Headwinds Lashing Japan's Moneylenders

By Katsuhiko SAKAI

Unprecedentedly severe headwinds are buffeting Japan's consumer loan lenders that once enjoyed dramatic growth by taking advantage of automatic lending machines, which allow consumers to borrow loans without meeting any person, and high-profile TV commercials that helped boost their social recognition. But borrowers' demands for refunding of overcharged interest on loans have forced these moneylenders to book heavy losses. In addition, their market has been shrinking fast in the wake of the gradual enforcement of the Moneylending Business Law since December 2007, designed to toughen regulations on moneylenders for the purpose of preventing consumers from becoming heavily indebted. These dramatic business environment changes are forcing Japan's consumer loan industry map to look totally different.

Earnings Plunge on Loss of Lucrative Interest Rates

Japan's consumer loan market expanded fast from ¥3 trillion in 1990 to ¥11 trillion in 2005. This means the consumer loan market grew 3.6-fold while Japan remained plagued with deflation for 15 years. Consumer loan lenders took advantage of the so-called gray-zone lending rates between two legal rate limits to boost earnings. The Interest Rate Restriction Law caps lending rates at 15-20% according to loan amounts, providing for no penalty on lenders imposing rates above the limits. In contrast, the Investment Deposit and Interest Rate Law sets the maximum rate at 29.2% and calls for penalties on those imposing higher rates. Registered moneylenders were allowed to impose the gray-zone lending rates between the two types of legal limits and generate massive earnings.

In a landmark ruling in January 2006, however, the Supreme Court invalidated the gray-zone lending rates. The ruling prompted borrowers to demand refunding of excessive interest payments beyond the ceilings under the Interest Rate Restriction Law, sending consumer loan lenders on a roller-coaster ride from hell. The four biggest Japanese consumer loan companies – Promise Co., Aiful Corp., Acom Co. and Takefuji Co. – chalked up consolidated net losses in fiscal 2006 for the first time since their respective stock market debuts. Their combined group net losses totaled as much as ¥1.7 trillion in the year to March 2007.

In fiscal 2007 that ended in March 2008, the Big Four took advantage of streamlining efforts to eke out group net profits. But their operating revenues continued declining. The Moneylending Business Law will repeal the gray-zone lending rates possibly by 2009 to unify the lending rate ceilings into 20%. Without waiting until the legal change, however, consumer loan companies have lowered their maximum lending rates to 18% for new customers and launched stricter screening of borrowers. As a result, they have selected safer borrowers with lower risk of default, bringing about a decline in outstanding loans. According to the Japan Financial Services Association's survey of 64 major moneylenders, their outstanding unsecured loans at the end of June posted a 14.5% decrease from a year earlier to ¥7,164 billion. The number of new lending contracts concluded in the month plunged 43.5% to 80,051.

Shakeout Sweeping Consumer Loan Industry

The number of registered moneylenders in Japan was 9,115 at the end of March 2008, slipping below 10,000 for the first time at the end of a fiscal year, according to the Financial Services Agency. Of the 2,717 moneylenders that disappeared in fiscal 2007, 97% were small firms that had limited their business areas to single prefectures. They are believed to have quit the business in a move timed with the implementation of the tightened Moneylending Business Law. Although refunding of overcharged interest payments is expected to peak soon, tougher regulations under the law are expected to further reduce the number of registered moneylenders. The repeal of the gray-zone lending rates will coincide with a new lending restriction that will limit the amount of a loan to not more than one-third of a borrower's annual income, in principle. The minimum net asset value for registered moneylenders will be raised to ¥50 million from ¥3 million for an individual or ¥5 million for a corporation at present. The number of registered moneylenders is estimated by some analysts to plunge to about 2,000 when the above curbs are introduced.

The wave of shakeout and realignment sweeping the moneylending industry has involved even medium-sized and larger companies doing wider-area operations. The Big Four moneylenders account for some 80% of the consumer loan market in Japan. The shrinking market under the tougher regulations does not allow those ranked just below the Big Four to maintain cost effectiveness in massive capital and advertising expenditures. In 2007, Promise acquired Sanyo Shinpan Finance Co. that was then ranked seventh in the industry. Credia Co. based in Shizuoka became Japan's first exchange-listed consumer loan firm to go bankrupt.

This year, foreign companies that had acquired Japanese consumer loan firms on the back of their strong financial power began to withdraw from the Japanese industry. US financial giant Citigroup said in June its consumer finance unit CFJ K.K. will shut down in one year all 32 manned branches and 540 unmanned outlets operated under DIC and other brands in Japan. CFJ is ranked fifth, just after the Big Four. In July, General Electric Co. of the United States decided to sell GE Consumer Finance Co., known for its Lake-brand consumer finance business, to Shinsei Bank for ¥580 billion. A combination of the Lake operations and Shinsei Bank's consumer loan operations including medium-sized Shinki Co. will create the fifth largest consumer loan firm after the Big Four.

Big Four Groping for Survival

The Big Four consumer loan lenders are about to participate in the next realignment stage. Industry people agree it willl be two or three of the Big Four that will survive the deteriorating business conditions, including a fast rise in refunding of overcharged interest and tighter regulations. Attracting attention in this respect are two independent lenders without the backing of megabanks, Aiful and Takefuji. As banks have grown cautious of lending funds to consumer loan firms, the two companies may have a sense of crisis regarding fundraising, among other things.

Sumitomo Mitsui Financial Group Inc. with a stake in Promise and Mitsubishi UFJ Financial Group Inc. with an interest in Acom have launched realignment of their respective nonbank operations including credit card, credit sale and leasing services as well as consumer finance. The lending business of credit card companies, in particular, has been hard hit by the tougher Moneylending Business Law, forcing them to walk on a tightrope. The megabank-led realignment of non-bank operations may change the position of consumer finance.

It is not tougher regulations alone that worry the Big Four. The falling birthrate coupled with the aging population is slowly choking them. A decline in the number of low-income young wage earners in their 20s and 30s means a shrinking main customer base for consumer finance. The Big Four are now required to restructure their long-term business models for their survival.

Eye-catching huge signboards of major consumer loan lenders are seen in every town in Japan.

New Opportunities in Asian Markets

Having a hard time at home, major consumer loan lenders are searching for new business opportunities in Asian markets other than Japan. In the rest of Asia, maximum lending rates are higher than in Japan, with no claims seen for refunding of overcharged interest. Japanese lenders are seeking to take advantage of their borrower-screening and loan collection know-how accumulated at home to expand overseas operations.

Taking the initiative in expanding into foreign markets are mega-bank-backed Acom and Promise. Acom founded a joint venture in Thailand in 1996 to provide consumers with unsecured loans under the Easy Buy brand. The Acom unit has become the biggest money-lender in terms of outstanding loans. In Indonesia, with the biggest population among Southeast Asian countries, Acom and the Bank of Tokyo-Mitsubishi UFJ jointly bought a medium-sized bank in December 2007. Acom has also opened representative offices in China (Beijing) and Vietnam (Ho Chi Min City), seeking to expand its geographical business territory. Promise set up a wholly owned subsidiary in Hong Kong in 1992. At the end of June 2007, the Hong Kong unit's outstanding loans stood at ¥24.3 billion. It booked ¥2.1 billion in net profit for the first half of 2007, benefiting from high lending rates ranging from 16.22% to 47.45%. Promise has also established a wholly owned subsidiary in Thailand and a representative office in Beijing.

Following Japan, however, some other Asian countries have begun to toughen regulations on moneylenders due mainly to the problem of heavily indebted borrowers. In Thailand, lending fees used to be limitless, even though lending rates were capped at 15%. In 2005, however, lending rates including fees were limited to a maximum 28%. This change has deteriorated the profitability of Acom's Easy Buy operations. Taiwan as well tightened curbs on consumer loan lenders, forcing Acom to withdraw from the Taiwanese market in 2005 and Promise to follow suit in 2007. If foreign countries tighten the grip on moneylenders, the Japanese Big Four moneylenders may see their overseas strategies derailed. JS

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