

**Towards Global Expansions of Japanese Companies
and Financial Institutions**

Public-Private Financial Roundtable

Global Expansion

Task Force

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1 Purpose

- ◆ Given the current trend of accelerating global expansion mainly in Asia by Japanese companies/financial institutions, the task force on global expansion (the “task force”) under the Public-Private Financial Round Table has been exchanging opinions since fall 2012, regarding current issues and necessary future actions from the perspective of providing support in the area of finance to Japanese companies, etc. that are expanding their businesses globally.

The FSA had been conducting interviews mainly with financial institutions in the past. This time, the task force decided to gather information directly from Japanese companies who are the overseas users of financial services, in order to understand the financial problems in foreign countries from the users’ point of view, and to reflect them in future public administration in the area of financial services. Specifically, the FSA conducted interviews individually with 27 entities consisting of both Japanese companies and financial institutions (associations), and obtained valuable opinions through the interviews.

Many institutions identified local regulatory issues as constraints on global expansion, especially that in Asia. In addition, the survey uncovered the situation that some companies cannot obtain the necessary financial services or fully utilize local financial services partly because the local financial markets and infrastructure are not well developed yet.

With a view to supporting the overseas expansion of Japanese companies, economic measures approved by the Japanese cabinet on January 11, 2013, incorporated a measure “supporting development of financial infrastructure in Asia: providing technical support to Asian countries for the development of their financial infrastructures (legal frameworks, settlement systems, etc.) in order to ensure the provision of sufficient funds for Japanese companies’ overseas activities.” The information collected by the above-mentioned interview survey will become a valuable source of reference when implementing the economic measure.

The following (sections 2 through 4) summarizes the status of global expansion by Japanese companies/financial institutions, finance-related challenges, and actions going forward, based on the comments and opinions gathered in the individual interviews conducted by the FSA with each company and financial institution (association).

2 Status of global expansion of Japanese companies/financial institutions

2.1 Status of global expansion of Japanese companies

- ◆ The rates of economic growth in Asian countries dropped significantly in 2009 but on average remains high, with the purchasing power of the high- and middle-income classes increasing year-by-year.

- ◆ According to the 2011 (41st) Survey of Overseas Business Activities (published by the Ministry of Economy, Trade and Industry), the number of overseas affiliates of Japanese companies at the end of FY 2010 totaled 18,599, of which 11,497 or more than 60% were located in Asia. The share of affiliates in Asia as a proportion of total overseas affiliates has been increasing every year.

- ◆ At the same time, investments from Japan to Asia appeared to become diverse. In the interview survey, wholesalers and other business operators have commented that their appetite for business expansion and other business activities in China is decreasing due to factors such as the increasing labor costs over the last few years. At the same time, an SME manufacturer of sanitary products has commented that it is primarily looking at Vietnam and Thailand, and would consider expanding its business especially into Thailand if long-term financing is available from the banks. We have received many similar comments.

- ◆ Furthermore, in terms of the trend of global expansion by Japanese companies, we saw a wider variety of companies starting overseas operations, in addition to an increased number of countries that Japanese companies invest in. A manufacturer of electrical products and many others have expressed their intention to increase the local procurement rate of parts used for local production. At the same time, from the quality control viewpoint, they have stressed their need for Japanese SMEs transacting with them in Japan to accompany their businesses overseas as well.

- ◆ Under the environment where different types of companies are investing in different countries, there are growing difficulties facing such companies in the host countries. An SME manufacturer of precision machines has commented that its sales branch in India had been unprofitable for 4-5 years after the start of operations. Lacking a sufficient flow of local information to Tokyo, the manufacturer also feels it is challenging to maintain a successful business in India.

- ◆ The interview survey has found that many companies have placed the central finance functions for their Asian operations in Singapore, not in Tokyo. A manufacturer of housing equipment commented that Singapore is a very convenient country for

business operations, as it is one of the major financial centers in Asia and is easily accessible with many available flights. A manufacturer of electric products has advised that for companies adopting Cash Management System (CMS), their Singapore operations have been playing the role of fund management for the Asian region as a whole.

2.2 Status of global expansion of Japanese financial institutions

2.2.1 General

- ◆ In response to those Japanese companies actively expanding overseas, mainly to Asia, Japanese financial institutions are also in the process of expanding globally to provide financial services. In recent years, Japanese financial institutions' motivations for global business expansion have been changing; for example, they are increasingly entering the Asian market in an attempt not only to provide support to Japanese companies, but also to capture opportunities in the growing Asian financial businesses.

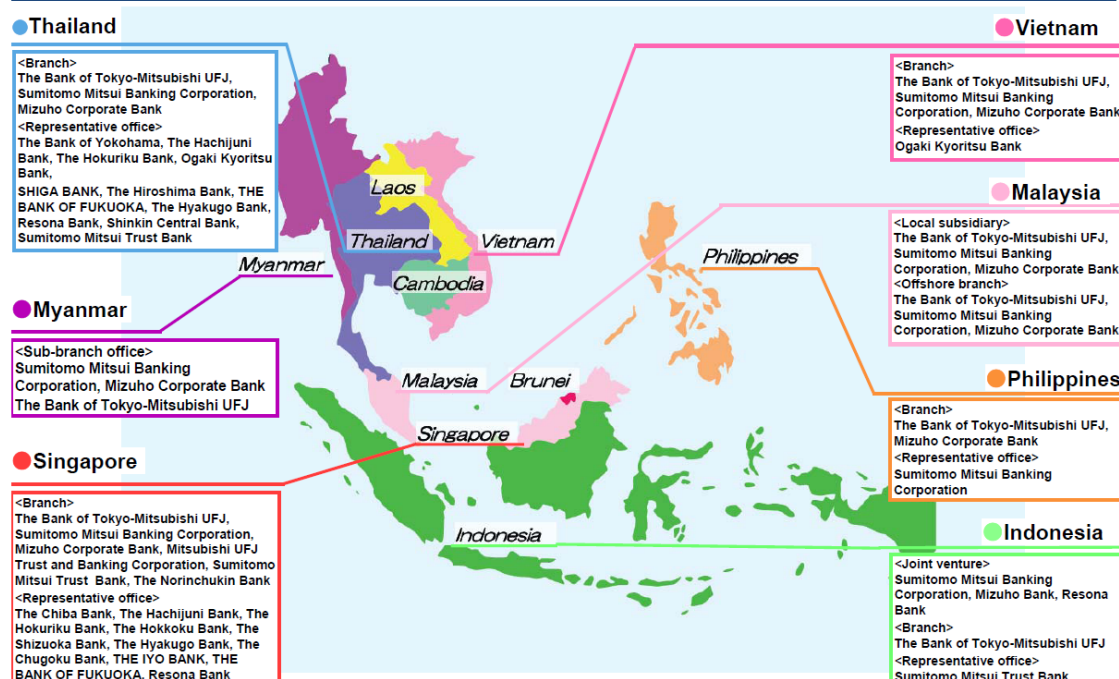
2.2.2 Banking sector

- ◆ Given the declining demand for borrowing in the Japanese market, major banks, for example, have set the improvement of their overseas revenue ratios as one of their management goals. As such, they are actively involved in the overseas expansion of their commercial banking and settlement functions by starting up local operations or forming strategic alliances with local financial institutions. Due to the financial crisis in Europe, the amount of credit extended to Asia by European financial institutions has been declining, and this, according to the Bank of International Settlement (BIS)'s Consolidated Banking Statistics, has been partially offset by active credit extension by Japanese banks.

In line with the SMEs accelerating their expansion to ASEAN countries, Japanese regional financial institutions are also increasingly expanding into Asian countries by setting up representative offices and/or business alliances with local banks, etc.

(Reference: Business Activities of Japanese Banks in ASEAN Countries)

Business Operations of Japanese Banks in ASEAN Countries (as of June 2013) (Thailand, Singapore, Vietnam, Malaysia, Philippines, Indonesia & Myanmar)



(Prepared by the FSA using various documents)

- ◆ The business activities of representative offices do not, however, necessarily generate earnings. In this regard, we have been advised that the costs associated with services provided by representative offices (e.g., provision of local market information, business matching and interpretation services, etc.) are not generally recognized by banks' customers as a source of additional fees, but are recognized as being included in the interest payment for the existing loans. On the other hand, there has been an opinion that in some cases these services could result in the banks expanding their lending businesses in Japan.

2.2.3 Insurance sector

- ◆ In recent years, Japanese insurance companies have been expanding to Europe and the U.S. through M&A and other means. They are also actively entering emerging countries in Asia with high growth potential. A general insurance company has advised us of their progressing localization with a higher share of contracts with local individuals/SMEs than with Japanese companies operating in the host countries. In addition, in terms of business expansion to Europe and the U.S., a life insurance company has mentioned that an increasing number of companies are making equity investments in asset management companies to strengthen their asset management businesses in addition to insurance businesses.

2.2.4 Securities sector

- ◆ The securities sector in Asia, where most countries have exchanges, is unique in that securities markets across Asia are at different stages of development, consisting of relatively developed financial centers such as Singapore and Hong Kong; countries with an emerging middle class where domestic securities markets are gradually developing; and developing countries with low income levels where regulatory frameworks are not yet fully developed. Japanese securities companies have been developing business in these Asian countries in various ways that are consistent with the development stages of such countries.
- ◆ In Asian financial centers, it is becoming increasingly important for Japanese securities companies expanding overseas to capture transactions with local companies as well as non-Japanese cross-border transactions (with Asian companies, between Asia and the U.S./Europe) in addition to the existing opportunities with Japanese companies such as support for stock listing, etc. In the countries with an emerging middle class where the domestic securities market is gradually developing, it is important to provide support to the local companies for stock listing on the stock exchanges in the host countries.

3 Financial challenges facing Japanese companies and financial institutions in global expansion

3.1 Challenges facing Japanese companies in global expansion

3.1.1 General

- ◆ When expanding globally, Japanese companies need to prepare a substantial amount of funding for purposes including equity investment in overseas subsidiaries, capital expenditure, and wages for local employees. The availability of sufficient financing contributes to the continuity of growth in host countries through the increased foreign investments and employment. In reality, however, due to various domestic circumstances/factors unique to the host countries, there exist a variety of regulations that constrain the financing activities of foreign companies' subsidiaries and prevent the support provided to them by foreign financial institutions. In addition, as the local markets become increasingly important for Japanese companies to provide their products and services, the procurement of local currency will become the key issue. In this regard, the financial markets and infrastructure that are not fully developed can become an even greater bottleneck.
- ◆ The individual interviews conducted this time have identified the issues for Japanese companies in terms of regulations, financial markets and infrastructure. The following section provides the major comments and opinions obtained through the survey.

3.1.2 Opinions obtained in the interview survey

(Issues concerning local regulation)

- ◆ Specific regulations constraining the financing activities of foreign subsidiaries include capital inflow/outflow regulations (including restrictions on overseas borrowing, foreign currency loans, and local currency export), exchange control regulations, and regulations on interest rates (against intra-group loans). While it is most desirable to integrate all the existing financing subsidiaries into one and centralize financing activities across Asia, the above-mentioned regulations necessitate the placement of a financing subsidiary in each country, making the financing and fund management inefficient (comments by companies using CMS). We have received many comments similar to this.

- ◆ In terms of implementation of the regulations concerning reporting, licensing and approval, many companies have advised us of the uncertainty in applying regulations, excessive window guidance, and the difficulty of smooth communication with the relevant authorities, delaying the processing of new applications. Further, a wholesaler has noted the challenges in observing the regulations even within the same country, because, in some countries, regulatory practices differ from one state/province to the other.

- ◆ Concerning capital inflow/outflow regulations, even the reporting requirements can interfere with group fund management because the adjustment of excess/shortage across the region should be ideally made on a daily basis (comment by a company utilizing the CMS).

(Issues concerning local financial infrastructure)

- ◆ In view of the local financial infrastructure not being fully developed, many companies have noted the difficulty of borrowing in local currency (particularly long-term borrowing), high interest rates on borrowings (especially on borrowings from local financial institutions), and foreign exchange risk having to be taken by the subsidiaries due to an underdeveloped foreign exchange (swap) market for the local currency.

(Issues concerning local trade practices, etc.)

- ◆ In commercial transactions based on credit, fund management is difficult in a country with a local trade practice allowing part of the sales amount (receivables) to be collected one year after the date of sales (comment made by a SME manufacturer of precision machines).

- ◆ Where the banks with which SMEs have business relationship have no subsidiary or branch office in the host country, these SMEs have more difficulty than large corporations and are not able to obtain funding from local financial institutions at an attractive interest rate, amount and period. Some Japanese banks (even if they have no operations in the country that their customers are located) issue stand-by letters of credit (L/C) to the local banks to cover the customer's credit risk, allowing the SMEs to readily borrow the local currency. However, in other cases, local banks do not accept the stand-by L/Cs issued by such Japanese banks or some local banks do not take stand-by L/Cs at all.

(Reference)

"Development and Strengthening of a System of Support for SMEs' Entry into the Asian Region, etc., under a Partnership between Japanese Financial Institutions, the Japan Bank for International Cooperation (JBIC), the Japanese External Trade Organization (JETRO) and Others" (published by FSA, Ministry of Finance, and Ministry of Economy, Trade and Industry on December 21, 2010)

1. Provision of information and consulting

- (1) (i) Japanese financial institutions will send staff to JETRO's offices in Japan and Asia; and (ii) Japanese financial institutions and JETRO will cooperate by sharing information etc., and providing information and consulting services to SMEs or their overseas subsidiaries
- (2) JBIC and Japanese financial institutions will cooperate and provide information and consulting services. JBIC, based on the customer needs identified by Japanese financial institutions, will execute Memorandums of Understanding (MOU) with the relevant local financial institutions. Then Japanese financial institutions will send staff to the Japan desk in the relevant local financial institutions.

2. Provision of funding

With the view of making borrowing from local financial institutions easier for SMEs, JBIC and Japanese financial institutions will cooperate in such a way that (i) JBIC makes lending available to the local financial institutions; and (ii) Japanese financial institutions provide credit support, such as guarantees, to the local financial institutions.

- ◆ SMEs have a limited number of Japanese staff that can be sent to the host countries; thus many of them appreciate not only the provision of financial services but also the provision of information on the local markets; advice on setting up local operations,

extending customer bases in the local countries, and back office functions, such as labor relations, tax, and legal affairs; and the setting up of business meetings/opportunities for discussions (comments by a financial institution).

3.2 Challenges facing Japanese financial institutions in global expansion (based on the interview survey)

3.2.1 Issues concerning local regulation

- ◆ For banks, securities companies, insurance companies and other Japanese financial institutions expanding globally, local regulations that are directly related to the entry into the host countries and the expansion of their businesses in those countries are one of the most challenging issues. Typical examples of these regulations include: cap on foreign equity participation, single presence policies that restrict setting up a subsidiary (branch office) in addition to the existing branch office (subsidiary), restrictions on the employment of foreign executives and staff (including sending staff to the local allied bank), and residency requirements for certain company executives. Other than these specific regulations, we have been advised that there are cases where the entry/business expansion by foreign financial institutions is effectively limited due to the slow approval process for start-up/expansion of local offices and the start-up of new business.

- ◆ Other than regulations regarding entry, there are a variety of regulations applied to financial institutions doing business in the host countries. Such regulations include loan-deposit ratio requirements, priority sector lending requirements and restrictions related to foreign exchange which, even though applied equally to both foreign and local institutions, would have a greater impact on Japanese financial institutions (i.e., foreign financial institutions from the viewpoint of the local country) because their business models and customer bases are different to those of local financial institutions. Furthermore, there are regulations that constrain the scope of business and impact earnings directly (e.g., for insurance companies: mandatory reinsurance concessions to the state-owned reinsurers and mandatory requirements to underwrite vehicle liability insurance on unfavorable terms and conditions).

Separately, we have found that there are cases where foreign financial institutions are in a relatively disadvantageous position as they fully comply with the regulations whereas local financial institutions do not comply with such regulations as strictly as foreign financial institutions do.

- ◆ In the insurance sector, it should be noted that establishing a comprehensive sales network and meeting local demand for insurance is the key for success. In this regard,

a regulatory environment that limits the setting up of branches and M&A activities will create barriers to entry, even when Japanese insurers try to develop relationships with potentially stronger partners on their own.

3.2.2 Issues concerning local financial infrastructure

- ◆ Section 3.1 noted the need for further improvement of local financial markets as a non-regulatory issue. Additional non-regulatory issues for Japanese banks include the underdeveloped infrastructure for credit support such as collateral/guarantee system, credit rating agencies and public credit support schemes. For trust banks, there is no equivalent business, or the trust business is not widespread in some countries. Securities companies face difficulties with an incomplete legal framework in relation to securities/exchanges and investment trusts. Furthermore, sometimes it is not easy to find eligible investment targets (i.e., candidates for stock listing) due to the lack of companies practicing appropriate bookkeeping and preparing financial statements. Issues for insurance companies include small market size due to the economy still being in the process of development, no market penetration of disaster insurance, and excessive competition.

- ◆ Also we have been advised that in providing financial support for Japanese companies expanding into Asia, Japanese financial institutions are faced with challenges such as the need to provide an ample supply of local currencies and the management of credit risks specific to the local countries that are difficult to be fully covered by the private sectors only.

3.2.3 Issues facing Japanese financial institutions in providing services to Japanese companies

- ◆ For Japanese banks expanding globally, finding ways to satisfy the financial needs of Japanese companies is key. In this regard, while Japanese companies highly regard Japanese banks' detailed services in the Japanese language, they compliment U.S. and other non-Japanese banks for their enthusiasm for transaction services. As such, Japanese financial institutions should endeavor to strengthen their services in relation to CMS businesses. In addition, Japanese financial institutions are expected to provide advice as to the coordination/interaction with the relevant finance-related authority (mentioned by a number of Japanese companies) over the local regulations. Further, we have found that some companies use local financial institutions for depositing cash/cash from receivables because even if Japanese banks have local operations, the number of bank branches is limited due to restrictions related to regulations, etc.

Japanese regional financial institutions are finding it difficult to meet fully their

customers' needs for information, advice and business matching. This is because their capacity does not allow expansion or operation in every Asian country even at the scale of representative offices, while their customers operate in a wide range of countries in Asia. It is also important for Japanese regional financial institutions to improve earnings by satisfying the above-mentioned customer's needs. Some SMEs commented that the ancillary services provided by Japanese regional financial institutions were valuable but have not resulted in executing transactions with them due to the lack of CMS.

4 Future actions

- ◆ Through the task force's individual interviews, we have confirmed that Japanese companies value the Japanese private financial institutions/governmental financial institutions for providing financing, settlement services, information services and business matching. However, we have also confirmed that there is a strong expectation for further efforts for future. At the same time, there is a strong hope for financial regulatory reform and further improvement of financial markets and infrastructure in the host countries (Asian countries, etc.) in which the Japanese companies and financial institutions have business activities (see sections 3.1 and 3.2).
- ◆ In response to the issues identified through the interview survey, we consider it necessary to maintain active efforts going forward by formulating action strategies by country/sector through cooperation among the relevant public and private sectors. For example, it is useful to utilize the outcome of financial cooperation agreements with Asian countries such as the ASEAN + 3 Bond Market Forum (ABMF) and Credit Guarantee and Investment Facility (CGIF).
- ◆ In order to achieve regulatory reform overseas, it is necessary to understand the rationale/background of the regulations in question, and present the potential benefits of their reform to the relevant authorities in the host countries.

(Note)

For example, regulations related to the transfer of capital and foreign exchange often reflect lessons learned from past events, such as the 1997 Asian financial crisis, each country's capital account structure, and the status of development of each country's domestic financial market and foreign exchange market. Regulations regarding the entry of foreign investment may be in place for protecting and developing the capital of own country; employment regulations for job security of local people; and the priority sector lending requirement for protecting/nurturing the relevant priority sectors. We need to understand clearly that regulations related to financial services

often reflect necessities out of the broad range of economic policy and in some cases social policy.

- ◆ Further, instead of one-sidedly requesting regulatory reform, it is essential to have the mindset of “grow together with host countries (Asia)” by supporting the host countries’ efforts to develop and improve their financial markets and infrastructure. That is, it is important to create a positive cycle of developing the environment in which Japanese companies can pursue businesses smoothly via providing support for developing financial infrastructure in the host countries, thereby promoting the host countries’ economic growth, and capturing such growth for Japan’s economic growth through the business activities of Japanese companies. Support should be provided in line with each country’s circumstances, such as the development stage of the local financial sector.
- ◆ The FSA has been providing support for the development of financial infrastructure in Asia. These efforts include support for Vietnam to develop financial/capital markets (invited staff of the State Securities Commission of Vietnam for seminars) and support to legislate a Myanmar Securities and Exchange Law (in cooperation with the Policy Research Institute, Ministry of Finance, Japan). The FSA also introduced Japan’s earthquake insurance system for reference and supported Thailand to set up a natural disaster insurance fund after the flooding in 2011. Providing technical assistance using Japanese systems as above will then contribute to structuring markets that are highly compatible with Japanese systems. Such a view is reflected upon one of the major measures in the Emergency Economic Measures for The Revitalization of Japanese economy approved by the Japanese cabinet as of January 11, 2013 - Providing technical support to Asian countries for their development of financial infrastructure (legal frameworks, settlement systems, etc.) in order to ensure sufficient fund provision for Japanese companies’ overseas activities.
- ◆ Going forward, in order to promote activities such as the above, it is essential to strengthen relationships between the FSA and the relevant overseas authorities by increasing dialogue, holding seminars and sending personnel, and continuing to provide technical assistance to countries in Asia and other regions that are useful for improving financial systems, financial infrastructure and financial administration.
- ◆ The impact of financial regulatory reform on the long-term financing necessary to sustainable economic growth has become the focus of recent international discussions. In promoting dialogue with the relevant authorities in Asia and other regions, it is important to have discussions from such a point of view and jointly raise our voices in

a constructive manner to encourage global financial regulatory reform, while ensuring that sufficient funding is available for economic growth.

- ◆ Going forward, the progress and outcome of the initiatives discussed in this report need to be monitored continuously. As such, it is essential to set up periodic meetings where related parties in Japan (FSA, related organizations and non-governmental experts, etc.) exchange opinions, and share the latest information/issues in order to follow the progress in the initiative as a whole so that our efforts can be improved and enhanced.