

**The Japanese Financial Industry:
Desirable State in the Medium- and Long-Term
(Present State and Future Outlook)**

[Summary]

**1. Towards a New Financial Industry
(A new phase for the Japanese economy)**

The Japanese economy is moving into a new phase. Amid the further diversifying of people's values, Japan is becoming a country at the forefront of entering the age of a declining and aging population with a falling birthrate. At the same time, as emerging countries in Asia and other regions continue to experience high growth, Japan has embarked on a journey to becoming a mature creditor nation. Whereas these structural changes raise difficult challenges, they generate new kinds of wants and needs among Japanese firms and individuals. This is opening new possibilities for financial services. In such a situation, Japan has maintained the stability of its financial system thanks partly to a relatively substantial safety net, in contrast to North America and advanced European countries, where restoring financial system stability has been an issue in recent years. Furthermore, there are worldwide moves afoot to give a positive reappraisal to the business model based on commercial banking, which is common among Japanese financial institutions.

(Towards a financial industry creating value that wins the admiration of customers)

The Japanese financial industry is requested to respond actively to the new demand emerging at home and abroad with the full mobilization of both savings and investment. To this end, the financial industry needs to get an accurate grasp of customer needs and create value that wins the admiration of customers, by fulfilling its primary functions, such as the risk conversion function and the information production function. This will be accompanied with Japanese financial institutions' reinforcing of their capacity to develop and sell financial products and services for which customers will be willing to pay a price. What are needed for this include: (i) formulating management strategies with a greater emphasis on the customer perspective, (ii) building business foundations necessary for executing the strategies, and (iii) developing human resources, all the while securing diversity among different financial institutions.

The Japanese financial and capital markets, on the other hand, need to provide an investment infrastructure befitting Japan as an investing nation. In addition to being the base of investment activities for Japanese firms and individuals, it is desirable that Japan's markets will also become the hub of the global flow of funds, especially in Asia.

2. How Financial Institutions Should Be

(Global expansion of corporate financial services)

Japanese enterprises, including small and medium-sized enterprises (SME's), begin a full-scale process for their overseas expansion. Japanese financial institutions need to support this by exercising the risk conversion and information production functions. To make such contributions, the financial institutions are required to expand globally with adequate breadth (expansion of branch networks, including alliances and joint branches, and development of settlement system networks) and adequate depth (localization of financial services, such as increasing the local customer base). This requirement can be met by Japanese financial institutions' improving of both tangible (global networks of overseas bases and information systems) and intangible (expertise and human resources) management resources, and by their strengthening of management strategies and capabilities so as to develop and establish the management resources in the medium- and long-term. These efforts make it possible to envision that some Japanese financial institutions may transform into truly global players with the ability to accommodate demand from global companies, including non-Japanese-owned ones, for financial services.

On the financial market front, Japan's financial and capital markets need to develop into those serving as the hub of the global flow of funds. This will entail further acceleration of improving financial market infrastructure, including reinsurance markets and systems, thereby enhancing their international attractiveness.

(Local expansion of corporate financial services)

Japanese regional economies have continued to be battered mainly due to the backdrop of population decreases. Because of this, (i) the rehabilitation and revival of local SME's and (ii) the general revitalization of individual rural communities are becoming urgent issues. It is also becoming an issue how to strengthen fund provision for the promotion of new industries in rural areas, including those related to medical and geriatric care, and the environment and biotechnology, and for the New Town Planning, including compact-city projects. These issues require Japanese financial institutions to enhance both the risk conversion and information production functions in local economies. What are needed for this include: (a) expanding financial institutions' ability to discern the business potential of customer local enterprises; (b) building up their roles in "industry, academia, finance + government" collaboration; and (c) broadening their means of taking risks that do not depend on real estate for collateral. To address these needs, the financial institutions will have to move on with attaching further importance to the customer perspective in the formulation of their management strategies, and also with making necessary organizational improvements of business foundations through enriching their human resources, expertise and financial capacity. At the same time, it is hoped that the types of suppliers of funds in regional economies will be increased, including several kinds of investment funds.

(Personal financial services)

Personal financial services form the most important segment for the financial industry. The challenge is to promote the effective utilization of the 1,400 trillion yen of household financial assets as well as to respond appropriately to a wide variety of needs of services users. Such agenda require Japanese financial institutions to enhance their capacity to develop and sell investment products by attaching further importance to the perspective of individual customers. What are needed to meet this requirement include (i) cultivating sales personnel so that they will assume the professional responsibility, and (ii) making efforts to improve the transparency of commissions and other costs for financial products and services. In addition, to link the financial assets of individuals to economic growth, it is beneficial that defined contribution pensions and institutional investors will intensify the activation of making investments and providing loans in areas of growth, and that new channels to mediate individual financial assets, such as microfinance-based funds, will be explored.

Apart from individual customers' needs related to their asset management, they go about their daily lives with several needs for financial products and services. For the accommodation of this kind of needs, it is indispensable for Japanese financial institutions to make efforts in several business lines, including insurance, trust, and loans, to develop and sell financial products and services well in concert with the Japanese demographic changes as well as the diversification of individual values. This will also make it necessary for the financial institutions to review how their sales channels ought to be.

As premises for Japanese financial institutions to make those efforts, an environment needs to be developed in which individual customers are able to get a clear understanding of their own needs and are able to make purchase decisions based on sufficient information and plentiful options. What are needed for building such an environment include nurturing independent financial intermediaries and neutral financial advisors, as well as reviewing the state of the production and sales separation for financial services.

3. The Roles of Government

As further importance is attached to the customer perspective in the financial industry, further development will have to be made in Japanese financial administration. In addition to viewpoints of stabilizing financial functions, securing fairness of the markets, and protecting users, a viewpoint of improving and revitalizing financial functions will be more relevant than before. Such a financial administration will employ an approach to advance the Better Regulation and provide the greatest support for the initiatives of private financial institutions. The financial authorities will be required to make efforts for public-private collaboration, in which they utilize dialogue with private financial institutions to look together for solutions. Japanese financial authorities would also be required to coordinate closely, not just with the financial industry, but also with a wide range of other players, such as relevant authorities in Japan and overseas, government-affiliated financial institutions, and local governments.

For example, to support the global expansion of Japanese financial institutions, what Japanese financial authorities would be required to do include: (i) working on foreign authorities to do regulatory reviews; and (ii) building cooperative relationships with government-affiliated financial institutions. As for Japan's financial and capital markets, the financial authorities will have to facilitate such strong and attractive infrastructure that the Japanese markets can attract funds from home and abroad, especially from other Asian countries. In order to support local expansion of corporate financial services, what the financial authorities would find it significant to consider include: (a) reviewing financial regulations; (b) developing an environment which encourages financial institutions to actively exercise their functions, including the risk conversion function; and (c) promoting an environment conducive to financial institutions strengthening their human resources and business foundations. For the enhancement of personal financial services, it is important for the financial authorities to create environments helpful for strengthening human resources, improving financial literacy, supporting the entry and development of new players, and developing and providing financial services in flexible response to changes in the needs of individuals.

4. Future Efforts

It would be profitable to establish a platform for sustained dialogue, such as a public-private roundtable, where the financial industry and financial authorities set tasks and goals from a shared point of view, and then they collaborate towards achieving those goals. At the round table, consideration would be given to the idea of adding financial services users to the mix of public and private to work on the development of codes of conduct (principles) in the financial industry that can be shared by all three groups in a sustained manner. The roundtable would also be a platform to promote specific public-private collaboration initiatives. It could be useful to formulate and share action plans for challenges to be tackled respectively by the public and private sectors.