Japanese banks' handicap chase.

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TOKYO

At the heart of the Japanese financial system are three specialist banks that distribute long-term loans to Japan Inc—the Industrial Bank of Japan, the Long-Term Credit Bank of Japan and Nippon Credit Bank. The three are stubbornly opposed to Japan's financial deregulation. Yet deregulation could put them among the world's most powerful investment banks.

Along with the mighty Miti (the ministry for international trade and industry), the three long-term credit banks masterminded Japan's industrial "miracle". In 1952, they were given an exclusive right to raise long-term money by issuing bank debentures—cheap because interest rates were rigged. They lent this money to heavy industry at fixed rates—still cheap for the borrowers but highly profitable for the banks.

Led by the Industrial Bank of Japan (IBJ), the three have become the most powerful banks in Japan. More than 200 of the 1,000-or-so firms listed on the first section of the Tokyo Stock Exchange have ex-IBJ men among their senior managers. IBJ's shareholdings in Japanese companies are worth more than Y2 trillion ($8 billion). The bank retains particularly close ties to firms around Nissan Motor and Hitachi, Japan's biggest electrical company.

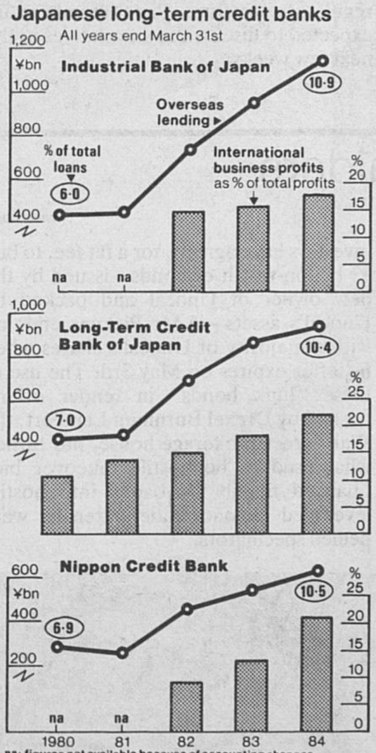
Before 1945, IBJ was the biggest underwriter of Japanese corporate bonds. When banking and securities businesses were separated, the long-term credit banks lost this right. But they could still underwrite government, local-government and government-guaranteed bonds, and be "lead commissioned bank" for corporate issues, ie, act as agent in disbursing payments and setting up collateral. Beyond this they are wholesale banks, taking deposits only from borrowers. About 80% of their resources come from bank debentures.

The three banks' basic business is now fading. Old customers in steel, heavy machinery, shipping and shipbuilding are in trouble. Long-term borrowing has shrunk and more of their outstanding loans look shaky. Between 1980 and 1984, IBJ increased its provisions against bad debts from Y1.4 billion to Y15 billion (16% of pre-tax profits); the Long-Term Credit Bank from Y363m to Y5.6 billion (9% of pre-tax profits); and Nippon Credit Bank from Y39m to Y4.6 billion (13%). Lending to medium-sized firms, big electric-power utilities and in long-term international syndications is healthier. But this patch is under threat from Japan's 12 commercial banks who want the right to issue debentures and make long-term loans.

Japan's schedule of financial deregulation is not working in favour of the long-term banks: lending is being opened up before deposit-taking. The commercial banks' fixed-rate deposits cost them 3-4%. They lend short-term at 5.5% and over, and (when they get permission) longer-term at 7.7%. The credit banks' debentures cost them around 7%.

They are responding in two ways. One is by doing more international business. Japanese banks are allowed to underwrite issues outside Japan and the long-term banks have been among the most energetic in chasing this business. In Eurobond underwriting, IBJ International in London ranks third among

Japanese long-term credit banks



na: figures not available because of accounting changes
Sources: Mikuni & Co; Company reports

Japanese firms (behind Nomura and Daiwa Securities) and Long-Term Credit Bank eighth. Nippon Credit Bank has been keener on syndicated lending. But margins on international business are narrow and costs high. Between April and September, 1984, the Long-Term Credit Bank earned 42% of its income outside Japan but only 26% of its profits.

The other response is to oppose domestic deregulation—with some success. Two examples:

- From April 1, 1985, all Japanese banks have been allowed to make medium- and long-term yen loans in the Euromarket; thanks to pressure from IBJ et al, such loans cannot be made to Japanese residents, the long-term banks' home base.
- Japanese companies are only allowed to issue straight bonds in Japan if they are secured by collateral. An electronic tape-maker, TDK, was the first to break that rule in January this year. The long-term credit banks are blocking further unsecured issues because they threaten to undercut long-term borrowing and because commissioned banks earn fat fees for arranging collateral.

A new role

The long-term credit banks' conservative attitude suggests that Japanese financial deregulation will be slow to come. Yet, if Japan ever dismantles the wall between banking and securities, it is these companies that will have most to gain. Armed with the best staff of all Japanese banks, huge reserves of capital, low overheads and peerless contacts with companies, they are ideally placed to rival Nomura, Daiwa, Nikko and Yamaichi Securities as investment banks.

IBJ, the smartest of the three, has close links with three medium-sized securities firms: New Japan Securities (the fifth biggest, of which IBJ owns 4.3%); Wako (4.4%); and Okasan (5%). If article 65 of the securities law (Japan's equivalent of America's Glass-Steagall Act which divides investment from commercial banking) is ever repealed, IBJ would absorb these firms to build its own broking and distribution network—still smaller than the big four brokers' but big enough to frighten them.

Long-Term Credit Bank and Nippon Credit Bank are weaker, but could follow the same path. Long-Term Credit Bank has effective ownership of a medium-sized broker, Dai-Ichi Securities (though it is only allowed formally to own 5%), and has other financial-service companies under its wing including Japan Lease, the country's biggest leasing firm. The need to sell bank debentures already gives all three long-term banks strong links with institutional investors and corporate treasurers.

Japan will only repeal article 65 if Glass-Steagall falls in America. In the meantime, the long-term credit banks' most likely strategy is a build-up of their investment banking overseas and a concerted lobby for rights to lead-manage Japanese issues overseas. The commercial bank Sumitomo's purchase last year of Banca del Gottardo in Switzerland could be a spur to some shopping by the long-term credit banks. A British broker or merchant bank would suit.