

Japanese Regional Banks Rushing Shakeup Prompted by Widening Economic Gaps

By *Katsuhiko SAKAI*

Regional banks throughout Japan are rushing to realign themselves as gaps are widening not only between financially strong banks and weaker ones but also between core cities and their surrounding areas in regional economies amid the prolonged economic slump and growing competition. Japanese regional banks have managed to coexist while serving their respective prefectural business areas. But it has become indispensable for them to enhance their business foundations for their very survival through mergers and alliances not only within their prefectures but also across prefectural borders.

M&A Deals & Megabanks' Influence

The number of regional banks in Japan was 108 at the end of March 2009. They include the 64 first-tier regional banks belonging to the Regional Banks Association of Japan. They are long-established and most of them are the largest in their respective prefectures. The remaining 44 are called second-tier regional banks, constituting the Second Association of Regional Banks. The latter had been mutual loan and savings banks for small enterprises before becoming ordinary banks in 1989. They are weaker than the first-tier regional banks. Some 20 second-tier regional banks have disappeared on failures or mergers since Japan's financial crisis began to erupt in 1997.

Despite the demise of so many second-tier regional banks, excess banking capacity, known as "overbanking," has remained in Japan. While the country's three megabank groups have penetrated into business territories of regional banks, new competitors for regional banks have emerged one after another. Japan Post Bank was set up in 2007 as the postal system was privatized. Government-controlled financial institutions have been privatized. In addition, Internet-based banks have been founded. As demand for funds is shrinking on the falling birthrate and aging population coupled with declining regional industries, officials at the Financial Services Agency and the Bank of Japan say each prefecture does not have to have two or three regional banks. In the future, regional banks other than the largest ones in their respective prefectures are likely to be involved in realignment.

The latest regional bank shakeup has shifted away from a traditional pattern where a bank rescues and absorbs a weaker one within one prefecture. In the Tohoku (northeastern) region of Japan, Yamagata Prefecture's Shonai Bank and Akita Prefecture's Hokuto Bank, both first-tier regional banks, have agreed to found a joint holding company and integrate their management on Oct. 1 this year. In the Kansai region including Osaka Prefecture, the prefecture's Kansai Urban Banking Corp. and Shiga Prefecture's Biwako Bank, both second-tier

regional banks, have agreed to merge next spring. In the adjacent Shikoku region, Kagawa Prefecture's Kagawa Bank and Tokushima Prefecture's Tokushima Bank, both second-tier regional banks, will integrate their management. Fearing that second-tier banks' integration with first-tier banks within the same prefectures would be nothing more than the absorption of weaker banks by stronger ones, managers of regional banks are beginning to consider finding merger partners in neighboring prefectures to secure their survival.

Megabank groups are leading their respective regional banking affiliates to implement mergers. Shonai and Hokuto are close to Mizuho Financial Group Inc., and Kansai Urban and Biwako to Sumitomo Mitsui Financial Group Inc. In Osaka Prefecture, Bank of Ikeda and Senshu Bank, both first-tier regional banks affiliated with Mitsubishi UFJ Financial Group Inc., have agreed to merge next spring.

Tochigi Prefecture's Ashikaga Bank, a first-tier regional bank that had failed and been nationalized, got support from Nomura Holdings Co., the largest Japanese brokerage group, in July 2008. In the Kanto region including Tokyo as well as Tochigi, there are many small and large regional banks that are exposed to fierce competition from the three megabank groups and subjected to realignment rumors. Among such regional banks, Ashikaga "would not like to be passive," its President Satoshi Fujisawa said in interviews with newspapers. The banking community is keeping a close watch on what action Nomura will take following its first bid for a share of the pie in the regional banking industry.

New Race for Market Dominance Looming

There is another major problem shaking regional banks' business bases. That is the possible introduction of a wider-area local government system that would integrate prefectures into fewer and broader administrative regions. In February 2006, the Local Government System Research Council submitted a recommendation to then Prime Minister Junichiro Koizumi about the system, suggesting 46 of the present 47 prefectures (other than Hokkaido) be reorganized into eight to 12 states or provinces. The objective is to eliminate problems associated with centralization and excessive concentration in Tokyo and promote decentralization. An outline of relevant draft basic legislation, as approved within the ruling Liberal Democratic Party in June, includes a plan for Japan to shift to the new regional administrative system in six to eight years after a set of bills is passed into law. If the system is implemented, even leading first-tier regional banks may find it difficult to ensure their survival merely by relying on the label of being the largest bank in any prefecture.

Whether the new system will be introduced smoothly is uncertain because many people are opposed to it. Irrespective of the system being put in place, however, the development of expressways and *Shinkansen* bullet train lines has prompted business demand to flow out increasingly into big cities from their surrounding areas throughout Japan. Core cities with branches of the central government and large companies have become “mini-Tokyos,” featuring heavy concentration.

For example, Miyagi Prefecture’s capital Sendai on the Pacific coast, the only government-designated major city in the Tohoku region, is attracting many people who come for shopping from neighboring Yamagata and Akita prefectures on the Japan Sea coast using expressway buses. As concentration in Sendai intensifies, surrounding areas are expected to decline in business activity. It was with such bleak prospects in mind that Shonai Bank in Yamagata and Hokuto Bank in Akita agreed on their integration across the prefectural border. Their decision to base their joint holding company in Sendai indicates their sense of crisis.

In the Kyushu region, southwestern Japan, Fukuoka with the largest local population looks like the de-facto capital of the region that could be a state under the proposed new administrative system. Bank of Fukuoka, a first-tier regional bank based in the city, has acquired two ailing regional banks in adjacent prefectures through its holding company Fukuoka Financial Group Inc., becoming a super regional bank covering three prefectures. Acquired were Kumamoto Family Bank, a second-tier regional bank in Kumamoto Prefecture, and Shinwa Bank, a first-tier regional bank in Nagasaki Prefecture. In a bid to check the megabank groups’ expansion into Kyushu, Bank of Fukuoka has taken an offensive attitude in view of the widening Fukuoka economic bloc. Regional banks in Kagoshima Prefecture at the southern tip of Kyushu now have no time to stay put. This is because the planned completion of the Kyushu *Shinkansen* line in 2011 is set to shorten the train travel time between Fukuoka at the northern tip and Kagoshima to 89 minutes from the present 220 minutes. Competition between regional banks within Kyushu may grow fiercer, leading to their further realignment.

Wider-area Alliances to Address Common Problems

Management integrations and mergers are the quickest means to cut overlapping costs and enhance management vitality. But the expansion of business territory is feared to cause a decline in locally based services peculiar to regional banks. Financially stronger first-tier regional banks are exploring their cooperation in enhancing their business operations while retaining independence in management.

On alert against the Bank of Fukuoka expansion, Eighteenth Bank in Nagasaki Prefecture and Kagoshima Bank in Kagoshima Prefecture have teamed up with Yamanashi Chuo Bank in Yamanashi Prefecture, some 1,000 kilometers away from Kyushu, to jointly develop a system to store customer data and control credit exposure. The three first-tier regional banks whose business territories are far away from each other are thus seeking to jointly reduce costs and share know-how.

In a similar move, 21 first-tier regional banks, led by Bank of Yokohama, have agreed to cooperate in think tank services such as research, consulting, lectures and seminars. They are trying to



Bank of Fukuoka President Masaaki Tani announces the establishment of Fukuoka Financial Group Inc. in October 2006. The group now owns Bank of Fukuoka and regional banks in Nagasaki and Kumamoto prefectures, serving as a super regional bank covering three prefectures.

develop human resources and improve their business efficiency and sophistication while enhancing locally based services the megabank groups cannot provide.

Japan Post Bank, which emerged in the October 2007 privatization of the postal system, is planning to expand into the housing loan market in a full-fledged manner through the nationwide network of post offices. Spurred by the Japan Post Bank move, the regional banking industry has created a study group to develop housing-loan products. Fifty-five first-tier regional banks, accounting for more than 80% of the banks in the same category, have taken part in the group to cooperate in coping with nationwide competition from Japan Post Bank.

In fiscal 2008 that ended in March 2009, many regional banks incurred net losses due to appraisal losses on securities holdings and increased nonperforming loan disposal costs amid the global recession triggered by the US-originated financial crisis. In the long run, the number of regional banks may decline further as regional economies shrink. But independence-oriented major regional banks are expected to enhance their wider-area alliances to address common rivals and challenges. **JS**

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