====	=====

FORWARD FOREIGN CURRENCY CONTRACT

	Cost (Local Currency) -----	Delivery Value -----	Maturity Date -----	Un App -----
U.S. Dollars-Long Contract	JPY654,073,000	\$ 5,300,000	03/11/02	\$
Japanese Yen-Long Contract	JPY654,073,000	(4,962,429)	03/11/02	-
		-----		-----
		\$ 337,571		\$
		=====		=====

* The description following each investment is unaudited and not covered by the Report of Independent Accountants.
+ Non-income producing security.

Portfolio securities and foreign currency holdings were translated at the following exchange rate as of February 28, 2002.

Japanese Yen JPY (Y) 133.995 = \$1.00

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.
STATEMENT OF ASSETS AND LIABILITIES
FEBRUARY 28, 2002

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ASSETS:

Investments in securities, at market value (cost-\$144,353,443)	\$
Investments in short-term securities, at market value (cost-\$204,093)	
Investments in foreign currency, at market value (cost-\$242,709)	
Receivable for investments sold	
Receivable for dividends and interest, net of withholding taxes	
Unrealized appreciation on foreign forward currency contracts	
 Total Assets	

LIABILITIES:

Payable for investments purchased	
Accrued management fee	
Other accrued expenses	
 Total Liabilities	

NET ASSETS:

Capital stock (par value of 15,846,384 shares of capital stock outstanding, authorized 100,000,000, par value \$0.10 each)	
Paid-in capital	1
Accumulated net realized loss on investments and foreign currency transactions	(
Unrealized net depreciation on investments and foreign exchange	(
Accumulated net investment loss	
 Net Assets	\$

Net asset value per share

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.
STATEMENT OF OPERATIONS
FOR THE YEAR ENDED FEBRUARY 28, 2002

INCOME:

Dividend income (less \$141,390 withholding taxes)	\$801,20
Interest income.....	12,63
 Total Income	-----

EXPENSES:

Management fee	1,137,91
Custodian fees	208,08
Legal fees	139,82
Shareholder reports	65,89
Auditing and tax reporting fees	56,46

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Directors' fees and expenses	37,15
Registration fees	29,20
Transfer agency fees	20,07
Annual meeting expenses	17,69
Miscellaneous	9,85
Insurance	4,19

Total Expenses

INVESTMENT LOSS-NET

REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS AND FOREIGN CURRENCY:

Realized loss on investments and foreign currency transactions:

Net realized loss on investments	
Net realized loss on foreign exchange	

Net realized loss on investments and foreign exchange

Change in net unrealized depreciation on translation of foreign currency
and other assets and liabilities denominated in foreign currency

Change in net unrealized depreciation on investments

Net realized and unrealized loss on investments and foreign exchange

NET DECREASE IN NET ASSETS RESULTING FROM OPERATIONS

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

STATEMENT OF CHANGES IN NET ASSETS

	For the Year Ended	
	February 28, 2002	February 28
	-----	-----
FROM INVESTMENT ACTIVITIES:		
Net investment loss	(\$912,515)	(\$1,397,7
Net realized gain/(loss) on investments	(14,623,705)	23,031,8
Net realized gain/(loss) on foreign exchange	(7,707,669)	437,4
Change in net unrealized depreciation on investments and foreign exchange	(2,947,753)	(148,569,3
	-----	-----
Decrease in net assets derived from investment activities.	(26,191,642)	(126,497,6
	-----	-----
FROM DISTRIBUTIONS TO SHAREHOLDERS:		
Long Term Capital Gains (\$0.08 and \$0.82 per share, respectively)	(1,267,704)	(12,993,9
	-----	-----
Decrease in net assets derived from distributions to shareholders	(1,267,704)	(12,993,9
	-----	-----
Net decrease in net assets	(27,459,346)	(139,491,6

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NET ASSETS:		
Beginning of period	120,274,815	259,766,4
End of period (including accumulated net investment losses of \$69,765 and \$62,906, respectively)	\$ 92,815,469	\$120,274,8

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS

1. Significant Accounting Policies

Japan Smaller Capitalization Fund, Inc. (formerly the Japan OTC Equity Fund, Inc.) (the "Fund") is registered under the Investment Company Act of 1940 as a non-diversified, closed-end management investment company. The Fund was incorporated in Maryland on January 25, 1990 and investment operations commenced on March 21, 1990. The Fund issued to its shareholders of record as of the close of business on October 25, 1999 non-transferable Rights to subscribe for up to an aggregate of 3,804,940 shares of Common Stock of the Fund at a rate of one share of Common Stock for three Rights held ("Primary Subscription"). The Fund had the ability to increase the number of shares subscribed for in this offering by up to 25% of the Primary Subscription, or an additional 951,235 shares, to honor record date shareholder requests to purchase more shares. During November 1999, the Fund issued a total of 4,458,565 shares of Common Stock on exercise of such Rights at the subscription price of \$11.99 per share, compared to a net asset value per share of \$16.20 and a market value per share of \$12.6875. Additionally, a sales load of 3.75% was charged to each share issued. Right offering costs of approximately \$546,000 and the sales load were charged directly against the proceeds of the Rights Offering. The following is a summary of significant accounting policies followed by the Fund.

(a) Valuation of Securities-Investments traded in the over-the-counter market are valued at the last reported sales price as of the the close of business on the day the securities are being valued or, if none is available, at the mean of the bid and offer price at the close of business on such day or, if none is available, the last reported sales price. Portfolio securities which are traded on stock exchanges are valued at the last sales price on the principal market on which securities are traded or lacking any sales, at the last available bid price. Short-term debt securities which mature in 60 days or less are valued at amortized cost if their original maturity at the date of purchase was 60 days or less, or by amortizing their value on the 61st day prior to maturity if their term to maturity at the date of purchase exceeded 60 days. Securities and other assets for which market quotations are not readily available are valued at fair value as determined in good faith by or under the direction of the Board of Directors of the Fund.

(b) Foreign Currency Transactions - Transactions denominated in Japanese yen are recorded in the Fund's records at the current prevailing rate at the time of the transaction. Asset and liability accounts that are denominated in

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yen are adjusted to reflect the current exchange rate at the end of the period. Transaction gains or losses resulting from changes in the exchange rate during the reporting period or upon settlement of foreign currency transactions are included in operations for the current period.

The net assets of the Fund are presented at the exchange rate and market values at the end of the period. The Fund isolates that portion of the change in unrealized appreciation (depreciation) included in the statement of operations arising as a result of changes in Japanese yen rates at February 28, 2002 on investments and other assets and liabilities. Net realized foreign exchange gains or losses includes gains or losses arising from sales of portfolio securities, sales and maturities of short-term securities, currency gains or losses realized between the trade and settlement dates on securities transactions, the difference between the amounts of dividends, interest, and foreign withholding taxes recorded on the Fund's books, and the U.S. dollar equivalent of the amounts actually received or paid.

(c) Financial Instruments with Off Balance Sheet Risk-At February 28, 2002, the Fund had outstanding two forward foreign currency exchange contracts ("forward contract") in order to hedge against changes in the Japanese exchange rate. A forward

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS-Continued

foreign currency contract is a commitment to purchase or sell foreign currency at a future date at a negotiated forward rate. The gain or loss arising from the difference between the original contracts and closing of such contracts is included in realized gain or loss on foreign exchange. Fluctuations in the value of forward foreign currency contracts are recorded for financial reporting purposes as unrealized gain or loss by the Fund. The forward contract involves elements of market risk in excess of the amount reflected in the Statement of Assets and Liabilities. The Fund bears the risk of an unfavorable change in the foreign exchange rate underlying the forward contract. Risks may arise as a result of the potential inability of the counterparty to meet the terms of the contract.

(d) Security Transactions, Investment Income and Distributions to Shareholders - Security transactions are accounted for on the trade date. Dividend income and distributions are recorded on the ex-dividend date and interest income is recorded on the accrual basis. Realized gains and losses on the sale of investments are calculated on the identified cost basis.

Distributions from net investment income and net realized gains are determined in accordance with Federal income tax regulations, which may differ from generally accepted accounting principles. To the extent these "book/tax" differences are permanent in nature (i.e., that they result from other than timing of recognition - "temporary"), such accounts are reclassified within the capital accounts based on their Federal tax-basis treatment; temporary differences do not require reclassification. Dividends and distributions which exceed net realized gains for financial reporting purposes, but not for tax purposes, are reported as distributions in excess of net realized gains.

(e) Income Taxes - A provision for United States income taxes has not been made since it is the intention of the Fund to qualify as a regulated investment company under the Internal Revenue Code and to distribute within the allowable time limit all taxable income to its shareholders.

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Under Japanese tax laws, a withholding tax is imposed on dividends at a rate of 20% and on interest at a rate of 15% and such withholding taxes are reflected as a reduction of the related revenue. There is no withholding tax on realized gains.

(f) Capital Account Reclassification - For the year ended February 28, 2002, the Fund's accumulated net realized loss was decreased by \$205,936 and paid in capital was decreased by \$1,111,592, with an offsetting decrease in accumulated net investment loss of \$905,656. This adjustment was primarily the result of the reclassification of foreign currency gains and the net operating loss.

(g) Use of Estimates in Financial Statement Preparation - The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from these estimates.

(h) Concentration of Risk - A significant portion of the Fund's net assets consists of Japanese securities which involve certain considerations and risks not typically associated with investments in the United States. In addition to the smaller size, and greater volatility, there is often substantially less publicly available information about Japanese issuers than there is about U.S. issuers. Future economic and political developments in Japan could adversely affect the value of securities in which the Fund is invested. Further, the Fund may be exposed to currency devaluation and other exchange rate fluctuations.

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS--Continued

2. Management Agreement and Transactions With Affiliated Persons

Nomura Asset Management U.S.A. Inc. (the "Manager") acts as the Manager of the Fund pursuant to a management agreement. Under the agreement, the Manager provides all office space, facilities and personnel necessary to perform its duties. Pursuant to such management agreement, the Manager has retained its parent company, Nomura Asset Management Co., Ltd. (the "Investment Adviser"), to act as investment adviser for the Fund.

As compensation for its services to the Fund, the Manager receives a monthly fee at the annual rate of 1.10% of the value of the Fund's average weekly net assets not in excess of \$50 million, 1.00% of the Fund's average weekly net assets in excess of \$50 million but not exceeding \$100 million, .90% of the Fund's average weekly net assets in excess of \$100 million but not exceeding \$175 million, and .80% of the Fund's average weekly net assets in excess of \$175 million. For services performed under the Investment Advisory Agreement, the Investment Adviser receives a monthly fee from the Manager at the annual rate of .50% of the Fund's average weekly net assets not in excess of \$50 million, .45% of the Fund's average weekly net assets in excess of \$50 million but not in excess of \$100 million, .40% of the Fund's average weekly net assets in excess of \$100 million but not exceeding \$175 million, and .35% of the Fund's average weekly net assets in excess of \$175 million. Under the Management Agreement, the Fund accrued fees to the Manager of \$1,137,918 for the year ended February 28, 2002. Under the Investment Advisory Agreement, the Manager informed the Fund that the Investment Adviser earned fees of \$513,623 for the year ended February 28, 2002. At February 28,

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2002, the fee payable to the Manager, by the Fund, was \$67,786.

Certain officers and/or directors of the Fund are officers and/or directors of the Manager. The Nomura Securities Co., Ltd. (the Manager's affiliate) and its affiliates earned \$11,515 in commissions on the execution of portfolio security transactions for the year ended February 28, 2002. The Fund pays each Director not affiliated with the Manager an annual fee of \$5,000 plus \$500 per meeting attended, together with such Director's actual expenses related to attendance at meetings. Such fees and expenses for unaffiliated Directors aggregated \$37,150 for the year ended February 28, 2002.

3. Purchases and Sales of Investments

Purchases and sales of investments, exclusive of investments in foreign currencies and short-term securities, for the year ended February 28, 2002 were \$40,724,919 and \$41,267,574, respectively.

As of February 28, 2002, net unrealized depreciation on investments exclusive of investments in foreign currency and short-term securities for Federal income tax purposes was \$52,996,182 of which \$2,538,035 related to appreciated securities and \$55,534,217 related to depreciated securities. The aggregate cost of investments, exclusive of investments in foreign currencies and short-term securities of \$446,802, at February 28, 2002 for Federal income tax purposes was \$145,168,587. In accordance with U.S. Treasury regulations, the Fund elected to defer \$69,765 of net realized foreign currency losses and \$1,372,594 of net realized capital losses arising after October 31, 2001. Such losses are treated for tax purposes as arising on March 1, 2002. The Fund has a capital loss carryforward as of February 28, 2002 of approximately \$22,683,799 which expires February 28, 2010.

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS-Continued

FINANCIAL HIGHLIGHTS

Selected per share data and ratios for a share of common stock outstanding throughout the period.

	For the Year End		
	February 28,		February 29,
	2002	2001	2000
	----	----	----
Net asset value, beginning of year	\$7.59	\$16.39	\$5.86
Rights Offering costs*	-	-	(0.16)
Net investment loss	(0.06)	(0.09)	(0.11)@
Net realized and unrealized gain (loss)			
on investments and foreign currency	(1.59)	(7.89)	11.99@
Total from investment operations	(1.65)	(7.98)	11.88@

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Distributions to shareholders from:

Net realized capital gains	(0.08)	(0.82)	-
Net investment income	-	-	-
	-----	-----	-----
Total distributions	(0.08)	(0.82)	0.00
Decrease in net asset value due to shares issued through Rights Offering*	-	-	(1.19)
	-----	-----	-----
Net asset value, end of period	\$5.86	\$7.59	\$16.39
	=====	=====	=====
Market value, end of period	\$5.53	\$6.89	\$11.00
Total investment return+	(18.6%)	(31.1%)	76.0%
Net asset value total return++.....	(21.7%)	(49.1%)	179.7%
Ratio to average net assets/supplemental data:			
Net assets, end of period (in 000)	\$92,815	\$120,275	\$259,766
Operating expenses	1.58%	1.33%	1.33%
Net investment loss	(0.84%)	(0.76%)	(0.88%)
Portfolio turnover	38%	78%	50%

+Based on market value per share, adjusted for reinvestment of income dividends and long term capital gain distributions, and capital share transactions. Total return does not reflect sales commissions.

++Based on net asset value per share, adjusted for reinvestment of income dividends and long term capital gain distributions, and capital share transactions. Total return does not reflect sales commissions.

*Decrease is due to Rights Offering (see note 1).

@Based on average shares outstanding.

Distributions

The Board of Directors of the Fund voted to pay to shareholders of record, the following distribution per share derived from capital gains realized from sales of portfolio securities:

Pay Date	Record Date	Dividends	Long-Term Capital Gains
-----	-----	-----	-----
December 14, 2001	December 7, 2001	-	\$0.08

The Fund hereby designates 100% of the long-term capital gain dividend distributed during the fiscal year as 20% rate capital gain dividend.

The Fund has notified shareholders in January, 2002 of amounts for use in preparing 2001 income tax returns.

JAPAN SMALLER CAPITALIZATION FUND, INC.

Supplemental Shareholder Information (Unaudited)

The 2001 Annual Meeting of the Shareholders of the Fund was held at the Fund's offices, 180 Maiden Lane, New York, New York on November 13, 2001. The purpose of the meeting was to elect five Directors to serve for the ensuing year; to consider and act upon a proposal to approve a new Management Agreement between the Fund and Nomura Asset Management U.S.A. Inc. ("NAM-U.S.A."); to consider and act upon a proposal to approve a new

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Investment Advisory Agreement between NAM-U.S.A. and Nomura Asset Management Co., Ltd. ("NAM"); and to transact such other business as may properly come before the Meeting or any adjournment thereof.

At the Meeting, the following persons were elected by the shareholders to serve as Directors of the Fund: William G. Barker, Jr., Kazuhiko Hama, Chor Weng Tan, Arthur R. Taylor, and John F. Wallace. The shareholders approved a new Management Agreement between the Fund and NAM-U.S.A. and a new Investment Agreement between NAM-U.S.A. and NAM. No other business was transacted at the meeting.

The results of the voting at the Annual Meeting are as follows:

1. To elect the Fund's Board of Directors:

	Shares Voted For	% of outstanding Shares	Shares Voted Withhold Author
William G. Barker, Jr.	11,984,603	75.6	303,574
Kazuhiko Hama	11,996,173	75.7	292,004
Chor Weng Tan	12,009,791	75.8	278,386
Arthur R. Taylor	11,990,562	75.7	297,615
John F Wallace	11,999,282	75.7	288,895

2. To approve a new Management Agreement between the Fund and NAM-U.S.A.:

Shares Voted For	% of outstanding Shares	Shares Voted Against	% of outstanding Shares	Shares Abstain
12,002,482	75.7	198,744	1.3	86,951

3. To approve a new Investment Advisory Agreement between NAM-U.S.A. and NAM:

Shares Voted For	% of outstanding Shares	Shares Voted Against	% of outstanding Shares	Shares Abstain
12,001,160	75.7	200,303	1.3	86,714

JAPAN SMALLER CAPITALIZATION FUND, INC.

REVIEW OF THE FUND'S MARKET PRICE COMPARED TO NET ASSET VALUE

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Shares of closed-end investment companies, including funds focusing on a single country, have at various times traded at both premiums and discounts to their net asset value ("NAV"). Although the shares of the Fund have traded at such a premium, they also have traded at a discount from NAV.

Since the Fund was established, the Board of Directors on a quarterly basis has reviewed the trading price of the Fund's shares. The purpose of such review has been to determine whether a discount exists and, if so, whether it would be in shareholders' overall best interests for the Fund to conduct share repurchases, make an issuer tender offer for shares or consider another means of possibly reducing the discount. For example, the Board of Directors has also considered whether it would be in the best interests of the Fund to convert to an open-end fund or to an interval fund, which is a form of investment company that makes periodic share repurchases at prices based on NAV.

To date, the Board of Directors has not authorized open-market share repurchases or a tender offer for shares of the Fund. The Board of Directors also has not felt that it would be in the best interests of the Fund or its shareholders to convert to an open-end fund or an interval fund. As a "country fund", emphasizing a smaller capitalization segment of the market, the Fund's NAV is more volatile than might be the case for a fund with a broader investment focus. The Board of Directors believe that converting the Fund to either an open-end or interval fund would subject the Fund to redemptions or repurchases at times when liquidation of portfolio securities could disadvantage remaining shareholders, and they believe that the recent volatility of the financial markets in Japan supports their view. Additionally, since an open-end fund has a limited ability to invest in illiquid securities, such a conversion could hinder the Fund's ability to pursue its investment objectives. The Board of Directors intend to continue to review, on a quarterly basis, the trading market for the Fund's shares.

JAPAN SMALLER CAPITALIZATION FUND, INC.

DIVIDEND REINVESTMENT PLAN

The Dividend Reinvestment Plan (the "Plan") is available automatically for any holder of Common Stock with shares registered in his/her own name who wishes to purchase additional shares with income dividends or capital gains distributions received on shares owned, unless such shareholder elects to receive all dividends and capital gain distributions in cash, paid by check and mailed to the shareholder. If a shareholder holds shares in his/her own name, communications regarding the Plan should be addressed to the Plan Agent, Equiserve Inc., 150 Royall Street, Canton, Massachusetts 02021. Under the Plan, shareholders appoint the Plan Agent to reinvest dividends and distributions in shares of the Fund. Such shares will be acquired by the Plan Agent for shareholders either through open market purchases if the Fund is trading at a discount or through the issuance of authorized but unissued shares if the Fund is trading at net asset value or a premium. If the market price of a share on the payable date of a dividend or distribution is at or above the Fund's net asset value per share on such date, the number of shares to be issued by the Fund to each shareholder receiving shares in lieu of cash dividends or distributions will be determined by dividing the amount of the cash dividends or distributions to which such shareholder would be entitled by the greater of the net asset value per share on such date or 95% of the market price of a share on such date. If the market price of a share on such distribution date is below the net asset value per share, the number of shares to be issued to such shareholders will be determined by dividing such amount, less brokerage commission, by the per share market price.

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Purchases will be made by the Plan Agent from time to time on the New York Stock Exchange (the "Exchange") or elsewhere to satisfy dividend and distribution investment requirements under the Plan. Purchases will be suspended on any day when the closing price (or the mean between the closing bid and ask prices if there were no sales) of the shares on the Exchange on the preceding trading day was higher than the net asset value per share. If on the dividend payable date, purchases by the Fund are insufficient to satisfy dividend or distribution investments and on the last trading day immediately preceding the dividend payable date the closing price or the mean between the closing bid and ask prices of the shares is lower than or the same as the net asset value per share, the Plan Agent will continue to purchase shares until all investments by shareholders have been completed or the closing price or the mean between the bid and ask prices of the shares becomes higher than the net asset value, in which case the Fund will issue the necessary additional shares from authorized but unissued shares. If on the last trading day immediately preceding the dividend payable date, the closing price or the mean between the bid and ask prices of the shares is higher than the net asset value per share and if the number of shares previously purchased on the Exchange or elsewhere is insufficient to satisfy dividend investments, the Fund will issue the necessary additional shares from authorized but unissued shares. There will be no brokerage charges with respect to shares issued directly by the Fund to satisfy the dividend investment requirements. However, each participant will pay a pro rata share of brokerage commissions incurred with respect to the Fund's open market purchases of shares. In each case, the cost per share of shares purchased for each shareholder's account will be the average cost, including brokerage commissions, of any shares purchased in the open market plus the cost of any shares issued by the Fund. For the fiscal year ended February 28, 2002, the Fund did not issue any new shares for dividend reinvestment purposes. The Fund purchased 2,344 shares (\$12,752) on the open market for dividend reinvestment purposes.

Shareholders who elect to hold their shares in the name of a broker or other nominee should contact such broker or other nominee to determine whether they may participate in the Plan. To the extent such participation is permitted, the Plan Agent will adminis-

ter the Plan on the basis of the number of shares certified from time to time by the broker as representing the total amount registered in the shareholder's name and held for the account of beneficial owners who are participating in such Plan. Shareholders that participate in the Plan holding shares in a brokerage account may not be able to transfer the shares to another broker and continue to participate in the Plan. Shareholders who are participating in the Plan may withdraw from the Plan at any time. There will be no penalty for withdrawal from the Plan, and shareholders who have previously withdrawn from the Plan may rejoin it at any time. Changes in participation in the Plan should be made by contacting the Plan Agent if the shares are held in the shareholder's own name and must be in writing and should include the shareholder's name and address as they appear on the account registration. If the shares are held in the name of a broker or other nominee, such person should be contacted regarding changes in participation in the Plan. Upon withdrawal from the Plan, the Plan Agent will deliver to the shareholder a certificate or certificates for the appropriate number of full shares and a cash payment for any fractional shares. In lieu of receiving a certificate, the shareholder may request the Plan Agent to sell part or all of the shareholder's shares at the market price and remit the proceeds to the shareholder, net of any brokerage commissions. A \$2.50 fee will be charged by the Plan Agent upon any cash withdrawal or termination. An election to withdraw from the Plan will, until such election is changed, be deemed to be an election by a shareholder to take all subsequent distributions in cash. An election will be effective only for a dividend or distribution if it is received by the Plan Agent not less than 10 days prior to such record

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date.

The Plan Agent will maintain all shareholders' accounts in the Plan, and furnish written confirmation of all transactions in such account, including information needed by shareholders for tax records. Shares in the account of each Plan participant may be held by the Plan Agent in non-certificated form in the name of the participant, and each shareholder's proxy will include those shares purchased or received pursuant to the Plan.

The automatic reinvestment of dividends will not relieve participants of any income taxes that may be payable (or required to be withheld) on such dividends. Shareholders receiving dividends or distributions in the form of additional shares pursuant to the Plan should be treated for Federal income tax purposes as receiving a distribution in an amount equal to the amount of money that the shareholders receiving cash dividends or distributions will receive and should have a cost basis in the shares received equal to such amount.

The Fund reserves the right to amend or terminate the Plan as applied to any dividend paid subsequent to written notice of the change sent to participants in the Plan at least 90 days before the record date for such dividend. There is no service charge to participants in the Plan; however, the Fund reserves the right to amend the Plan to include a service charge payable by the participants. All correspondence concerning the Plan, including requests for additional information about the Plan, should be directed to the Plan Agent.

SHAREHOLDERS ACCOUNT INFORMATION

Shareholders whose accounts are held in their own name may contact the Fund's transfer agent, Equiserve, Inc. at (800) 426-5523 for information concerning their accounts.

BOARD OF DIRECTORS

William G. Barker, Jr.
Kazuhiko Hama
Chor Weng Tan
Arthur R. Taylor
John F Wallace

OFFICERS

Kazuhiko Hama, President
Keisuke Haruguchi, Vice President
Kenneth L. Munt, Vice President
David G. Stoeffel, Vice President
John J. Boretti, Secretary and Treasurer
Rita Chopra-Brathwaite, Assistant Treasurer

MANAGER

Nomura Asset Management U.S.A. Inc.
180 Maiden Lane
New York, New York 10038-4936
Internet Address

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www.nomura-asset.com

INVESTMENT ADVISOR

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1-14-2-Chome Nihonbashi, Chuo-ku,
Tokyo 103-8260, Japan

DIVIDEND PAYING AGENT, TRANSFER AGENT AND REGISTRAR

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COUNSEL

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180 MAIDEN LANE
NEW YORK, NEW YORK 10038-4936

This Report, including the Financial Statements, is transmitted to the Shareholders of Japan Smaller Capitalization Fund, Inc. for their information. This is not a prospectus, circular or representation intended for use in the purchase of shares of the Fund or any securities mentioned in the Report.