Quality and Profits

Japan's banking community characterized 1988 as the year of internationalization.

For the Japanese banking community, 1988 was a year when it was pressed hard by new international banking rules to switch over its management strategy from traditional "quantitative expansion" such as increasing deposits to qualitative enhancement represented by improved profitability. The new rules, set by the Bank for International Settlements (BIS), feature a capital-adequacy standard requiring banks with international operations to boost the minimum capital-to-asset ratio to 8% by March 1993.

The change is taking shape in three major directions – expansion of retail banking, greater involvement in securities business, and internationalization of operations. Considerably different strategies are followed by three groups of major Japanese banks – those in the upper echelon of the 13 largest banks (known as city banks), smaller city banks, and three banks specializing in long-term finance.

A major change known as securitization of finance has occurred in the nation's banking climate in the 1980s. It means major businesses have become more dependent on direct fund-raising from the capital market in the form of securities issues than on borrowing from banks. The move has prompted smaller city banks to terminate unprofitable lending to big businesses and convert the funds thus made available into loans to medium-sized and small firms and individual borrowers.

In the world financial community, securitization has begun to bring about a structural change, with the weight of securities business growing in financial services. Internationalization of finance has also made rapid progress, making international operations a main pillar of Japanese banking. The city banks' earnings from international operations accounted for about 20% of their gross profits in fiscal 1987.

Discussions are expected to heat up in 1989 on fundamental problems associated with Japan's financial system in the wake of progress in the liberalization and internationalization of finance. With liberalization of interest rates on large-lot time deposits set to be completed in late 1989, debate on rate decontrol on small-lot deposits got into full swing in the fall of 1988.

Standing in the way of rate liberalization for small-lot time deposits is a dispute over the balance between postal and bank deposits. Postal savings deposits account for some 30% of the nation's total deposits. Banks insist that the terms of high-yield fixed-amount time deposits, the mainstay of postal deposits, be brought into line with those of bank deposits before liberalization of small-lot deposit rates.

City Banks' Domestic and Int'l Profits (FY 1987) (¥ billion; %)

	Domestic (A)	Int'l (B)	Total (C)	B/C (%)
Dai-Ichi Kangyo	448.9	74.3	523.2	14.2
Sumitomo	399.5	106.2	505.7	21.0
Fuji	410.3	91.3	501.6	18.2
Mitsubishi	380.8	67.2	448.0	15.0
Sanwa	355.2	84.4	439.6	19.2
Tokai	286.4	44.7	331.1	13.5
Mitsui	278.2	75.3	353.5	21.3
Taiyo Kobe	250.3	27.5	277.8	9.9
Kyowa	171.7	17.4	189.1	9.2
Daiwa	133.2	19.9	153.1	13.0
Saitama	150.4	18.4	168.8	10.9
Hokkaido Takushoku	109.2	10.8	120.0	9.0
Tokyo	58.2	159.0	217.2	73.2
Total	3,432.3	796.4	4,228.7	18.8

Source: *Financial & Fiscal Affairs*, June 20, 1988

Another basic problem about the financial system is the traditional practice of limiting long-term finance to specialized banks and allowing only specified banks to do trust business. A review of the problem is expected to lead to a wholesale reform of the nation's entire financial system and it appears inevitable this will develop into discussions on the advisability of continuing to separate securities business from banking and of maintaining government-run financial institutions serving special purposes. Yet another issue, involving *sogo* (mutual) savings and loan banks, has been resolved. Such banks are being allowed to convert themselves into commercial banks in three stages, starting in February.

Massive public bond offerings, swelling overseas investments and other developments accompanying a shift in Japan's economy from rapid to stable growth have caused a radical change in the flow of funds, with the securities market replacing the capital market as a primary source of fund-raising. Such a change in the domestic cycle of fund flows has combined with calls for market liberalization and internationalization to require a review of the workings of the securities and capital market systems.

Debate will intensify on this question in 1989. The securities industry is on the defensive regarding the issue of separating securities operations from banking. In the sphere of brokerage, banks have been allowed into bond futures trading and have shown a strong intention to participate in underwriting. Also at issue is whether to authorize banks to manage investment trusts, an area that trust and banking companies are seeking to enter.

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