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Japan Financial Report

Report 1

Regional Finance in an Age of Population Decline:

– Falling Capital Demand Requiring Banks to Find New Business Models –

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1. Population decline and aging in Japan

Regional banks in Japan are facing the inevitable consequence of changing demography; i.e. aging and declining of population whereby shrinking credit demand. According to estimates by the Statistics Bureau of the Ministry of Internal Affairs and Communications, Japan's population trend has already entered the era of gradual decline. In particular, working-age population, the 15 to 64 age group with significant influence on regional economy, has continuously dropped in all 47 prefectures since 2012.

The future looks even grimmer according to projections by the National Institute of Population and Social Security Research. The Institute predicts that in 2025, the working-age population will decline by 10 to 20% compared to 2010 in most prefectures. Old age population over 65, on the contrary, will continue to increase.

2. The Conditions Surrounding Regional Financial Institutions

2.1. Government, Political Calls for "Reorganization of Regional Finance"

Within the Japanese government and the ruling political parties, interest in the question of the nation's regional financial institutions is on the rise. The Liberal Democratic Party's Headquarters for Japan's Economic Revitalization, in its Japan Revival Vision announced in May 2014, remarked on the low profitability of regional financial institutions and the wide variance seen in their capital adequacy, leading to lingering doubts as to whether they would be able to meet the various needs of their regions in years to come.

The revised Japan Revitalization Strategy issued in June 2014 also touches on the issue of regional banks. In taking on more risk, it notes, these institutions will have to enhance their profitability and make more risk money available to regional borrowers as urgent tasks. Furthermore, the strategy states, as regional financial institutions appropriately assess their own business performance, they will need to coordinate with other institutions on the operations side and even view a reorganization of the regional financial sector as one promising option going forward. The Council on Economic and Fiscal Policy, chaired by Prime Minister Shinzo Abe, has also focused on ways to revitalize regional economies in its deliberations, proposing that regional banks and other financial institutions pursue business efficiency, including through bold reorganization in the sector, and provide capital to the regions they serve via investment funds and other more diverse modes of funding.

2.2. FSA and BOJ Trends: Concern over Regional Banks' Profitability

The Financial Services Agency published its first Financial Monitoring Report in July 2014. On the subject of the medium to long-term sustainability of regional financial institutions' business models, the report sees it as problematic that despite the predicted fall in outstanding loans given the nationwide decline in population, regional banks are aspiring to increase lending volume in their medium-term management plans: "Across the sector as a whole, there is a possibility that business models depending on lending growth will fall apart over the medium to longer term." And in its April 2014 Financial System Report, the Bank of Japan indicated its concern that by increasing their loans outside their home regions, the country's regional financial institutions may be dragging down their profitability.

2.3. Private-Public Funds on the Rise; Investment in Healthcare, Other Areas

As a means of ensuring their survival, regional banks are increasingly creating investment funds in partnership with public-sector actors to provide businesses with funding and managerial support. This is because by taking on public money, the institutions can reduce their own risk exposure. Many of these funds aim to provide risk capital to areas like so-called senary industries ("sixth-level" enterprises integrating secondary and tertiary industry functions with the primary industries of agriculture or fisheries) and healthcare.

January 2013 saw the launch of A-FIVE, the Agriculture, forestry and fisheries Fund corporation for Innovation, Value-chain, and Expansion Japan. For regional financial institutions, agriculture had not traditionally been an area for vigorous unilateral investment due to the small scale of businesses and the high risk associated with factors like unfavorable weather. A-FIVE, however, can provide direct funding to joint ventures backed by agricultural, forestry, or fisheries concerns and companies from other industries. There are also cases where investment is directed to "subfunds" that are managed by city or regional banks and provide capital to primary industry.

In March 2013, the Enterprise Turnaround Initiative Corporation of Japan (ETIC) was reorganized to form the Regional Economy Vitalization Corporation of Japan (REVIC) to take on new tasks including the facilitation of investment by general (unlimited liability) partnerships in funds aiming to revitalize businesses or regional economies. In September 2014, REVIC launched Japan's first fund specializing in support for the regional healthcare industry. With participation by major city bank Mizuho and leading regional banks, this fund directs investment to medical and nursing care providers around the country.

2.4. Moves to Reorganize Along System-Based Lines

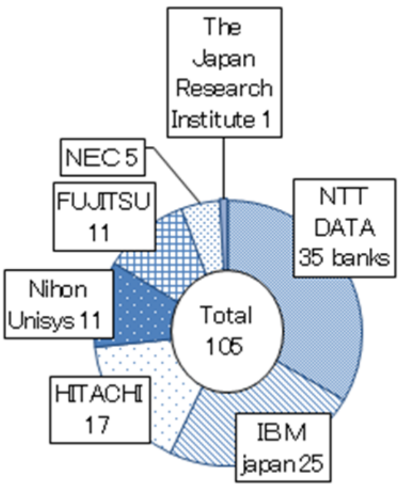
Cost cutting is one aim of the tie-ups and consolidations of regional financial institutions. Merely integrating two separate accounting systems can chop 20–30% off of the running cost, which can range from several hundred million yen up to the ¥3 billion level. Today many regional banks share common accounting systems with other banks (see Table 1 and Figure 1).

Table 1. Accounting systems shared by financial institutions

	System	Bank
HITACHI (17)	Open System	Shizuoka, Keiyo
	Banks'ware	Michinoku, San-In Godo, Higo
	NEXTBASE	Tokushima, Kagawa, Kita-Nippon, Tomato, Kochi, Tochigi, Chukyo, Taiko, Daisan, Shizuoka Chuo, Taisho, Daito
NTT DATA (34)	Regional banks joint center	Kyoto, Chiba Kogyo, Iwate, Senshu Ikeda, Fukui, Aomori, Hokuetsu, Akita, Shikoku, Nishi-Nippon City, Ashikaga, Oita, Tottori, Aichi
	BeSTA cloud	Shonai, Hokuto
	STELLA CUBE	Tokyo Tomin, Tajima, Toyama, Nagano, Kanagawa, Tohoku, Sendai, Kirayaka
	MEJAR	Yokohama, Hokuriku, Hokkaido, 77
	SYSTEM BANKING KYUSHU KYOUDOU CENTER	Fikuoka chuo, Saga Kyoei, Nagasaki, Howa, Miyazaki Taiyo, Minami Nippon
FUJITSU (3)	PROBANK	Toho, Shimizu, Saikyo
IBM japan (22)	TSUBASA	Chiba, Chugoku, Daishi, Iyo
	Fight21	Fukuoka, Hiroshima, Shinwa, Kumamoto
	Chance	Joyo, Hyakujushi, Juroku, Nanto, Yamaguchi, Kitakyushu, Momiji
	JUUDANKAI	Yamagata, Tsukuba, Musashino, Hachijuni, Awa, Miyazaki, Ryukyus
Nihon Unisys (10)	BankVision	Hyakugo, Eighteenth, Chikuho, Kiyo, Saga, Yamanashi Chuo, Kagoshima, Suruga, Hokkoku, Ogaki Kyoritsu
NEC (4)	BankingWeb21	Yachiyo, Mie, Tokyo Star, Okinawa

Note: Including financial institutions that have expressed plans to participate in shared systems.
Source: Created based on financial institutions websites and various reports such as Nikkei Sangyo Shimbun

Figure 1. Market shares of IT firms for bank accounting systems（Including systems for single banks）



Source: Created based on financial institutions websites and various reports such as Nikkei Sangyo Shimbun

Major IT firms are engaged in fierce competition to land accounting system orders from first- and second-tier regional banks. The outcome of this competition, along with other factors in the reorganization and integration of these systems, could impact the tie-ups among regional banks going forward. Already, financial institutions that are using the same system are showing moves toward deepening their ties on the banking operations side as well. In April 2014, the Chiba Bank and other institutions that have built up a cooperative framework through the “TSUBASA Project”, an effort to boost use of common systems, decided to go beyond the system level and provide one another with needed personnel and other resources in times of emergency, such as after a major disaster. The scope of this cooperation is extending also to areas like personnel exchanges and joint sponsorship of regional tourism and product fairs. The banks are constructing a framework in which they can cooperate according to their own fields of excellence. The regional banks involved in the “TSUBASA Project” signed an agreement in September 2014 to strengthen ties in areas including international operations. This represented a measure to remedy a weakness these banks have vis-à-vis megabank competitors, namely their lack of bases of operations overseas, by sharing personnel and branches with one another. Other regional banks are expected to follow suit by continuing to reduce system costs, of course, but also by accelerating coordination efforts in a wide range of fields centered on those systems.

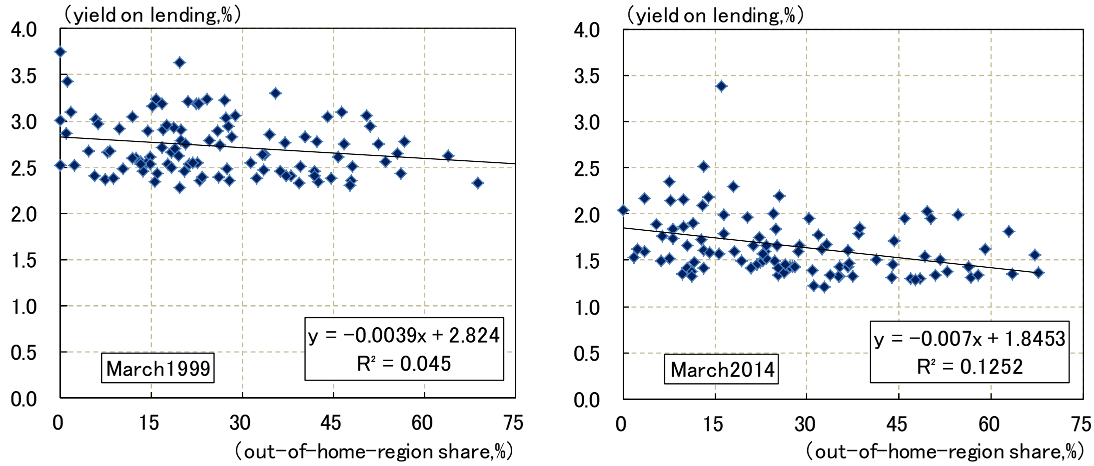
3. The Competitive Environment Surrounding Regional Banks

3.1. Lower Margins Even on Lending Growth; Extra-regional Loans Impact Profitability

The total net income for Japan’s regional banks in FY 2013 (April 2013–March 2014) reached its highest level in eight years. A total of 20 regional banks reported their highest profit ever on a net income basis for FY 2013. As of the end of the fiscal year, total outstanding loans for all regional banks were up 3.0% from the previous year. However, despite this rise in outstanding loans, profit margins were down. Interest rates have continued to fall in the wake of the Bank of Japan’s quantitative and qualitative monetary easing, and this, along with the heightened competition among lenders, has kept the lending-deposit profit margin on a steady decline. In addition to the sparse demand for capital among enterprises brought along by long years of deflationary conditions, banks have directed lending to the few places where there is still demand at ever-lower interest rates, leading to the present situation.

A clear evidence of the harshness of the lending competition among regional financial institutions is the growth in their lending outside their home regions—loans to borrowers located other than the prefectures where they are headquartered. Nationwide, the total of such loans has grown to reach 30% of all outstanding lending. In regions where this figure is particularly high, more than 50% of loans have been extended outside the home region, and there are some prefectures, such as Shimane, where the figure has topped over 60%. And a trend is clearly discernible connecting banks with high out-of-home-region lending ratios to lower investment yields on their loans (see Figure 2).

Figure 2. Out-of-home-region shares and yields on lending

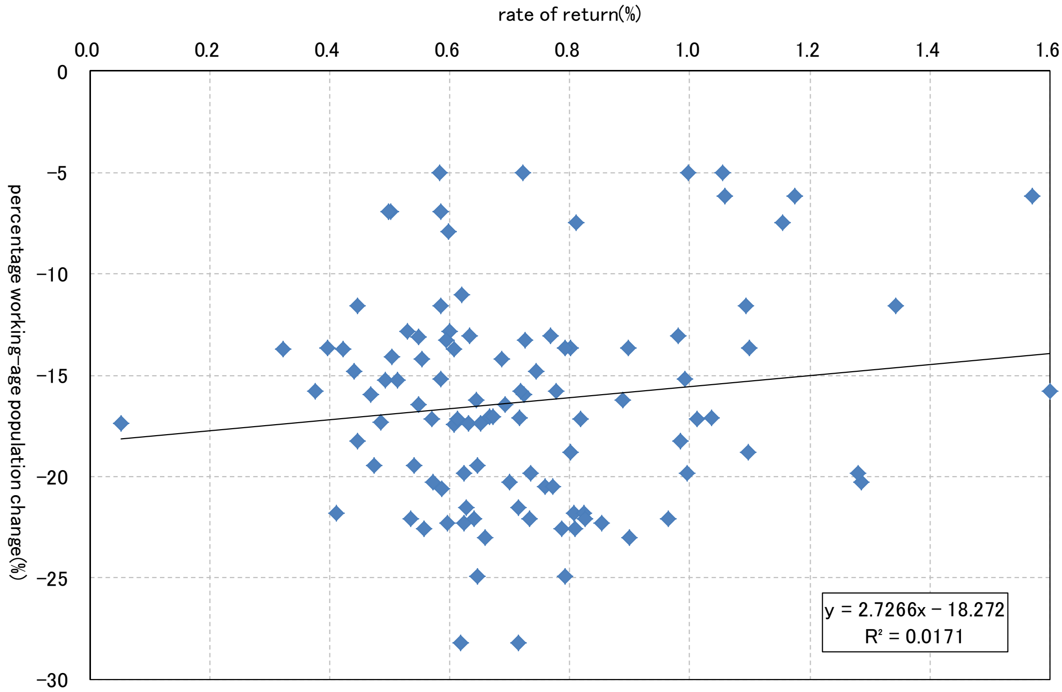


Source: The Financial Journal Co.,Ltd. "*Financial Map*", NEEDS-Financial QUEST

3.2. Population Declines and Profit Structures

A report titled "Analysis of Financial Institutions' Future Profit Structures" recently gained considerable attention among those interested in regional bank management. In December 2013, the so-called Mori Paper was delivered to presidents of regional banks. The Mori Paper was written by Nobuchika Mori, former director-general of the FSA Inspection Bureau, analyzing Japan's population trends and regional bank profitability. As the report has not been disclosed to the public, we attempted to reproduce some of the content of the Paper in Figure 3 taking hints from media reports. The vertical axis shows the rate of change in working-age population from 2010 to 2025 in the prefectures where each regional bank has its headquarters; the horizontal plot shows the FY 2013 profitability of the banks, as measured by their loan yield minus interest paid on deposits, credit cost ratio, and expense ratio. In regions where the change in working-age population is gradual, the profitability is higher, while in regions whose populations are plummeting rapidly, profit figures are correspondingly lower.

Figure 3. Analysis of Financial Institutions' Future Profit Structures



Note1: The vertical axis shows the rate of change in productive population from 2010 to 2025 in the prefectures where each regional bank has its headquarters; the horizontal plot shows the FY 2013 profitability of the banks, as measured by their loan yield minus interest paid on deposits, credit cost ratio, and expense ratio.
Note2: Given space limitations, the highest rate of return was 2.6% but includes it for 1.6%.
Source: National Institute of Population and Social Security Research "Population Projection by Prefecture", Annual report of regional banks , NEEDS-Financial QUEST

3.3. Regional Banks Accelerate Their Regional Tie-ups

As regional populations fall and local companies pursue opportunities overseas instead of in the home market, demand for funding is waning. Regional banks are responding by seeking fresh business chances through tie-ups. The "nine-bank consortium," which brought together the Bank of Fukuoka and eight other institutions to coordinate financing and other operations, was the wide-area tie-up that attracted the most attention in 2014. This consortium aims to diversify revenue sources and secure new profit streams, such as by engaging in financing to revitalize businesses on a per-bank basis while sharing risk going beyond what a single bank can take on across multiple institutions. The participants are also expected to cooperate in efforts to introduce business partners.

Management integration is also underway among Japan's regional banks. In October, Tokyo Tomin Bank and Yachiyo Bank formed a joint holding company. In November, the Bank of Yokohama, Japan's largest regional bank headquartered in Kanagawa Prefecture, was reported to integrate its business with Higashi-Nippon Bank headquartered in Tokyo. For the Bank of Yokohama, this deal offered a way to expand its geographical coverage and the chance to capture more of the demand expected to accompany preparations for the Tokyo Olympics, to be held in 2020. A few days after the newspaper reporting, Higo Bank and Kagoshima Bank announced their merger. Both of these banks are the front-runners in their respective prefectures, Kumamoto and Kagoshima, making the deal appears more like a future-oriented move to expand business and less like the mergers meant to prop up ailing banks that were frequently seen in the past.

4. Lending Expected to Decrease for 70% of Regional Banks by FY2025

We developed projections for lending and deposit changes for 101 regional banks over the long term. As the first step we established two models explaining past lending and deposit changes (see Table 2). The descriptions of variables can be found in Table 3. Estimation results are shown in Table 4 for loan and Table 5 for deposit.

We then proceeded to estimate the possible changes of lending and deposit between FYs 2013 and 2025 for each bank. Estimation results of Equation No.4 were employed for both Model 1 (loan) and Model 2 (deposit). As for the projections of the variables, for the ratio of ordinary profit to total assets, we took the average of the three fiscal years from 2011 to 2013. Population projection by the National Institute of Population and Social Security Research were used for the future population and working-age population of the prefectures where the banks are headquartered. For long-term interest rates and prefectural GDP figures, we set the figures based on the JCER's Medium-Term Economic Forecasts. As for the constants reflecting the fixed effects of individual banks, we used the values obtained from the estimation formula.

Table 2. Estimation models

Model 1 (loan)	$l_{it} = \alpha f_{it} + \beta g_{it} + \delta P_{it} + \theta X_{it} + \varepsilon_{it}$
Model 2 (deposit)	$d_{it} = \alpha f_{it} + \beta g_{it} + \delta P_{it} + \theta X_{it} + \varepsilon_{it}$
l_{it}	Bank's loan growth
d_{it}	Bank's deposit growth
f_{it}	Bank's profit ratio (recurring profit/total asset)
g_{it}	Real GDP growth of the prefecture in which bank's headquarter is based
P_{it}	Total population (or working-age population) growth of the prefecture in which bank's headquarter is based
X_{it}	Other independent variables
ε_{it}	Residual term

Table 3. Details of variables

Variable	Description	Value
loan	Bank's loan	Bank's loan at end of reference fiscal year (million yen)
deposit	Bank's deposit	Bank's deposit at end of reference fiscal year (million yen)
profit	Bank's profit ratio	Bank's ordninary profit of reference fiscal year (million yen)/Total asset of reference fiscal year (million yen)
realgdp/pop	Real GDP per capita	Real gross domestic production of prefecture (million yen)/Total prefectural population (thousands), reference year
cpi	CPI	National consumer price index, year-on-year change (%)
r10y_yield	Real interest rate	10-year Japanese government bond yield at end of reference year (%) - National consumer price index, year-on-year change (%)

pop	Prefectural population	Total prefectural population (thousands)
w_age	Prefectural working-age population	Total prefectural working-age population (thousands)
pref_loan/pop	Total loan per capita in prefecture	Total loan in prefecture (hundred million yen)/Total prefectural population (thousands)
pref_depo/pop	Deposit per capita in prefecture	Total deposit in prefecture (hundred million yen)/Total prefectural population (thousands)
no_regbk	Number of regional banks in prefecture	Number of regional banks that base their headquarters in prefecture, reference year
ctybk_lshare	City banks' share in total loan in prefecture	City banks' share in total loan by commercial financial institutions in prefecture (%)
shinkin_lshare	Shinkins' share in total loan in prefecture	Shinkins' share in total loan commercial financial institutions in prefecture (%)
ja_lshare	JA's share in total loan in prefecture	JA's share in total loan commercial financial institutions in prefecture (%)
ctybk_dshare	City banks' share in total deposit in prefecture	City banks' share in total deposit of commercial financial institutions in prefecture (%)
shinkin_dshare	Shinkins' share in total deposit in prefecture	Shinkins' share in total deposit of commercial financial institutions in prefecture (%)
ja_dshare	JA's share in total deposit in prefecture	JA's share in total deposit of commercial financial institutions in prefecture (%)
post_dshare	Japan Post Bank's share in total deposit in prefecture	Japan Post Bank's share in total deposit of commercial financial institutions in prefecture (%)
ctybk_branch/pop	No. of city banks branches per capita	Number of city banks branches in prefecture/Total prefectural population (thousands)
shinkin_branch/pop	No. of Shinkin branches per capita	Number of Shinkin branches in prefecture/Total prefectural population (thousands)
ja_branch/pop	No. of JA branches per capita	Number of JA branches in prefecture/Total prefectural population (thousands)
post_branch/pop	No. of Japan Post Bank branches per capita	Number of Japan Post Bank branches in prefecture/Total prefectural population (thousands)

Note: "Prefecture" signifies the prefecture in which the referred bank's headquarter is based

Source: Cabinet Office, Government of Japan, Prefectural Accounts, Statistics Bureau, Ministry of Internal Affairs and Communications, Population Estimates, Bank of Japan, Deposits, Vault Cash, and Loans and Bills Discounted by Prefecture (Domestically Licensed Banks), NEEDS-Financial Quest, Corporate Financial Data (TANSHIN/YUHO) (Incl. Shinkin Banks), Foreign exchange and Interest Rates, The Financial Journal Co.,Ltd., Financial Map

Table 4. Estimation results for Model 1(loan)

Dependant variable	dlog(loan)						
Estimation period (year)	1980～2011	1986～2011	1980～2011	1986～2011	1999～2011	1998～2011	1998～2011
Equation no.	1	2	3	4	5	6	7
No. of samples	3865	3100	3865	3100	1429	1545	1548
profit	1.17***	0.98***	1.08***	0.94***	0.50***	0.46***	0.46***
dlog(realgdp/pop)	0.41***	0.43***	0.34***	0.38***	0.04	0.04	0.04
dlog(cpi)	0.85***		0.86***				
r10y_yield		0.01***		0.01***	-0.01***	-0.01***	-0.01***
dlog(pop)	2.90***	2.08***					
dlog(w_age)			1.92***	1.97***	-0.38**	-0.62***	-0.53***
dlog(pref_loan/pop)					0.29***		
ctybk_lshare						-0.00***	
shinkin_lshare						-0.00**	
ja_lshare						-0.00***	
ctybk_branch/pop							0.07
shinkin_branch/pop							-0.32*
ja_branch/pop							-0.09***
R-squared	0.43	0.36	0.46	0.40	0.46	0.40	0.40

Note: * denotes significance at 10% level, ** denotes significance at 5% level, *** denotes significance at 1% level.

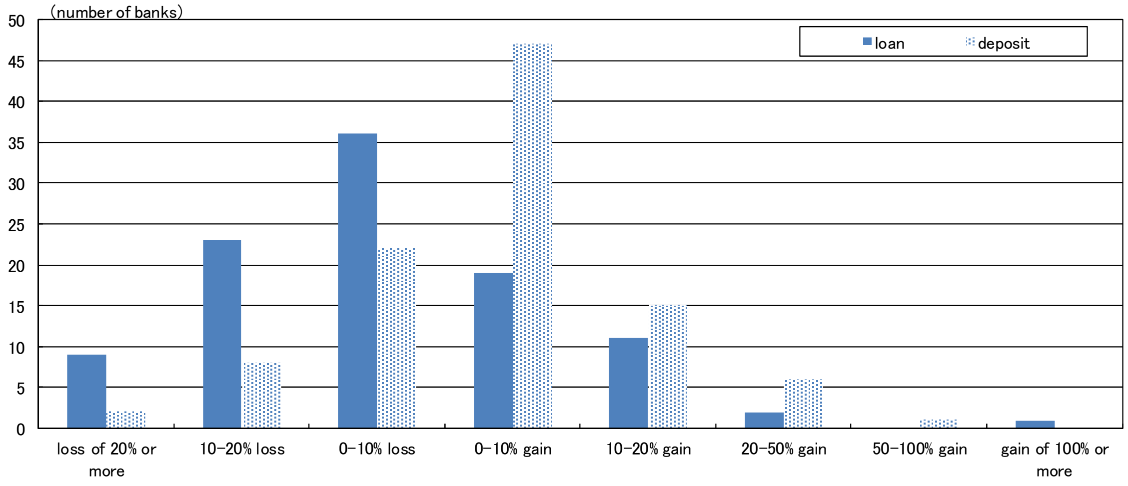
Table 5. Estimation results for Model 2(deposits)

Dependant variable	dlog(deposit)							
Estimation period (year)	1980～2011	1986～2011	1980～2011	1986～2011	1999～2011	1986～2011	1998～2011	1998～2011
Equation no.	1	2	3	4	5	6	7	8
No. of samples	3865	3100	3866	3100	1428	3100	1546	1548
profit	2.54***	2.32***	2.45***	2.29***	1.60***	2.29***	1.24***	1.31***
dlog(realgdp/pop)	0.34***	0.31***	0.27***	0.26***	-0.02	0.26***	-0.03	-0.01
dlog(cpi)	0.60***		0.57***					
r10y_yield		0.01***		0.01***	-0.00	0.01***	-0.00*	-0.00
dlog(pop)	2.36***	0.61						
dlog(w_age)			1.82***	1.66***	0.20	1.71***	0.13	0.26
dlog(pref_depo/pop)					0.62***			
no_regbk						-0.00*		
ctybk_dshare							-0.01***	
shinkin_dshare							-0.00***	
ja_dshare							-0.01***	
post_dshare							-0.00***	
ctybk_branch/pop								-0.16
shinkin_branch/pop								0.23
ja_branch/pop								-0.08**
post_branch/pop								-1.04***
R-squared	0.41	0.41	0.43	0.43	0.80	0.43	0.58	0.58

Note: * denotes significance at 10% level, ** denotes significance at 5% level, *** denotes significance at 1% level.

Our estimation suggests that business strategies assuming continued credit demand growth are less likely to succeed in the future (see Figure 4). Out of the 101 banks, 68 banks or nearly 70% of them are expected to see lending decrease in FY 2025 compared to 2013. Meanwhile, 32 banks are likely to see deposits fall over the same period.

Figure 4. Loan and deposit projections for Regional Banks, changes over FY 2013 to 2025



5. Housing Loans Market Must Grapple with Falling Populations

5.1. Empirical Analysis: Both First- and Second-Tier Regional Banks Could Take Losses on Loans

Banks have been attempting to compensate for the failing growth of corporate loans by expanding housing loans. Growth in regional banks' housing loans has been particularly dramatic; since July 2012, their lending in this sector has outpaced that of city banks.

In this section, we analyze the profitability of introductory 10-year fixed-rate loans (those whose interest rates are fixed for the first 10 years after issuance).Given the current low interest rate, the benefits of fixed-rate loans for borrowers are considerable. In our model, we posit a 35-year term, with repayment made via equal monthly payments with interest.

For the first 10 years, the procurement interest rate for housing loans is set at the swap rate (the LIBOR yen-yen swap rate). As it is unclear whether borrowers will opt for a fixed or a floating rate from the eleventh year on, we set the rate at the average interest paid on deposits and bonds over the most recent five years from FY2009 to FY2013. The credit risk of each bank is also factored into this procurement interest rate.

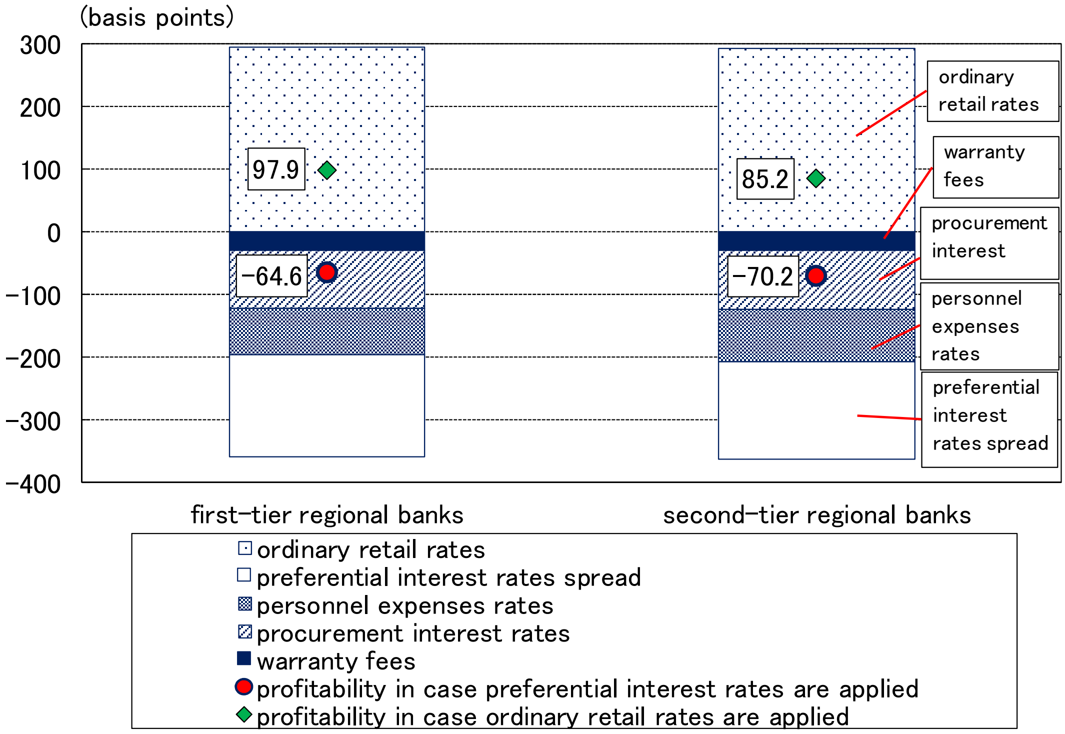
The conditional prepayment rate (CPR) is based on the Prepayment Standard Japan (PSJ) Model created by the Japan Securities Dealers Association. It is impossible to cover all credit risk with warranty fees alone, so assuming that a portion of this risk will be borne by the banks, we set the default rate at 30 basis points (0.3%) for first-tier regional banks and 38.5 basis points (0.385%) for second-tier regional banks. In addition, we consider the attributes of the lending targets based on the ratio of risk-monitored loans for both first- and second-tier regional banks.

In line with the method used by Tozaka and Mio (2008)[1], we calculate profitability of loans with a 6% PSJ model. This projects that CPR will climb by 10 basis points (0.1%) each month, remaining at 600 basis points (6%) from month 60 onward. No fees are levied for prepayment. Such prepayment is followed by a reduction in the equal monthly payments with interest and no change to the term of the loan. The present discounted value of the outstanding loan is calculated based on zero coupon yields.

[1] Tozaka Hironobu and Hitoshi Mio(2008) "Ginko-no Jutaku Loan wo meguru saikin no doukou to risk kanrijou no kadai" Bank of Japan Review 2008-J-14

Figure 5 shows profitability for housing loan products in the first year of the lending. When the preferential interest rate spread is taken into account, both first- and second-tier regional banks see profitability fall into negative territory. A comparison of the two groups shows that their lending rates are around the same, but the second-tier regional banks, with their higher costs, are deeper in the red.

Figure 5. Profitability for housing loan products in the first year of the lending

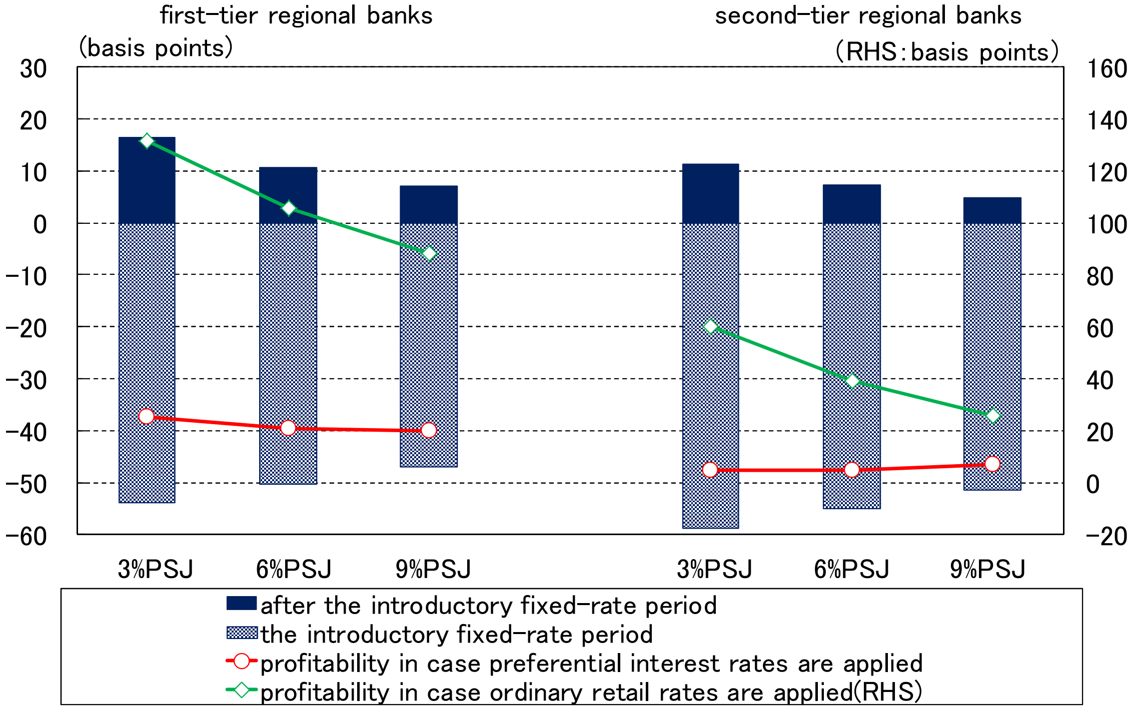


Source: Bank websites, interviews on banks, NEEDS-Financial QUEST, Nikkei Quick, Japanese Bankers Associations "National bank financial statements analysis"

5.2. Preferential Rates Can Push Profitability into Red for Entire Loan Term

Looking at profitability over the entire loan term, with the preferential interest rate spread, both first- and second-tier regional banks again see negative profitability (Figure 6). The second-tier regional banks are even deeper in the red. When preferential interest rates are applied, the introductory fixed-rate period shows a particular trend toward the red, and as a result the loans tend to lose money over their entire term. In cases where ordinary retail rates are applied, meanwhile, both first- and second-tier regional banks can make a profit over the entire term of the loans.

Figure 6. Profitability for housing loan products for entire loan term



Source: Bank websites, interviews on banks, NEEDS-Financial QUEST, Nikkei Quick, Japanese Bankers Association "National bank financial statements analysis"

The banks have been expanding their preferential rate offers for the loans' introductory periods in an effort to win reliable customers. And with the exception of a handful of banks, they have been extending slightly better rates to customers even after the introductory periods come to an end. All of this spurs banks on to compete still more energetically in the interest rate race, pointing to a situation where most of them will be unable to make profit from their lending.

6. Japan Post Bank Enters the Loan Business

Despite the expected shrink of lending opportunities caused by population decline in various regions of Japan over medium to long term, Japan Post Bank appears set to make a full-fledged entry to the financing field, particularly in the area of home loans. Japan Post Bank has a nationwide reach and abundant financial resources, making it all the more likely that it will go head to head against other financial institutions in each region (see Figure7).

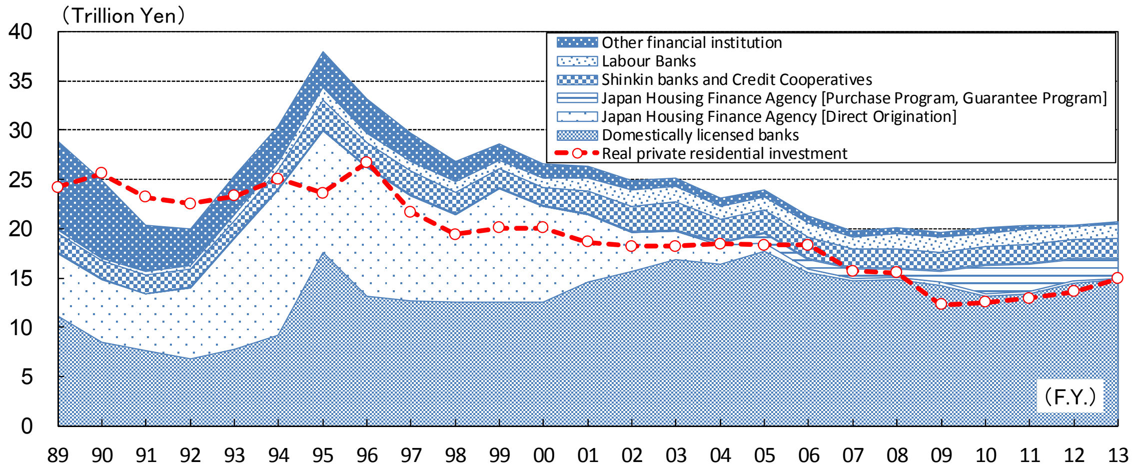
Figure 7. Comparison with the private sector leading （Year ending March 2014）

Japan Post Group		The business year ending March 2014		Private representative example
ゆうちょ銀行 Japan Post Bank Co., Ltd.	176.6 trillion	Savings (Yen)	132.7 trillion	三菱東京UFJ銀行 The Bank of Tokyo-Mitsubishi UFJ, Ltd.
	3,547 hundred million	Net income (Yen)	7,543 hundred million	
かんぽ生命 Japan Post Insurance Co., Ltd.	87 trillion	Total assets (Yen)	57 trillion	NISSAY Nippon Life Insurance Company
	634 hundred million	Net surplus/Net income (Yen)	2,844 hundred million	
日本郵便 Japan Post Co., Ltd.	4.3 hundred million	The number of home delivery (Number)	16.7 hundred million	ヤマトホールディングス Yamato Holdings Co., Ltd.
	329 hundred million	Net income (Yen)	348 hundred million	

Source: Companies Annual Report, Ministry of Land Infrastructure Transport and Tourism

The Japanese Bankers Association and National Association of Shinkin Banks have noted that "the approval of Japan Post Bank's entry into new retail fields such as lending could bring disorder to regional finance and lead to greater burdens on the public," urging the Japan Postal Privatization Committee to be cautious in deciding what will be allowed. As seen in Figure8, financial institutions have been competing more aggressively in the home lending field, an area that has seen a steady decline in private housing investment since the mid-1990s. Japan Post Bank's entry into housing loan operations could heat up this competition still more.

Figure 8. Amount of mortgage origination and private residential investment



Notes: "Domestically licensed banks" are city banks, first-tier regional banks, second-tier regional banks, trust banks, long-term credit banks and trust accounts. "Shinkin banks and Credit Cooperatives" are shinkin banks, Shinkin Central Bank, credit cooperatives and the Shinkumi Federation Bank. "Other financial institutions" are National Mutual Insurance Federation of Agricultural Cooperatives, life insurance companies, non-life insurance company, housing loan companies, local governments, Welfare and Medical Service Agency, Organization for Workers Retirement Allowance Mutual Aid and Okinawa Development Finance Company.
Source: Japan Housing Finance Agency

7. Reforming Agricultural Cooperatives to Invigorate Regional Agriculture

7.1. Considering the Joint-Stock Company Route for The Norinchukin Bank and JA SHINREN, JA ZENKYOREN

The Abe administration is tackling the task of reforming JA(Japan Agricultural Cooperatives), the nation's network of agricultural cooperatives. As of the end of FY2013, there were 738 corporations with a total of 9.98 million union members handling the so-called three JA businesses: agricultural cooperative activities, credit operations, and mutual insurance. JA has its hands in many business areas, including arrangements for weddings, funerals, and other ceremonies, travel agency operations, hospital management, automobile sales, and real estate brokerage. Currently the regulations that keep private-sector financial institutions and insurance firms from entering other business fields, or from offering both life and nonlife insurance products, are not applied to JA. The Abe administration is considering the joint-stock company route for the JA banking system ; the Norinchukin Bank(Central Cooperative Bank for Agriculture, Forestry and Fisheries), JA Shinren (Prefectural Credit Federations of Agricultural Cooperatives), and JA Zenkyoren (National Welfare Federation of Agricultural Cooperatives).

7.2. JA Membership: A Majority of Non-farming Associate Members

A look at the JA membership shows that while full members, the category of membership granted to active farmers, have been falling in number recently, associate members not involved in agriculture are on the rise. The associate membership surpassed the full membership in 2009, and to this day the majority of JA members are associates. These associates cannot take part in decision-making on JA management issues, but they can make use of JA services so long as they provide capital to the organization. JA's credit operations (its financial services) offer products that often have better terms than those of other financial institutions, creating an incentive for nonfarming residents of a community to make use of the JA system as associates.

In FY2012, the total pretax income for JA as a whole amounted to ¥238.9 billion. Of this amount, credit operations provided ¥251.0 billion and mutual assistance operations ¥152.4 billion; meanwhile, the cooperative activities (agriculture- and lifestyle-related business) lost ¥51.7 billion and farm management guidance activities lost ¥112.7 billion. The losses incurred by the services for farming full members, namely cooperative activities and the guidance provided through Zenchu, the Central Union of Agricultural Cooperatives, are covered by the profitable financial activities (credit and mutual aid).

The JA Bank group is seeing a decline in the share of its lending directed to agricultural concerns. At the same time, the proportion of long-term lending in JA's overall credit operations consisting of housing loans has been rising year after year, and as of FY2013 stands at 50.8%. This means that the red ink that JA bleeds in its agriculture-related operations for farming full members is covered by the profits from financial services (credit and mutual aid) used mainly by non-farming associate members. What is more, the associate members have no say in the management of the organization, which means that the full members are the ones deciding that the funds will be used in this way. The current situation in the JA differs widely from its original purpose as a collective organization. This deviation has a considerable influence on the operations of regional banks and other regional financial institutions.

8. Rising Pressure to Shift Business Models

As the population shrinks, leaving little chance for the pie to grow in the traditional banking fields of lending and deposits, we will likely see continuing tie-ups and mergers among regional banks within the same prefecture and even extending over wider regions. For regional financial institutions to secure long-term, continued growth, they will need to shift from a defensive to an offensive stance. By providing capital to prospective fields such as agriculture, medical and nursing care they can revitalize Japan's regions that face the challenge of population drain. It is precisely here that the true role of regional finance lies. Today these banks are showing relatively healthy financials. They must seize this chance to make full use of their deep roots in their home regions and create new capital demand.

Reference Works:

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