

JAPAN SMALLER CAPITALIZATION FUND INC  
Form N-CSR  
May 12, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT

INVESTMENT COMPANIES

Investment Company Act file number: 811-9521

JAPAN SMALLER CAPITALIZATION FUND, INC.

180 Maiden Lane, New York, N.Y. 10038

Nomura Asset Management U.S.A. Inc.  
180 Maiden Lane, New York, N.Y. 10038

Registrant's telephone number, including area code: (800) 833-0018

Date of fiscal year end: February 29, 2004

Date of reporting period: February 29, 2004

ITEM 1. REPORT TO SHAREHOLDERS

JAPAN SMALLER CAPITALIZATION FUND, INC.

April 22, 2004

To Our Shareholders:

We present the Annual Report of Japan Smaller Capitalization Fund, Inc. (the "Fund") for the fiscal year ended February 29, 2004. The Net Asset Value per share ("NAV") of the Fund increased by 63.8% for the year. The closing market price of the Fund on February 29, 2004, on the New York Stock Exchange was \$10.79 representing a premium of 14.8% to the NAV of \$9.40. The net assets of the Fund amounted to \$149,011,877 on February 29, 2004.

The TOPIX, consisting of all companies listed on the Tokyo Stock Exchange (the "TSE") First Section, increased by 43.1%

The Fund underperformed the JASDAQ Index by 38.7 percentage points and underperformed the OTC Index by 5.1 percentage points during the year. Disappointing performances from some of the Fund's holdings in sectors such as Consumption and Information/Systems, and the underexposure to major internet-related issues with large market capitalizations, such as Yahoo Japan and Rakuten, had a negative impact on the relative performance.

The NAV of the Fund increased by 8.2% for the quarter ended February 29, 2004. During the same period, the TOPIX and the

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and the Nikkei Average Index (a price weighted index of 225 leading stocks on the TSE) increased by 42.9%, in United States ("U.S.") dollar terms, for the year ended February 29, 2004. The Nikkei JASDAQ Average Index (the "OTC Index"), a price-weighted index of the quotations of the OTC registered stocks increased by 68.8%, and the Index of the Japan Securities Dealers Association Quotation System (the "JASDAQ Index"), a capitalization-weighted index of all OTC stocks, increased by 102.5%, respectively, in U.S. dollar terms, during the same period. The Japanese yen ("Yen") appreciated by 7.6% against the U.S. dollar during the year.

Nikkei Average Index decreased by 8.5% and 9.6%, respectively, and the OTC Index and the JASDAQ Index increased by 11.4% and 10.4%, respectively, in U.S. dollar terms. For the quarter ended February 29, 2004, the Fund underperformed the OTC Index and the JASDAQ Index by 3.2 percentage points and 2.3 percentage points, respectively.

### The Portfolio

The Fund's equity exposure rose to 98.5% at February 29, 2004 from 96.4% at November 30, 2003. The Fund was diversified into 98 issues, of which 57

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issues were OTC stocks, 25 were other smaller capitalization stocks and 16 were TSE First Section stocks, comprising 52.6%, 30.0% and 15.9%, respectively, of net assets on February 29, 2004.

### Market Review

The OTC Index achieved a substantial return of 56.0%, in local currency terms for the year ended February 29, 2004.

The Japanese stock market enjoyed a strong rebound in the quarter ended June 30, 2003. Japanese equities including the JASDAQ market began to show signs of a nascent recovery following the announcement of a public fund injection into the ailing banking group Resona Holdings, while a turnaround in the U.S. stock market also helped to push Tokyo stock prices higher. Although most Asian markets struggled early in the quarter amid fears about the economic implications of the SARS outbreak, this had little impact on Japan. The OTC index recovered the 1,000 level in mid-April.

The OTC index was able to extend its rally through the quarter ended September 30, 2003, driven by steady performances from some major JASDAQ issues including Yahoo Japan and Rakuten. The massive price gains followed some encouraging domestic macroeconomic indicators, a more positive outlook for the U.S. economy, and

The JASDAQ market saw a temporary correction in the quarter ended December 31, 2003. Early gains in October, when the Nikkei JASDAQ Average index exceeded the 1,500 level, were subsequently eroded by profit taking in November. Investors who had an early entry into this strong rally in 2003 appeared to have chosen to lock in some of their profits before Christmas. Subsequently, the release of some encouraging macroeconomic data from Japan as well as the U.S. contributed to strong gains toward the end of the quarter. Overseas investors remained active buyers of Japanese stocks.

The year 2004 began with the OTC index extending its strong recovery. The market found plenty of support from the favorable performances of a number of initial public offering issues, which attracted the attention of individual investors. The OTC index again recovered the 1,500 level. After posting such strong gains in January, the market became narrowly range-bound throughout much of February. However, the weakening Yen helped the OTC index to resume its upward trend towards the month end.

### Outlook and Strategy

Following the strong surge in Japan's real Gross Domestic Product ("GDP") figure for the fourth quarter of 2003 the Fund has raised the economic growth forecasts for fiscal 2004 to 2% from 1.8%. Nevertheless, the Fund maintains the view that the cycli-

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an improving fundamental outlook for Japanese companies. Buying activity from overseas investors continued to support the market.

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time being, as robust corporate earnings growth continues to support stock prices in Japan, while ample liquidity and low interest rates continue to underpin the markets globally. This global monetary support looks set to continue, since benign inflation conditions on the U.S. will tend to preclude any increase in the Federal Funds rate this year.

Strong earnings growth can be observed mainly within the manufacturing and basic materials sectors in Japan, so the market's fortunes remain sensitive to changes in the Yen to one U.S. dollar exchange rate. Recent imbalances between the amount of funds used for the Bank of Japan's market intervention operations, the current account surplus, and direct investment toward Japan could indicate that it was speculative pressure that had pushed the Yen toward the 105-level against the U.S. dollar. Hence, the latest reversal that saw the Yen decline back toward the 110 Yen to one U.S. dollar level can be attributed to a short covering rally in the U.S. dollar, and it would be premature to conclude that the greenback had marked a turning point. Although the current exchange rate is not a threat to earnings growth, a further slide in the U.S. dollar towards the important psychological threshold of 100 Yen to one U.S. dollar would begin to neutralize corporate earnings growth in the Japanese market. Currently, the Fund maintains the view that corporate profits will grow by around 10% for fiscal year 2004.

Recent announcements of strong GDP and industrial production growth figures have invoked another strong inflow of money from foreign investors. On the other hand, as the fiscal year end approaches,

cal recovery will approach its peak around the summer of this year. As for the stock market, Japanese stocks in aggregate terms are likely to remain resilient for the

supply from domestic investors could start to weigh on the Tokyo market again. Cross shareholding disposals tend to intensify around the fiscal year end. In addition, there may also be some frictional selling pressure this year due to a change in regulations governing the postal savings and insurance scheme that will allow the post office to transfer assets from trust banks to other asset management organizations. This supply pressure will be limited to the immediate term, however, and is not expected to linger in the next fiscal year.

Stock selection remains the primary focus. The Fund will continue searching for stocks that are relatively undervalued or those where fundamental changes have not yet been reflected in the current share price.

The sector allocation strategy remains unchanged for the moment, although the Fund is looking for an opportunity to reduce the overexposure to the Electronics sector and shift towards more undervalued sectors. While the Fund believes the market's current resilience will prove sustainable, supported by decent corporate earnings, some Electronic sector stocks in particular are approaching the over-valued range and it is becoming harder to justify holding them.

We appreciate your continuing support of your Fund.

Sincerely,

/s/  
Yasushi Suzuki  
President

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BYLAW AMENDMENTS

On February 18, 2004, the Fund's Board of Directors, based on the unanimous recommendation of its independent Directors, approved amendments to the Fund's Bylaws and certain other elective provisions of Maryland law. The Fund is incorporated under Maryland Law. The amendments and the elections to be subject to various provisions of the Maryland General Corporation Law include provisions that, among other things, (i) require shareholders to provide notice to the Fund, normally not less than 90 or more than 120 days before the anniversary of the mailing date of the notice of the prior year's annual meeting of shareholders, of any nomination of Directors or other proposals intended for consideration at the next annual meeting of shareholders, (ii) classify the Board into three classes each with three-year terms which expire only when a successor is duly elected and qualifies, (iii) provide that shareholder meetings can be convened at shareholder request only upon the written request of shareholders entitled to vote a majority of the Fund's outstanding shares and establish procedures for shareholder-requested special meetings, and (iv) provide that a majority of the Fund's outstanding shares entitled to vote is required to elect a Director.

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NEW DIRECTOR

Effective January 1, 2004, the Fund's Board of Directors, based on the unanimous recommendation of its Nominating Committee, elected Dr. William K. Grollman as a Director to fill a vacancy among the independent Directors on the Board. Dr. Grollman is the President and co-founder of SmartPros Ltd., a leading provider of professional education programs, and a former Partner and National Director of BDOSeidman, LLP, an international accounting firm. He is also a former professor at Fordham University Graduate School of Business Administration. He received his Ph.D. degree from New York University Graduate School of Business Administration and his M.B.A. degree in accounting from New York University. Dr. Grollman, who is a non-interested Director (as defined in the Investment Company Act of 1940), will serve as the Fund's Audit Committee Financial Expert.

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NEW PORTFOLIO MANAGER

On April 1, 2004, Mr. Takeshi Ebihara became the new Portfolio Manager for the Fund. Mr. Ebihara is a Portfolio Manager for the Japan Equity Team for Institutional Clients at Nomura Asset Management Co., Ltd. and the Chairman of the Japan Small-Capitalization Stock Selection Committees. He was a former analyst in the Corporate Research Department at Nomura Asset Management Co., Ltd. and a former member of the Japan Stock Selection Committee.

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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.com](http://www.nomura.com). We invite you to view the Internet website.

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JAPAN SMALLER CAPITALIZATION FUND, INC.

FUND HIGHLIGHTS--FEBRUARY 29, 2004

KEY STATISTICS

Net Assets.....	\$149,011,877
Net Asset Value per Share.....	\$ 9.40
Closing NYSEMarket Price.....	\$10.79
Percentage Change in Net Asset Value per Share*+.....	63.8%
Percentage Change in NYSEMarket Price*+.....	69.1%

MARKET INDICES

Percentage change in market indices:\*

	YEN ---	U.S.\$ -----
TOPIX.....	32.2%	43.1%
Nikkei Average.....	32.0%	42.9%
JASDAQ.....	87.1%	102.5%
Nikkei OTCAverage.....	56.0%	68.8%

\*From March 1, 2003 through February 29, 2004.

+Reflects the percentage change in share price.

ASSET ALLOCATION

Japanese Equities

OTCStocks.....	52.6%
Other Smaller Capitalization Stocks.....	30.0
TSE First Section Stocks.....	15.9
	-----
Total Investments.....	98.5
Other Assets Less Liabilities.....	1.5
	-----
Net Assets.....	100.0%
	=====

INDUSTRY DIVERSIFICATION

	% of Net Assets -----		% of Net Assets -----
Miscellaneous Manufacturing.....	15.7	Food Manufacturing.....	4.2
Retail.....	15.7	Electric.....	3.2
Services.....	12.2	Real Estate and Warehouse.....	2.9
Chemicals and Pharmaceuticals....	11.2	Machinery and Machine Tools.....	2.5
Electronics.....	8.2	Textiles and Apparel.....	2.3
Wholesale.....	6.6	Restaurants.....	1.6
Automotive Equipment and Parts...	5.7	Banks and Finance.....	1.0
Information and Software.....	5.5		

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TEN LARGEST EQUITY HOLDINGS BY MARKET VALUE

Security -----	Market Value -----	% of Net Assets -----
C. Uyemura & Co., Ltd.....	\$4,123,112	2.8
Toys R Us-Japan, Ltd.....	3,319,954	2.2
Nitori Co., Ltd.....	3,007,623	2.0
T & K Toka Co., Ltd.....	2,967,391	2.0
Chiyoda Co., Ltd.....	2,820,714	1.9
Exedy Corporation.....	2,665,937	1.8
Suruga Co., Ltd.....	2,662,654	1.8
Leopalace21 Corporation.....	2,605,950	1.7
Nichiha Corporation.....	2,595,260	1.7
United Arrows Corporation.....	2,516,412	1.7

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JAPAN SMALLER CAPITALIZATION FUND, INC.

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REPORT OF INDEPENDENT AUDITORS

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. (the "Fund") at February 29, 2004, 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 29, 2004 by correspondence with the custodian and brokers, provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP  
New York New York  
April 21, 2004  
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SCHEDULE OF INVESTMENTS\*

FEBRUARY 29, 2004

	Shares -----	Cost -----	Market Value -----	% N As ---
EQUITY SECURITIES				
Automotive Equipment and Parts				
Exedy Corporation .....	202,400	\$ 1,703,184	\$ 2,665,937	
Automobile clutches				
Musashi Seimitsu Industry Co., Ltd.....	73,000	1,358,184	2,111,487	
Ball joints, camshafts and gears				
Nippon Cable Systems Inc.....	187,300	1,698,791	2,177,309	
Control cables				
Nissin Kogyo Co., Ltd.....	68,000	1,519,767	1,524,943	
Brake systems				
Total Automotive Equipment and Parts.....		6,279,926	8,479,676	
Banks and Finance				
Ricoh Leasing Co., Ltd.....	69,000	1,473,994	1,515,789	
Credit sales and leasing				
Chemicals and Pharmaceuticals				
Arisawa Manufacturing Co., Ltd.....	63,230	990,131	2,170,366	
Glassfibers and insulating resins				
C. Uyemura & Co., Ltd.....	143,000	2,365,695	4,123,112	
Chemicals				

See notes to financial statements

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JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS\*--Continued

FEBRUARY 29, 2004

	Shares -----	Cost -----	Market Value -----
FP Corporation.....	100,500	\$ 1,895,348	\$ 1,763,465

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Polystyrene and other synthetic resin foodware			
Konishi Co., Ltd.....	103,500	1,131,121	864,000
Adhesives and construction sealants			
Mandom Corporation.....	69,000	962,431	1,386,316
Cosmetic products			
Matsumoto Yushi-Seiyaku Co., Ltd.....	52,000	1,014,987	970,984
Analgesic anti-inflammatory agents			
Milbon Co., Ltd.....	51,260	1,526,033	1,205,842
Hair-care products for beauty salons			
Shizuokagas Co., Ltd.+.....	366,000	1,024,377	1,276,394
Natural gas supplier			
T & K Toka Co., Ltd.....	131,250	2,225,242	2,967,391
		-----	-----
Ink for printing			
Total Chemicals and Pharmaceuticals.....		13,135,365	16,727,870
		-----	-----
Electric			
Citizen Electronics Co., Ltd.....	27,900	1,277,286	2,247,323
Electric parts			
Eneserve Corporation.....	28,000	688,269	1,166,133
Electric generation system for supermarkets			
Mirai Industry Co., Ltd.....	261,000	2,586,427	1,290,069
		-----	-----
Plastic molded electric materials			
Total Electric.....		4,551,982	4,703,525
		-----	-----
Electronics			
Chiyoda Integre Co., Ltd.....	82,100	913,011	2,344,641
Electronic components			
Cosel Co., Ltd.....	76,500	1,986,521	1,967,643
Electrical machinery			
Dainippon Screen Mfg. Co., Ltd.+.....	287,000	1,116,079	2,007,030
Electronic components			
Fuji Electric Industry Co., Ltd.....	58,000	613,710	384,897
Electronic parts			
Fukuda Denshi Co.....	39,000	961,762	828,192
Medical electronic equipment			
Kuroda Electric Co., Ltd.....	70,700	889,579	2,485,016
Materials and components			
Toshiba Tec Corp.....	280,000	1,126,847	1,122,563
Electronic equipment manufacturing			
UMCJapan +.....	1,466	2,670,710	1,072,159
		-----	-----
Semiconductor memory chips			
Total Electronics.....		10,278,219	12,212,141
		-----	-----

See notes to financial statements



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JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS\*--Continued

FEBRUARY 29, 2004

	Shares -----	Cost ----	Market Value -----
Food Manufacturing			
Arcs Co., Ltd.....	150,480	\$ 1,606,660	\$ 1,515,130
Supermarket chain			
Ariake Japan Co., Ltd.....	35,530	739,366	1,086,226
Natural seasonings			
Kakiyasu Honten Co., Ltd.....	80,600	674,732	988,595
Processed meat products, fresh meats, and side dishes			
Ozeki Co., Ltd.....	12,000	1,132,929	443,753
Supermarket chain			
Plenus Co., Ltd.....	63,360	1,468,613	1,423,788
Japanese lunch-boxes			
Q'sai Co., Ltd.....	120,000	474,013	796,339
		-----	-----
Frozen and processed foods and juice drinks			
Total Food Manufacturing.....		6,096,313	6,253,831
		-----	-----
Information and Software			
Argo Graphics Inc.....	36,000	896,182	830,389
Computer aided design software			
CACCorp.....	132,100	1,495,499	941,930
Information technology services			
Index Corporation.....	568	395,185	2,391,579
Cellular phone, internet content			
Jastec Co., Ltd.....	47,000	631,062	687,899
Business application software			
Konami Computer EntertainmentTokyo, Inc.....	82,960	871,645	1,685,777
Video games software			
Trend Micro Inc.+.....	19,500	1,488,482	603,295
Computer software, anti-virus server			
Works Applications Co., Ltd.+.....	280	529,903	1,204,577
		-----	-----
Software development			
Total Information and Software .....		6,307,958	8,345,446
		-----	-----
Machinery and Machine Tools			
THK Co., Ltd.....	132,400	4,015,427	2,320,787
Linear motion systems for industrial machines			
Yushin Precision Equipment Co., Ltd.....	57,800	2,342,621	1,391,432
		-----	-----
Injection molding related machinery			
Total Machinery and Machine Tools.....		6,358,048	3,712,219
		-----	-----
Miscellaneous Manufacturing			
Central Glass Co., Ltd.....	297,000	1,565,509	1,930,160
Glass products			

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Eidai Kako Co., Ltd.....	53,000	243,478	196,476
Synthetic resin processed products			

See notes to financial statements

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JAPAN SMALLER CAPITALIZATION FUND, INC.  
SCHEDULE OF INVESTMENTS\*--Continued

FEBRUARY 29, 2004

	Shares	Cost	Market Value
	-----	----	-----
Fuji Seal, Inc.....	29,550	\$ 542,645	\$ 1,244,210
Packing materials			
Fujimi Inc.....	62,500	1,625,209	1,521,739
Polishing materials for silicone wafers			
Hoden Seimitsu Kako Kenkyusho Co., Ltd.....	62,000	1,015,688	398,389
Aluminum extruding molds			
Koito Industries Ltd.....	136,000	442,495	471,799
Electric lighting, electrical, and traffic signal equipment			
Mani, Inc.....	66,200	962,882	1,363,387
Medical goods and equipment			
Maruko Co., Ltd.....	73,500	865,850	666,041
Intimate apparel			
Mizuno Corporation.....	374,000	1,279,317	1,650,050
Sporting goods			
Nichiha Corporation.....	194,600	1,739,791	2,595,260
Ceramic exterior walls and fiber boards			
Nippon Kodoshi Corp.....	188,000	2,839,396	1,608,970
Paper for electric insulation			
Nippon Signal Co., Ltd.....	234,000	1,087,517	1,163,039
Traffic signals			
Onkyo Corp.....	115,000	1,053,288	1,115,789
Multi-media products			
Riso Kagaku Corporation.....	35,100	1,333,217	1,606,407
Printing and copying machines			
Secom Techno Service Co., Ltd.....	44,000	1,176,991	1,389,474
Security systems, provides maintenance service			
Shinkawa Ltd.....	27,900	540,404	646,105
Bonders for semiconductors			
SKKaken Co., Ltd.....	49,500	1,135,503	1,282,243
Paints			
Suruga Co., Ltd.....	141,900	2,165,222	2,662,654
Daily necessities, novelties and promotional items			
Total Miscellaneous Manufacturing.....		21,614,402	23,512,192

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Real Estate and Warehouse			
Leopalace21 Corporation.....	219,000	1,928,030	2,605,950
Builds, repairs, sells, leases and manages real estate properties			
Nippon Kanzai Co., Ltd.....	75,580	1,103,449	1,245,946
Comprehensive building maintenance			
Recrm Research Co., Ltd.+.....	945	1,172,070	598,572
Building management			
Total Real Estate and Warehouse.....		4,203,549	4,450,468

See notes to financial statements

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JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS\*--Continued

FEBRUARY 29, 2004

	Shares	Cost	Market Value
	-----	----	-----
Restaurants			
Saint Marc Co., Ltd.....	34,700	\$ 961,983	\$ 1,140,256
Restaurants and bakery shop chain			
Watami Food Service Co., Ltd.....	159,350	2,489,530	1,093,936
Restaurant chain			
Total Restaurants.....		3,451,513	2,234,192
Retail			
Askul Corporation.....	28,400	1,419,284	1,429,748
Catalog shopping			
Cawachi Limited.....	22,400	1,241,833	1,638,224
Drug store chain			
Chiyoda Co., Ltd.....	221,700	1,565,569	2,820,714
Specialty store chain			
Edion Corporation.....	206,000	1,006,273	1,911,982
Consumer electronics			
Kyoto Kimono Yuzen Co., Ltd.	491	1,664,707	1,137,053
Japanese traditional kimonos			

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Nissen Co., Ltd.....	83,600	350,876	1,362,087
Mail-order business			
Nitori Co., Ltd.....	49,560	1,599,142	3,007,623
Home furnishings			
Otsuka Kagu, Ltd.....	55,900	2,237,581	2,015,982
Furniture			
Prime Network Inc.....	396	930,215	384,220
TV shopping business			
Toys R Us-Japan, Ltd.....	150,500	4,069,477	3,319,954
Toy store chain			
Uoriki Co., Ltd.....	208,400	1,422,799	1,730,149
Fresh fish and sushi stores			
USS Co., Ltd.....	31,300	703,008	2,300,586
Automobile auction			
Total Retail.....		18,210,764	23,058,322
Services			
Alps Logistics Co., Ltd.....	84,000	515,309	1,660,778
Transportation			
Bellsystem 24, Inc.....	3,100	1,015,540	620,284
Telemarketing			
E-System Corporation +.....	760	685,655	800,000
Consulting services			
Fullcast Co., Ltd.....	594	970,096	1,973,656
Human resources			

See notes to financial statements

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JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS\*--Continued

FEBRUARY 29, 2004

	Shares	Cost	Market Value
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Leoc Japan Co., Ltd.	123,000	\$ 2,593,420	\$ 298,352
Nursing home caterer			
Nichii Gakkan Company	32,560	1,434,734	1,540,826
Hospital administration services			
Nissin Healthcare Food Service Co., Ltd.	107,400	1,976,466	2,261,053
Nursing home caterer			
Pasona Inc.+	265	704,397	1,697,941
Human resources			
Sumisho Auto Leasing Corporation	6,800	182,552	225,318

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Auto leasing and maintenance Toei Animation Co., Ltd.	28,300	1,447,047	1,352,183
Animated cartoon movies production Tohokushinsha Film Corporation	59,300	624,843	1,443,826
Produces tv programs, movies and commercial films Toppan Forms Co., Ltd.	105,200	1,113,807	1,198,847
Commercial printing Tow Co., Ltd.	226,720	1,403,612	1,718,299
Entertainment Weathernews Inc.	147,300	1,816,185	1,523,561
Custom weather forecasting services Total Services		16,483,663	18,314,924
Textiles and Apparel United Arrows Limited	53,800	972,762	2,516,412
Casual clothes Workman Co., Ltd.	43,000	691,495	873,776
Uniforms Total Textiles and Apparel		1,664,257	3,390,188
Wholesale ArcLand Sakamoto Co., Ltd.	125,400	1,502,668	1,624,174
Home appliances Hakuto Co., Ltd.	177,600	1,916,241	2,113,318
Electric parts Kato Sangyo Co., Ltd.	197,000	1,393,669	2,145,812
Processed foods Paltac Corporation	85,000	701,892	1,392,677
Cosmetics, toiletries, and other consumer goods Takachiho Electric Co., Ltd.	37,400	640,364	672,687
Electronics parts			

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.  
SCHEDULE OF INVESTMENTS\*--Continued  
FEBRUARY 29, 2004

Shares	Cost	Market Value
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Toba, Inc.....	48,000	\$ 586,907	\$ 667,826
Trading company for control systems			
Toshin Denki Co., Ltd.....	72,000	892,909	1,186,270
		-----	-----
Lighting equipment and electrical engineering materials			
Total Wholesale.....		7,634,650	9,802,764
		-----	-----
TOTAL INVESTMENTS IN EQUITY SECURITIES.....		127,744,603	146,713,547
		-----	-----
OTHER ASSETS LESS LIABILITIES, NET.....		2,303,083	2,298,330
		-----	-----
NET ASSETS.....		\$130,047,686	\$149,011,877
		=====	=====

\* The description following each investment is unaudited and not covered by the Report of Independent Auditors.

+ Non-income producing security.

Portfolio securities and foreign currency holdings were translated at the following exchange rate as of February 29, 2004.

Japanese Yen      JPY(Y)      109.25 = \$1.00

See notes to financial statements

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JAPAN SMALLER CAPITALIZATION FUND, INC.  
STATEMENT OF ASSETS AND LIABILITIES  
FEBRUARY 29, 2004

ASSETS:

Investments in securities, at market value (cost--\$127,744,603).....	\$146,713,547
Receivable for investments sold.....	474,000
Receivable for dividends and interest, net of withholding taxes.....	245,878
Cash or cash equivalent.....	2,105,310
	-----
Total Assets.....	149,538,735
	-----

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LIABILITIES:

Payable for investments purchased.....	248,666
Accrued management fee.....	111,377
Other accrued expenses.....	166,815
	-----
Total Liabilities.....	526,858
	-----

NET ASSETS:

Capital stock (par value of 15,846,384 shares of capital stock outstanding, authorized 100,000,000, par value \$0.10 each).....	1,584,638
Paid-in capital.....	167,057,114
Accumulated net realized loss on investments and foreign currency transactions.....	(38,594,066)
Unrealized net appreciation on investments and foreign exchange.....	18,964,191
	-----
Net Assets.....	\$149,011,877
	-----
Net asset value per share.....	\$9.40
	=====

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.  
STATEMENT OF OPERATIONS  
FOR THE YEAR ENDED FEBRUARY 29, 2004

INCOME:

Dividend income (less \$127,359 withholding taxes).....	\$1,280,313
	-----
Interest income.....	7,514
	-----
Total Income.....	\$ 1,287,827
	-----

EXPENSES:

Management fee.....	1,233,249
Legal fees.....	174,453
Custodian fees.....	139,500
Auditing and tax reporting fees.....	64,606
Shareholder reports.....	45,018

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Directors' fees and expenses.....	35,090	
Registration fees.....	29,206	
Annual meeting expenses.....	26,058	
Transfer agency fees.....	24,130	
Miscellaneous.....	9,882	
Insurance.....	5,856	
	-----	
Total Expenses.....		1,787,048
		-----
INVESTMENT LOSS--NET.....		(499,221)
		-----
REALIZED AND UNREALIZED GAIN/(LOSS) ON INVESTMENTS AND FOREIGN CURRENCY:		
Realized loss on investments and foreign currency transactions:		
Net realized loss on investments.....		(5,808,231)
Net realized loss on foreign exchange.....		(1,558,350)
Net realized loss on investments and foreign exchange.....		(7,366,581)
Change in net unrealized appreciation on translation of foreign currency and other assets and liabilities denominated in foreign currency.....		11,507,568
Change in net unrealized appreciation on investments.....		54,440,512
		-----
Net realized and unrealized gain on investments and foreign exchange.....		58,581,499
		-----
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS.....		\$58,082,278
		=====

See notes to financial statements

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JAPAN SMALLER CAPITALIZATION FUND, INC.

STATEMENT OF CHANGES IN NET ASSETS

	For the Year Ended	
	February 29, 2004	February 28, 2003
	-----	-----
FROM INVESTMENT ACTIVITIES:		
Net investment loss.....	(\$499,221)	(\$772,617)
Net realized loss on investments.....	(5,808,231)	(5,991,125)
Net realized gain/(loss) on foreign exchange.....	(1,558,350)	18,060
Change in net unrealized appreciation/(depreciation) on investments and foreign exchange.....	65,948,080	4,859,812

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Increase/(decrease) in net assets derived from investment activities.....	58,082,278	(1,885,870)
NETASSETS:		
Beginning of year.....	90,929,599	92,815,469
End of year .....	\$149,011,877	\$ 90,929,599

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS

1. Significant Accounting Policies

Japan Smaller Capitalization 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

cost if their original maturity at the time was 60 days or less, or by amortizing the 61st day prior to maturity if the date of purchase exceeded 60 days. Debt securities and other assets for which market quotations are not readily available are valued at fair market value in good faith by or under the supervision 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 exchange rate at the time of the transaction. Asset and liability values that are denominated in Yen are adjusted to the current exchange rate at the end of the reporting period. Transaction gains or losses resulting from changes in the exchange rate during the reporting period are included in operations for the current period.

The net assets of the Fund are presented in Japanese Yen at the current exchange rate and market values at the end of the reporting period. The Fund does not isolate that change in unrealized appreciation (depreciation) that is included in the statement of operations. The result of changes in Japanese Yen rates

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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 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

29, 2004 on investments and other assets and liabilities. Net realized foreign exchange losses includes gains or losses arising from the sale of portfolio securities, sales and maturities of short-term securities, currency gains or losses from foreign exchange transactions, the difference between the book value of dividends, interest, and foreign withholds recorded on the Fund's books, and the difference between the book value and the equivalent of the amounts actually received.

(c) Security Transactions, Investments, and Distributions to Shareholders--Security transactions are accounted for on the trade date. Dividends and distributions are recorded on the dividend date and interest income is recorded on an accrual basis. Realized gains and losses

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JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS--Continued

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.

(d) 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.

Under Japanese tax laws, a withholding tax is imposed on dividends at a rate of 7% (7% effective 1/1/04 to 3/31/08; 10% effective 4/1/03 to 12/31/03; 15% effective prior to 4/1/03) and on interest at a rate of 10% and such withholding taxes are reflected as a reduction of the related revenue. There is no

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

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

(h) Indemnifications--Under the Fund's governing documents its officers and directors are indemnified against certain liabilities arising from the performance of their duties to the Fund. In the normal course of business, the Fund enters into contracts that contain a variety of indemnifications which provide general indemnification to the Fund's maximum exposure under these agreements is unknown as this would involve future

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withholding tax on realized gains.

(e) Capital Account Reclassification -- For the year ended February 29, 2004, the Fund's accumulated net realized loss was increased by \$853 and paid in capital was decreased by \$498,368, with an offsetting decrease in accumulated net investment loss of \$499,221. This adjustment was primarily the result of the reclassification of foreign currency gains and the net operating loss.

that may be made against the Fund that occurred. However, based on experience, the Fund expects the risk of loss to be remote.

### 2. Management Agreement and Transactions With Affiliated Persons

Nomura Asset Management U.S.A. Inc. (the "Investment Adviser") acts as the manager of the Fund pursuant to a management agreement. Under the agreement, the Manager provides all office space

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## JAPAN SMALLER CAPITALIZATION FUND, INC.

### NOTES TO FINANCIAL STATEMENTS--Continued

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 \$1,233,249 for the year ended February 29, 2004. Under the Investment Advisory Agreement, the Manager informed the Fund that the Investment Adviser earned fees of \$556,341 for the year ended February 29, 2004. At February 29, 2004, the fee payable to the Manager, by the Fund, was \$111,377.

attended, together with such Director, the expenses related to attendance at meetings and expenses for unaffiliated Directors aggregated \$35,090, for the year ended February 29, 2004.

### 3. Purchases and Sales of Investments

Purchases and sales of investments, investments in foreign currencies and securities, for the year ended February 29, 2004, were \$33,189,487 and \$35,178,815, respectively.

As of February 29, 2004, net unrealized gain on investments exclusive of investments in foreign currency and short-term securities for Federal income tax purposes was \$18,968,944 of which \$37,278,186 related to appreciated securities and \$18,309,242 related to depreciated securities. The aggregate cost of investments, exclusive of investments in foreign currencies of \$0, at February 29, 2004 for Federal income tax purposes was \$127,744,603. The Fund has a capital loss as of February 29, 2004 of approximately \$38,594,066 of which \$22,683,799 expires February 28, 2010, \$6,143,866 which expires February 28, 2011 and \$9,766,401 which expires February 28, 2012.

Certain officers and/or directors of the Fund are officers and/or directors of the Manager. Affiliates of Nomura Holdings, Inc. (the Manager's indirect parent) earned \$448 in commissions on the execution of portfolio security transactions for the

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year ended February 29, 2004. The Fund pays each Director not affiliated with the Manager an annual fee of \$5,000 plus \$500 per meeting

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### JAPAN SMALLER CAPITALIZATION FUND, INC.

#### FINANCIAL HIGHLIGHTS

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

	For the Year Ended				
	February 29,		February 28,		February
	2004	2003	2002	2001	2000
Net asset value, beginning of year..	\$5.74	\$5.86	\$7.59	\$16.39	\$5.
Rights offering costs*.....	--	--	--	--	(0.
Net investment loss @.....	(0.03)	(0.05)	(0.06)	(0.09)	(0.
Net realized and unrealized gain (loss) on investments and foreign currency.....	3.69	(0.07)	(1.59)	(7.89)	11.
Total from investment operations..	3.66	(0.12)	(1.65)	(7.98)	11.
Distributions to shareholders from:					
Net realized capital gains.....	--	--	(0.08)	(0.82)	
Net investment income.....	--	--	--	--	
Total distributions.....	0.00	(0.00)	(0.08)	(0.82)	0.
Decrease in net asset value due to shares issued through rights offering*.....	--	--	--	--	(1.
Net asset value, end of year.....	\$9.40	\$5.74	\$5.86	\$7.59	\$16.
Market value, end of year.....	\$10.79	\$6.38	\$5.53	\$6.89	\$11.
Total investment return+.....	69.1%	15.4%	(18.6%)	(31.1%)	76.
Ratio to average net assets/supplemental data:					
Net assets, end of period (in 000)	\$149,012	\$90,930	\$92,815	\$120,275	\$259,7
Operating expenses.....	1.47%	1.63%	1.58%	1.33%	1.3
Net investment loss.....	(0.41%)	(0.75%)	(0.84%)	(0.76%)	(0.8
Portfolio turnover.....	28%	28%	38%	78%	5

+ 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.

\* Decrease is due to rights offering (see note 1).

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@ Based on average shares outstanding.

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JAPAN SMALLER CAPITALIZATION FUND, INC.  
Supplemental Shareholder Information (Unaudited)

The 2003 Annual Meeting of the Shareholders of the Fund was held at the Fund's offices, 180 Maiden Lane, New York, New York on November 12, 2003. The purpose of the meeting was to elect five Directors to serve for the ensuing year; 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., Yasushi Suzuki, Chor Weng Tan, Arthur R. Taylor, and John F. Wallace. 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 Authority	% of outstanding Shares
	-----	-----	-----	-----
William G. Barker, Jr.....	12,622,007	79.6	111,515	0.7
Yasushi Suzuki.....	12,632,857	79.7	100,665	0.6
Chor Weng Tan.....	12,644,585	79.8	88,937	0.5
Arthur R. Taylor.....	12,623,115	79.6	110,407	0.7
John F. Wallace.....	12,626,072	79.7	107,450	0.6

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Certain biographical and other information relating to each Director who is an "interested person," as defined in the Investment Company Act of 1940 ("Investment Company Act"), of the Fund is set forth below:

Name, Address and Age of Director	Position(s) Held with the Fund	Term of Office and Length of Time Served	Principal Occupation(s) During Past Five Years
Yasushi Suzuki (49)** 180 Maiden Lane New York, New York 10038	President and Director	President and Director since May 2003	President of the Fund since May 2003; President and Director of Nomura Asset Management U.S.A. Inc. ("NAM-U.S.A.") since May 2003; Management Executive of Nomura Asset Management Co., Ltd. ("NAM") from 1998 to April 2003.
John F. Wallace (75)*** 17 Rhoda Street West Hempstead, New York 11552	Director	Director since 1993	Vice President of the Fund from 1997 to 2000 and Secretary and Treasurer of the Fund from 1990 to 1997; Senior Vice President of NAM-U.S.A. from 1981 to 2000, 2 portfolios Secretary from 1976 to 2000, Treasurer from 1984 to 2000 and Director from 1986 to 2000.

\* In addition to the Fund, the "Fund Complex" includes Korea Equity Fund, Inc.

\*\* Mr. Suzuki is a director and President of Korea Equity Fund, Inc. for which NAM-U.S.A. acts as manager and for which NAM acts as investment adviser. Mr. Suzuki is an "interested person," as defined in the Investment Company Act, of the Fund based on his positions as President of the Fund, and as President and Director of NAM-U.S.A. and former Management Executive, Senior Officer and Director of NAM. Effective May 8, 2003, Mr. Kazuhiko Hama resigned as President and Director of the Fund and Mr. Yasushi Suzuki was elected as President and Director of the Fund.

\*\*\* Mr. Wallace is a director of Korea Equity Fund, Inc. for which NAM-U.S.A. acts as manager and for which NAM acts as investment adviser. Mr. Wallace is an "interested person," as defined in the Investment Company Act, of the Fund based on the positions he has previously held with the Fund and NAM-U.S.A.

Certain biographical and other information relating to the Directors who are not "interested persons," as defined in the Investment Company Act of 1940, of the Fund is set forth below:

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Name, Address and Age of Director	Position(s) Held with the Fund	Term of Office and Length of Time Served	Principal Occupation(s) During Past Five Years
William G. Barker, Jr. (71) 111 Parsonage Road Greenwich, Connecticut 06830	Director	Director since 1993	Consultant to the television industry since 1991.
Chor Weng Tan (68) 3 Park Avenue New York, New York 10016	Director	Director since 1993	Managing Director for Education, The American Society of Mechanical Engineers since 1991; Director, U.S.-China Education Foundation since 1992.
Arthur R. Taylor (68) 339 North Leh Street Allentown, Pennsylvania 18104	Director	Director since 1993	President of Muhlenberg College from 1992 to 2002.

\* Each director is a director of Korea Equity Fund, Inc. for which NAM-U.S.A. acts as manager and NAM acts as investment adviser, and each is a member of the Audit and Nominating Committees of Korea Equity Fund, Inc. and a member of the Audit and Nominating Committees of the Fund.

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JAPAN SMALLER CAPITALIZATION FUND, INC.  
INFORMATION PERTAINING TO THE OFFICERS OF THE FUND

Certain biographical and other information relating to the officers of the Fund is set forth below:

Name, Address* and Age of Officers	Position(s) Held with the Fund	Term of Office** and Length of Time Served	Principal Occupation(s) During Past Five Years
Yasushi Suzuki (49)	President and Director	President since 2003	President and Director May 2003; Management from 1998 to April 2003

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Keisuke Haruguchi (53)	Vice President	Vice President since 1999	Senior Vice President U.S.A. since 1999 from 1997 to 1998
Kenneth L. Munt (57)	Vice President	Vice President since 2001	Senior Vice President U.S.A. since 1999 man Resources for ance Company from
Rita Chopra-Brathwaite (35)	Treasurer	Treasurer since 2002	Vice President of sistant Vice Pres to 2000. Senior A to 1998.
Neil Daniele (43)	Secretary	Secretary since 2002	Senior Vice President 2002; Vice President Munich Re Capital 2001 to 2002; Vice Investment Group, Compliance Office

- 
- \* The address of each officer listed above is 180 Maiden Lane, New York, New York 10038.
  - \*\* Elected by and serves at the pleasure of the Board of Directors.
  - \*\*\* Effective May 8, 2003, Mr. Kazuhiko Hama resigned as President and Director of the Fund and Mr. Yasushi Suzuki was elected as President and Director of the Fund.

### JAPAN SMALLER CAPITALIZATION FUND, INC.

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

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



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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.

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### 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 Trust Company, N.A., 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.

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 mean between the closing bid and ask price (there were no sales) of the shares on the change on the preceding trading day was less 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 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, 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

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 29, 2004, the Fund did not issue any new shares 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 administer 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 to the Plan Agent upon any cash withdrawal or termination. An election to withdraw from the Plan until such election is changed, be deemed to be an election by a shareholder to take all subsequent distributions in cash. An election to receive dividends effective only for a dividend or distribution is received by the Plan Agent not less than 30 days prior to such record date.

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

The automatic reinvestment of dividends will not relieve participants of any income tax 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 dividend in an amount equal to the amount

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 record date for such dividend. There will be no service charge to participants in the Plan. However, the Fund reserves the right to amend the Plan to include a service charge payable to the Plan from participants. All correspondence concerning the Plan, including requests for additional

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minate 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

tion about the Plan, should be directed Plan Agent.

SHAREHOLDERS ACCOUNT INFORMATION

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

BOARD OF DIRECTORS

William G. Barker, Jr.  
William K. Grollman  
Yasushi Suzuki  
Chor Weng Tan  
Arthur R. Taylor  
John F. Wallace

OFFICERS

Yasushi Suzuki, President  
Keisuke Haruguchi, Vice President  
Kenneth L. Munt, Vice President  
Rita Chopra-Brathwaite, Treasurer  
Neil A. Daniele, Secretary

MANAGER

Nomura Asset Management U.S.A. Inc.  
180 Maiden Lane  
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INVESTMENT ADVISOR

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Tokyo 103-8260, Japan

JAPAN  
Smaller Capitalization  
Fund, Inc.

DIVIDEND PAYING AGENT, TRANSFER AGENT AND REGISTRAR

Equiserve Trust Company, N.A.  
P.O. Box 43011  
Providence, RI 02940-3011

CUSTODIAN

Brown Brothers Harriman & Co.  
40 Water Street  
Boston, Massachusetts 02109

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COUNSEL

Sidley Austin Brown & Wood LLP  
787 Seventh Avenue  
New York, New York 10019

ANNUAL REPORT

INDEPENDENT ACCOUNTANTS

PricewaterhouseCoopers LLP  
1177 Avenue of the Americas  
New York, New York 10036-2798

FEBRUARY 29, 2004

JAPAN SMALLER CAPITALIZATION FUND, INC.

180 MAIDEN LANE  
NEW YORK, NEW YORK 10038-4936

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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.

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ITEM 2. CODE OF ETHICS

- (a) As of February 29, 2004, the Registrant had adopted a code of ethics that applies to the Registrant's Principal Executive Officer, Principal Financial Officer, Principal Accounting Officer or Controller, or persons performing similar functions, regardless of whether these individuals are employed by the Registrant or a third party.
- (c) There were no amendments during the fiscal year ended February 29, 2004 to a provision of the code of ethics that applies to the Registrant's Principal Executive Officer, Principal Financial Officer, Principal Accounting Officer, or persons performing similar functions, and that relates to any element of the code of ethics definition enumerated in paragraph (b) of Item 2 of Form N-CSR.
- (d) Not applicable.
- (e) Not applicable.
- (f) A copy of the Registrant's code of ethics is attached as an exhibit.

ITEM 3. AUDIT COMMITTEE FINANCIAL EXPERT

The Registrant's Board of Directors has determined that William K. Grollman, a member of the Registrant's Audit Committee, is an "audit committee financial expert" and "independent," as such terms are defined in this Item. This designation will not increase the designee's duties, obligations or liability as compared to his duties, obligations and liability as a member of the Audit Committee and of the Board; nor will it reduce the responsibility of the other Audit Committee members. The Board believes each member of the Audit Committee contributes significantly to the effective oversight of the Registrant's financial statements and condition.

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### ITEM 4. PRINCIPAL ACCOUNTANT FEES AND SERVICES

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(a) Audit Fees for the Registrant were \$49,000 and \$47,000 for the fiscal years ended 2/29/04 and 2/28/03, respectively.

(b) Audit-Related Fees for the Registrant were \$9,000 and \$9,000 for the fiscal years ended 2/29/04 and 2/28/03, respectively. These amounts represent procedures performed in connection with the review of the Registrant's semi-annual reports.

In addition, there were no Audit-Related Fees billed in the fiscal years ended 2/29/04 and 2/28/03 for assurance and related services by the Accountant to the Registrant's investment adviser (not including any sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser), and any entity controlling, controlled by or under common control with the investment adviser that provides ongoing services to the Registrant ("service affiliates"), that were reasonably related to the performance of the annual audit of the service affiliates. Accordingly, there were no such fees that required pre-approval by the Audit Committee for the fiscal years ended 2/29/04 and 2/28/03, respectively.

(c) Tax Fees for the Registrant were \$7,500 and \$7,500 for the fiscal years ended 2/29/04 and 2/28/03, respectively. These amounts represent aggregate fees paid for tax compliance, tax advice and tax planning services, which include (the filing and amendment of federal, state and local income tax returns, timely RIC qualification review and tax distribution and analysis planning) rendered by the Accountant to the Registrant.

There were no fees billed for tax services by the Accountants to service affiliates for the fiscal years ended 2/29/04 and 2/28/03, respectively.

(d) There were no All Other Fees for the Registrant for the fiscal years ended 2/29/04 and 2/28/03, respectively.

There were no other fees billed for services rendered by the Accountant to service affiliates for the fiscal years ended 2/29/04 and 2/28/03, respectively,

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by the Audit Committee.

(e) (1) The Charter for the Audit Committee of the Registrant requires the Audit Committee (a) to preapprove all auditing services to be provided to the Registrant by the Registrant's independent accountants; (b) to preapprove all non-audit services, including tax services, to be provided to the Registrant by the Registrant's independent accountants in accordance with the Securities Exchange Act of 1934, as amended (the "1934 Act"); provided, however, that the preapproval requirement with respect to the provision of non-audit services to the Registrant by the Registrant's independent accountants may be waived by the Audit Committee under the circumstances described in the 1934 Act; and (c) to preapprove non-audit services to be provided to the Registrant's investment adviser (and any entity controlling, controlled by or under common control with the investment adviser that provides ongoing services to the Registrant) if the engagement relates directly to the operations and financial reporting of the Registrant.

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(f) N/A

(g) Non-audit fees billed by the Accountant for services rendered to the Registrant and NAM-USA and any entity controlling, controlled by, or under common control with NAM-USA that provides ongoing services to the Registrant were \$259,700 and \$363,375 for the fiscal years ended 3/31/04 and 3/31/03, respectively. These amounts represent aggregate fees paid for tax compliance, tax advice and tax planning services and non-audit related services rendered by the Accountant to service affiliates.

(h) Yes. The Registrant's Audit Committee has considered whether the provision of non-audit services that were rendered to Service Affiliates which were not pre-approved (not requiring pre-approval) is compatible with maintaining the Auditor's independence. All services provided by the Accountant to the Registrant or to Service Affiliates which were required to be pre-approved were pre-approved as required.

ITEM 5. AUDIT COMMITTEE OF LISTED REGISTRANTS

(a) The Registrant's Board of Directors has a standing Audit Committee, which consists of the Directors who are not "interested persons" of the Registrant within the meaning of the Investment Company Act of 1940, as amended. Currently, Messrs. William G. Barker, William K. Grollman, Chor Weng Tan and Arthur R. Taylor are members of the Audit Committee.

(b) Not applicable.

ITEM 6. SCHEDULE OF INVESTMENTS

Form N-CSR disclosure requirement not yet effective with respect to the Registrant.

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ITEM 7. DISCLOSURE OF PROXY VOTING POLICIES AND PROCEDURES FOR CLOSED-END MANAGEMENT INVESTMENT COMPANIES

The Registrant has delegated proxy voting responsibilities to its investment adviser, subject to the Board of Directors' general oversight. The investment adviser has adopted its own Policy and Process on Corporate Governance and Proxy Voting for this purpose. The Policy and Process is set forth below.

Policy and Process on Corporate Governance and Proxy Voting

NOMURA ASSET MANAGEMENT

NOMURA ASSET MANAGEMENT CO., LTD.  
NOMURA ASSET MANAGEMENT U.S.A. INC.  
NOMURA ASSET MANAGEMENT U.K. LIMITED  
NOMURA ASSET MANAGEMENT SINGAPORE LIMITED  
NOMURA ASSET MANAGEMENT HONG KONG LIMITED

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August 2003

## I. Basic Policy for Proxy Voting

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This policy regarding proxy voting has been adopted by Nomura Asset Management Co., Ltd. ("NAM") and its investment advisory subsidiaries (listed on Schedule 1). These companies are hereinafter collectively referred to as "Nomura Asset Management". The overall objective of Nomura Asset Management is to increase the value of its clients' investments. We recognize that the power to influence management through voting rights is an effective way to achieve such an objective. Nomura Asset Management believes the right to vote proxies is an important financial asset that must be managed with the same care and diligence as any other client asset. We exercise proxy voting decisions solely in the best interests of our clients and will acquire a company's equity securities only because we believe it is good investment. We will not acquire equity securities to obtain control of an issuer.

## II. Organizational Structure for Proxy Voting Process

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The Proxy Voting Committee is primarily responsible for making final determinations on proxy voting for Nomura Asset Management. The day-to-day operational activities relating to proxy voting are performed at each of the departments within Nomura Asset Management.

Notwithstanding the foregoing, proxy voting shall be instructed through NAM's overseas affiliates which owe a primary responsibility for proxy voting under the investment advisory agreements entered into with their clients.

### 1. Proxy Voting Committee

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The Proxy Voting Committee develops the firm's positions on specific voting issues, creates proxy voting guidelines (the "Proxy Voting Guidelines"), and has oversight responsibility over the proxy voting process. From time to time, it shall have direct decision-making input on a company's specific proxy voting matters, as more fully described in Section V of this Policy. NAM's Board of Directors appoints the Chairman of the Proxy Voting Committee, who, in turn, appoints the other members of the Committee. The Proxy Voting Committee may be held whenever necessary.

### 2. Fund Administration Division (Fund Operation Department and Fund Accounting Department)

For accounts for which NAM serves as manager, its Fund Administration Division has the primary responsibility for handling proxy voting instructions. The Division also provides necessary supports to NAM's overseas affiliates with respect to their accounts.

For a Japanese issuer, Fund Administration Division classifies the proxy materials received from the custodian depending upon whether (i) it is a company on the Watch List (as defined in Section VI below), (ii) its proxy agenda includes any extraordinary items (defined as an item not considered as "routine agenda". See III.) and (iii) its audit opinion attached to the company's financial statement is qualified. If a company meets one or more of the foregoing conditions, the company's proxy materials shall be forwarded to

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NAM's Corporate Research Department for its review. If none of the conditions apply to a company, Fund Administration Division shall instruct the custodian to vote for the agenda. For the agendas that have been forwarded to Corporate Research Department, Fund Administration Division shall instruct the custodian to vote in accordance with the determinations made by Corporate Research Department, or when necessary, the Proxy Voting Committee.

For a non-Japanese issuer, Fund Administration Division, after receiving the proxy materials from the custodian, shall forward such materials to either Corporate Research Department (for Japanese investment trusts) or Equity Investment Department (for NAM's institutional clients). If proxy materials are available through other information sources, Corporate Research Department or Equity Investment Department may rely upon the information from such sources. Fund Administration Division shall instruct the custodian to vote in accordance with the determinations made by Corporate Research Department or Equity Investment Department based on the recommendations made by the overseas affiliates, or when necessary, the determinations made by the Proxy Voting Committee. Records of the proxy voting instructed shall be maintained.

### 3. Operations Department at Overseas Affiliate

The operations department of each overseas affiliate ("Overseas Operations Department") generally handles proxy voting instructions in accordance with the investment advisory agreements entered into with its client. The Overseas Operations Department shall also provide necessary supports to NAM or other overseas affiliates with respect the accounts of NAM or other overseas affiliates.

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The Overseas Operations Department, after receiving the proxy materials from the custodian, shall forward, if necessary, such materials to NAM or other relevant overseas affiliates. If proxy materials are available through other information sources, NAM or other relevant overseas affiliates may rely upon the information from such sources. After having the agenda reviewed by NAM or other relevant overseas affiliates, the Overseas Operations Department shall instruct the custodian to vote. Records of the proxy voting instructed shall be maintained.

### 4. Corporate Research Department

NAM's Corporate Research Department, through the support it provides to the Proxy Voting Committee, plays an important role in the review of proxy materials.

For Japanese issuers, Corporate Research Department is responsible for preparing, reviewing and maintaining the Watch List. Corporate Research Department reviews the proxy materials received from Fund Administration Division and informs of their determinations on proxy voting. When Corporate Research Department believes that further review is necessary, Corporate Research Department requests the Proxy Voting Committee to deliberate on a specific agenda in question. Corporate Research Department shall inform Fund Administration Department of the Proxy Voting Committee's determinations in a timely manner. Corporate Research Department shall keep the minutes of the Proxy Voting Committee meeting.

Corporate Research Department also reviews the proxy materials received from NAM's overseas affiliates. Corporate Research Department shall provide its determinations on proxy voting through the process described above to the



relevant overseas affiliate.

For non-Japanese issuers whose equity securities are held in Japanese investment trust portfolios, Corporate Research Department, after receiving the proxy materials from Fund Administration Division, shall forward such materials to the relevant overseas affiliates. The recommendations of the overseas affiliates are delivered to Corporate Research Department. General Manager of Corporate Research Department is responsible for the final determinations on proxy voting, or when necessary, may refer a specific agenda to the Proxy Voting Committee.

#### 5. Equity Investment Department

NAM's Equity Investment Department plays an important role in handling proxy voting for non-Japanese issuers whose equity securities are held in NAM's institutional accounts. Equity Investment Department, after receiving the proxy materials received from Fund Administration Division, shall forward such materials to the relevant overseas affiliates. The recommendations of the overseas affiliates are delivered to Equity Investment Department. General Manager of Equity Investment Department is responsible for the final determinations on proxy voting, or when necessary, may refer a specific agenda to the Proxy Voting Committee.

Equity Investment Department also provides its determinations on proxy voting to the overseas affiliates managing Japanese equity accounts. When Equity Investment Department finds that (i) a company is on the Watch List, (ii) its proxy agenda includes any extraordinary items, or (iii) its audit opinion attached to the company's financial statement is qualified, the company's proxy

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materials shall be forwarded to Corporate Research Department, and otherwise, Equity Investment Department shall recommend the overseas affiliate to vote for the agenda.

#### 6. Investment Department at Overseas Affiliate

The investment department of each overseas affiliate ("Overseas Investment Department") handles proxy voting for non-Japanese issuers whose equity securities are held in NAM's Japanese investment trust portfolios and institutional accounts. The Overseas Investment Department is responsible for providing recommendations for proxy voting for the issuers in its region, i.e., Nomura Asset Management U.S.A. Inc. is responsible for North American equity proxy voting recommendations, Nomura Asset Management U.K. Limited is responsible for European equity proxy voting recommendations, and Nomura Asset Management Singapore Limited is responsible for Asian equity recommendations. When necessary, other Overseas Investment Departments may provide to the relevant Overseas Investment Department their recommendations about a certain issuer even if the issuer is not in its region. In addition, the Overseas Investment Department may utilize third party proxy voting service providers (e.g., Institutional Shareholder Services (ISS)) to formulate their recommendations. These recommendations are delivered to NAM's Corporate Research Department or Equity Investment Department.

The Overseas Investment Departments also provide proxy voting recommendations to other overseas affiliates managing non-Japanese equity accounts. For such accounts, the Overseas Operations Department sends voting information to the relevant overseas affiliate and instructs the custodian as recommended. The

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relevant overseas affiliate shall make the determinations on proxy voting through the process described above.

### III. Proxy Voting Process for Japanese Equities

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Nomura Asset Management carries out the following proxy voting process for Japanese equities:

1. Corporate Research Department prepares, reviews and maintains the Watch List.
2. Fund Administration Division classifies the proxy materials received from the custodian into companies: 1) which are on the Watch List, 2) their proxy agenda includes any extraordinary items (defined as an item not considered as "routine agenda." See III.), and 3) their audit opinion attached to their financial statement is qualified.
3. If none of the conditions stated above applies to a company, Fund Administration Division then instructs the custodian to vote for the agenda.
4. When Fund Administration Division finds that (i) the company is on the Watch List, (ii) the proxy agenda includes any extraordinary item, or (iii) its audit opinion attached to the company's financial statement is qualified, the proxy material is then forwarded to Corporate Research Department for its review.
5. Corporate Research Department reviews the agenda and when they find that the agenda has any problem, details are sent to the Proxy Voting Committee for its deliberation. When Corporate Research Department determines that there is no problem involved, Corporate Research Department informs Fund Administration Division of its determinations on proxy voting.

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6. The Proxy Voting Committee closely reviews the agenda in accordance with the Proxy Voting Guidelines. When the Proxy Voting Committee finds a specific agenda would not be in the clients' best interests, the Proxy Voting Committee shall determine whether to abstain from or vote against, such specific agenda. The Proxy Voting Committee's determinations shall be informed to Fund Administration Division.
7. The agendas reviewed by the Proxy Voting Committee shall be reported to the NAM's Management Committee or Board of Directors.
8. For Japanese issuers whose equity securities are held in the overseas affiliates' accounts, the Overseas Operations Department receives the proxy materials from the custodian, and instructs the custodian in accordance with the determinations on proxy voting made by the NAM's Equity Investment Department. When the Equity Investment Department finds that (i) a company is on the Watch List, (ii) its proxy agenda includes any extraordinary item, or (iii) its audit opinion attached to the company's financial statement is qualified, the company's proxy materials shall be forwarded to Corporate Research Department for its review, and otherwise, Equity Investment Department shall recommend Overseas Operations Department to vote for the agenda. Corporate Research Department shall provide its determinations through the process described above.

Note 1. "Routine agendas" are as follows:

1. Appropriation of profit
2. Election of directors (uncontested elections only)

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3. Election of statutory auditors
4. Payment of lump sum bonus to retiring directors
5. Payment of lump sum bonus to retiring statutory auditors
6. Amendment to compensation table for directors or statutory auditors
7. Notwithstanding foregoing, any shareholder proposal is not considered as routine proposals.

### IV. Proxy Voting Process for Non-Japanese Equities

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Nomura Asset Management carries out the following proxy voting process for non-Japanese equities:

1. For institutional client accounts, cash flow of which is infrequent, Nomura Asset Management shall instruct, in principal, proxy voting with respect to each issuer of equity securities held in its institutional accounts; provided the Company is authorised to do so by the client.
2. For Japanese investment trusts or other open-ended investment vehicles, cash-flow of which is frequent, Nomura Asset Management and its overseas affiliates shall instruct proxy voting on each proxy voting matter; provided, however, that a proxy voting shall not be instructed if the exercise of proxy imposes any restriction on disposal of the securities. Nomura Asset Management, in instructing proxy voting, considers costs and benefits associated therewith.
3. NAM's Corporate Research Department or Equity Investment Department, in accordance with the Proxy Voting Guidelines, prepares, reviews and maintains the Watch List or list of companies that potentially have problems in terms of clients' best interests.

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4. NAM's Fund Administration Division, after receiving the proxy materials from the custodian, shall forward such materials to Corporate Research Department or Equity Investment Department. If proxy material are available through other information sources, they may rely upon the information from such sources.
5. If the custodian has not sent a proxy material, Corporate Research Department or Equity Investment Department may seek information through other informational sources such as third party information vendors.
6. Corporate Research Department or Equity Investment Department shall forward the proxy materials to the relevant overseas affiliates. The proxy materials that are available through other information sources may be used in lieu of their hardcopies.
7. Each overseas affiliate sends its proxy voting recommendations to Corporate Research Department or Equity Investment Department. The overseas affiliates may utilize third party proxy voting service providers to formulate their recommendations.
8. Corporate Research Department or Equity Investment Department, after reviewing the proxy voting recommendations from the overseas affiliates, shall inform Fund Administration Division of its determinations. Fund Administration Division shall instruct the custodian to vote in accordance therewith. When necessary, General Manager of Corporate Research Department or Equity Investment Department may refer a specific agenda to the Proxy Voting Committee for its review. The Proxy Voting Committee closely reviews the agenda in accordance with the Proxy Voting Guidelines. If the Proxy Voting Committee believes the agenda referred to is not in our clients' best interests, it shall determine either to abstain from or vote against, such agenda. The determinations of the Proxy Voting Committee shall be informed to Fund Administration Division.

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The agendas reviewed by the Proxy Voting Committee shall be reported to NAM's Management Committee or Board of Directors.

9. Corporate Research Department and Equity Investment Department shall maintain records of the proxy voting recommendations.
10. Fund Administration Division shall maintain records of the proxy voting instructed.
11. For non-Japanese issuers whose equity securities are held in the overseas affiliate's accounts, the Overseas Operations Department receives the proxy materials from the custodian, and instructs the custodian in accordance with the proxy voting recommendations made by the Overseas Investment Department of other relevant overseas affiliate. The Overseas Investment Department shall provide its recommendations through the process described above.

### V. Proxy Voting Guidelines

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The Proxy Voting Committee closely examines company voting agendas under the cases listed below. If it believes that a specific agenda is not in our clients' best interests, the Proxy Voting Committee shall decide either to abstain from or vote against, such agenda.

- 1) If it is publicly announced that the issuer violated the law or otherwise its conduct severely harms social interests. In such cases, Nomura Asset Management would vote for shareholder social or political proposals only if it enhances investment value.
- 2) If the issuer's audit opinion is qualified (for Japanese equity securities).
- 3) If the issuer's disclosure is inadequate and deemed to be considerably harmful to the investor interest.

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- 4) If the issuer continuously reports poor business results and its management's efforts for improvement are found to be inadequate.
- 5) If the issuer plans a substantial change in its financial or business strategy and such plan has the potential to severely harm the shareholder interest or the issuer's long-term business development. Notwithstanding the foregoing, Nomura Asset Management may vote for such a plan in consideration of the reasonable business judgment.
- 6) If the issuer's board of directors or statutory auditors do not provide an adequate level of internal control and is likely to harm shareholder interest.
- 7) If an extraordinary agenda such as amendment to articles of incorporation is proposed which is likely to harm shareholder value.
- 8) For a shareholder proposal, the Proxy Voting Committee makes the final determination based upon whether the proposal would contribute to higher shareholder value.

### VI. The Watch List

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Instructing exercise of proxy voting appropriately and effectively is often made difficult by the large number of proxies and information to be processed. In order to facilitate the proxy voting process, Nomura Asset Management shall screen its investments based on certain predetermined criteria to create a list of the problematic companies that requires increased review (the "Watch List"). A separate Watch List is created for Japanese and non-Japanese issuers.

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1. Watch List Criteria for Japanese Companies: A Japanese company shall be placed on the Watch List if:
  - a. it is publicly announced that the company violated the law and/or if it was determined that the company's conduct severely harms social interests;
  - b. the company's disclosure is determined to be inadequate, or its financial strategy and/or business operations are deemed to pose a severe threat to shareholders' interests and to the company's future business developments, or it is deemed that its internal control program is inadequate and is likely to harm shareholder interests;
  - c. it meets one or more of the following conditions:
    - i. the company has an accumulated deficit in the most recent accounting period;
    - ii. the company has reported losses or has paid no dividend for the past three accounting periods;
    - iii. the company has reported losses or has paid no dividend for the past five accounting periods, and has an accumulated deficit in the most recent accounting period.
  - d. it meets one or more of the following conditions:
    - i. the company's net financial assets exceed its the total market capitalization;
    - ii. the company's net financial assets exceed 50 percent of its total sales;
    - iii. the company's net financial assets exceed 50 percent of its total assets;
    - iv. the company's ROE is below 5 percent.  
(The term "net financial asset" shall equal current assets less current liabilities)
  - e. it meets one or more of the following conditions:
    - i. For a company listed on the First Section of either of Tokyo, Osaka, or Nagoya Stock Exchanges, its annual investment return has belonged to the worst quartile of its TSE 33 industry sector during the past three years.
    - ii For a company listed on the Second Section of either of Tokyo, Osaka, or Nagoya Stock Exchanges, its annual investment return has belonged to the worst quartile of its TSE 33 industry sector during the past three years.
    - iii For a company traded on an OTC market, its annual investment return has belonged to the worst quartile of the entire OTC stocks during the past three years.
2. Watch List Criteria for non-Japanese Issuers: A non-Japanese company shall be placed on the Watch List if:
  - a. if it meets one or more of the following conditions:
    - i. its investment return has been below the sector index return (i.e., an index based upon the MSCI's 10 sectors) by 40 percent for the past three years, and if the company has reported losses (computed on earnings per share basis) for the past three accounting periods. If sector classification information is not available for a certain company, the company is compared to the MSCI country index to which the issuer belong;
    - ii. its investment return has been below the sector return index (i.e., an index based upon the MSCI's 10 sectors) by 70 percent

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for the past three years. If sector classification information is not available with respect for a certain company, the company is compared within the MSCI country index to which the issuer belongs;

- iii. when Nomura Asset Management holds more than 1 percent of all the outstanding shares of a certain issuer.
- b. Corporate Research Department or Equity Investment Department shall produce and send the Watch List to the overseas affiliates and other relevant departments. Each overseas affiliate reviews the company on the Watch List, in accordance with the Proxy Voting Guidelines, and may remove a company from the Watch List if it reasonably believes that its inclusion on the list is not warranted. The overseas affiliate, when necessary, may add a company to the Watch List;
- c. General Manager of Research Department or Equity Investment Department are responsible for making the final determinations regarding the deletion or addition of certain companies to and from the Watch List. Corporate Research Department or Equity Investment Department shall maintain records of their determinations;
- d. The Watch List generally shall be up-dated on semi-annual basis. Screening criteria shall be reviewed when necessary, and any change to the criteria must be approved by the Proxy Voting Committee.

### VII. Conflicts of Interest

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Due to the nature of Nomura Asset Management's business and its large size, it is possible that material conflicts of interest will arise in voting of proxies of public companies (for example,

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Nomura Asset Management may have a business relationship with an issuer whose securities are held in client portfolios).

When such a material conflict arises, Nomura Asset Management shall vote in accordance with recommendations made by a third party proxy voting service vendors (e.g., ISS). A material conflict of interest will occur if Nomura Asset Management is to vote on behalf of its client for a certain issuer with a close business relationship generating revenue of more than 1 percent of the total revenue of Nomura Asset Management and such proxy voting is for the purpose of providing an unjust enrichment to the director, officer, or other affiliate of this issuer. If the revenue from a business relationship with this issuer is more than 0.5 percent of the total revenue of Nomura Asset Management, Nomura Asset Management shall closely examine the agenda to see whether there is any potential conflict of interest.

### VIII. Positions on Special Matters

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#### Corporate Governance

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##### o Election of Directors

Nomura Asset Management votes for the management's proposed directors in uncontested elections. For contested elections, we vote for candidates that best serve our clients' best interests. Nomura Asset Management votes, in principal, for proposals calling for a board consisting of directors who are independent of the company, subject to the skills and experience of the candidates. We vote against proposals that stagger the

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board, if it does material harm to the shareholder's interest.

- o Mergers, Acquisitions and Other Corporate Restructurings  
Nomura Asset Management views all proposals on a case-by-case basis by looking at the financial impact on our clients.
- o Anti-takeover Measures  
Nomura Asset Management will vote, in principal, against proposals that make it more difficult for a company to be acquired by another company. We believe that anti-takeover measures may depress the company's market value.

Shareholder Rights Protection Plans (Poison Pills): Shareholder rights plans, typically known as poison pills, often involve issuing stock purchase rights or warrants to shareholders. These rights or warrants are usually not exercisable unless a hostile takeover offer is tendered or a potential acquirer of the company purchases a specific percentage of the shares. Typically, the plan will allow the rights holders to purchase shares from, or sell shares to, the company at very favorable prices. This increases the costs to the potential acquirer, thus making the takeover less attractive.

Nomura Asset Management recognizes that there are arguments in favor and against shareholder rights plans (i.e., "Poison Pills"). Therefore, we support, in principal, proposals that ask that shareholders to approve such plans. Nomura Asset Management will assess shareholder rights plans on a case-by-case basis, generally supporting plans designed to protect shareholder value rather than to insulating the board and management.

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Supermajority Provisions: Supermajority voting requires the vote of more than a simple majority (typically 66.7% to 80% of the vote) to approve a decision or transaction. Supermajority voting can limit the ability of shareholders to effect change by essentially giving veto power to a large minority shareholder or group of minority shareholders. As a result, Nomura Asset Management will vote against proposals to impose supermajority requirements, while vote for proposals that remove supermajority voting requirements.

### Capital Structure Changes

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- o Increased Authorized Common Stocks  
Companies may request increases in authorized stocks for a variety of legitimate business purposes. For example, the additional shares may be used to raise new investment capital for acquisitions, stock splits, recapitalizations or debt restructurings. Nomura Asset Management votes for these proposals in the absence of unusual circumstances. Otherwise, proposals will be voted on a case-by-case basis.
- o "Blank Check" Preferred Stocks  
Nomura Asset Management will highly scrutinize proposals to authorize preferred stocks whose voting, conversion, dividend and distribution, and other rights are determined by the company's board of directors when the stocks are issued ("Blank Check Preferred Stock"). We recognize that Blank Check Preferred Stocks can be used for legitimate financing purposes, but also could be used to thwart hostile but desirable takeovers without shareholder approval. To protect our clients, but still give financial

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flexibility to management, Nomura Asset Management will vote for the authorization of, or an increase in, Blank Check Preferred Stock in cases where the company expressly states that the stock will not be used as an anti-takeover defense or carry superior voting rights. All other Blank Check Preferred Stock proposals will be handled on a case-by-case basis.

### Management Compensation

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Nomura Asset Management votes for reasonable compensation of executives, particularly equity-based compensation plans that are linked to the interests of the company's long-term shareholders. We vote against plans that are inconsistent or inequitable with the company's overall financial condition or that would substantially dilute the interests of our clients.

### Corporate and Social Responsibility

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NOMURA ASSET MANAGEMENT BELIEVES IT IS MANAGEMENT'S RESPONSIBILITY TO HANDLE ORDINARY BUSINESS MATTERS. RATHER THAN ARBITRARILY IMPOSE A JUDGMENT ON SUCH MATTERS, WE WILL TYPICALLY ABSTAIN FROM VOTING ON PROPOSALS CONCERNING CORPORATE AND SOCIAL POLICY ISSUES. HOWEVER, NOMURA ASSET MANAGEMENT MAY DECIDE TO VOTE ON SUCH ISSUES ON A CASE-BY-CASE BASIS RECOGNIZING THAT CORPORATE AND SOCIAL RESPONSIBILITY ISSUES SOMETIMES DO IMPACT THE RISK-ADJUSTED FINANCIAL RETURN OF OUR INVESTMENTS.

Nomura Asset Management  
Policy and Process on Corporate Governance and Proxy Voting

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### Schedule 1

Nomura Asset Management Co., Ltd.  
Nomura Asset Management Hong Kong Limited  
Nomura Asset Management Singapore Limited  
Nomura Asset Management U.K. Limited  
Nomura Asset Management U.S.A. Inc.

### ITEM 8. PURCHASES OF EQUITY SECURITIES BY CLOSED-END MANAGEMENT INVESTMENT COMPANY AND AFFILIATED PURCHASERS

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Form N-CSR disclosure requirement not yet effective with respect to the Registrant.

### ITEM 9. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

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The principal purpose of the Registrant's Nominating Committee is to select and nominate the Directors of the Registrant. It evaluates candidates' qualifications for Board membership and, with respect to nominees for positions as independent directors, their independence from the Registrant's manager and its affiliates and other principal service providers.



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The Nominating Committee will consider potential director candidates recommended by Registrant shareholders provided that the proposed candidates satisfy the director qualification requirements provided in the Nominating Committee's Charter; are not "interested persons" of the Registrant or the Registrant's investment adviser within the meaning of the Investment Company Act; and are "independent" as defined in the New York Stock Exchange listing standards. The Committee has determined that potential director candidates recommended by Registrant shareholders must satisfy the Securities and Exchange Commission's ("SEC") nominee requirements found in Regulation 14A of the Securities and Exchange Act of 1934, as amended ("1934 Act"). Shareholders recommending potential director candidates must substantiate compliance with certain requirements at the time of submitting their proposed director candidate to the attention of the Registrant's Secretary.

The Nominating Committee identifies prospective candidates from any reasonable source and has the ability to engage third-party services for the identification and evaluation of potential nominees. The Committee meets annually to identify and evaluate nominees for Director and makes its recommendations to the Board. In identifying and evaluating a potential nominee to serve as an independent Director of the Registrant, the Nominating Committee will consider, among other factors: (i) whether the individual has any material relationships that could create any appearance of impropriety with respect to or a lack of independence from NAM-U.S.A. or any of its affiliates; (ii) whether the individual has the integrity, independence of mind and personal qualities to fulfill the fiduciary duties of an independent Director of the Registrant and to protect the interests of Registrant shareholders; (iii) the individual's corporate or other business experience in significant positions which demonstrate sound business judgment; (iv) whether the individual has financial and accounting experience; (v) the individual's ability to and attend at least four regular meetings a year and (vi) whether the individual can add to the balance of experience of the present independent Directors. The standard of the Nominating Committee is to treat all equally qualified nominees in the same manner.

### ITEM 10. CONTROLS AND PROCEDURES

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The Registrant's Principal Executive Officer and Principal Financial Officer have evaluated the Registrant's disclosure controls and procedures within 90 days of the filing of this report and have concluded that they are effective in providing reasonable assurance that the information required to be disclosed by the Registrant in its reports or statements filed under the 1934 Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission.

There were no changes in the Registrant's internal control over financial reporting that occurred during the Registrant's last fiscal half-year (the Registrant's second fiscal half-year in the case of an annual report) that have materially affected, or are reasonably likely to materially affect, the Registrant's internal control over financial reporting.

### ITEM 11. EXHIBITS

- 99(a) (1) Code of Ethics.  
99(a) (2) Certifications of Principal Executive Officer and Principal Financial Officer pursuant to Rule 30a-2 under the Investment Company Act of 1940 are attached hereto as an exhibit.  
99(a) (3) Not applicable.

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99.(b)(1) Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 are furnished herewith as an exhibit.

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SIGNATURES

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Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Japan Smaller Capitalization Fund, Inc.

By: /s/ Yasushi Suzuki

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Yasushi Suzuki, President  
(Principal Executive Officer)

Date: May 12, 2004

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Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

By: /s/ Rita Chopra-Brathwaite

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Rita Chopra-Brathwaite, Treasurer  
(Principal Financial Officer)

Date: May 12, 2004

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