Financial Crisis and the “Big Bang”

Yasuyuki Fuchita

1. Financial Crisis: Its structure and countermeasures

Three types of credit contraction

Since autumn 1997, markets in Japan have fallen into unprecedented event where three fires of credit contraction are obvious. First, banks restrict their lending to companies. Second, the providers hesitate lending money in view of borrower’s credit standing in inter-bank market. Third, individuals refrain from depositing their funds to financial institutions. These are the credit contraction in question (see Figure 1). When the funds often fails to flow smoothly from final providers to the borrowers here and there, the outcome would be sluggish economic activities, which leads to expansion of bad loans, and loss from share and real estate holdings, and further shrinkage of credit. In response to the obviously critical situation that overshadows Japan after a year from its declaration for the Big Bang in November 1996, some commentators even speak of suspending the implementation.

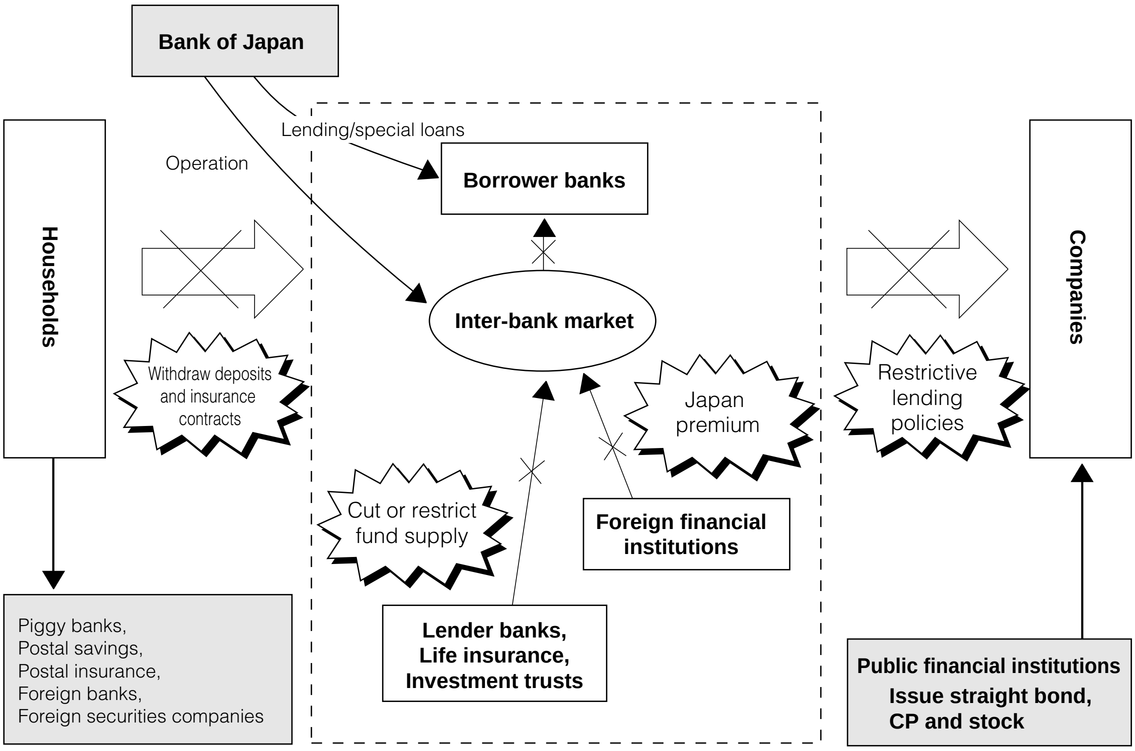
It goes without saying that the movements towards the Big Bang do not bring the crisis. In 1990s, financial sector in Japan has come to be overwhelmed by two burdens: one is lack of competitiveness due to continuation of “convoy system”, and the other is bad loan problems after de-bubble period. Japan’s declaration for the Big Bang was an explicit commitment to solve the former problem through implementing competitive principle by thorough deregulation. As for the latter problem, however, Japan has postponed its essential resolution by taking stimulative measures such as tax cut and increased public expenditures, expecting optimistically for recoveries in stock price as well as land price. Eventually Japan has reached the point of no further postponement, and is required to deal with the second issue directly just like it decided to do for the first issue.

The convoy’s voyage

These two problems are not independent. Looking into the background reveals that lack of inherent competitive principle resulted in accelerating the bubble process via uniformly expanded real estate investment. Lest that maneuvering mistake in the late 80s, there would have been no bad loan problems as the reaction. Proper recognition that the convoy system is the initial origin of current financial crisis would allow no option of avoiding the crisis by suspending the Big Bang and maintaining the convoy march.

Drawing a diagram that illustrates the movements of financial issues in Japan so far would help us certifying this point. Financial markets in Japan after World War II have boosted

Figure 1. Three fires of credit contraction



Souce: Nomura Research Institute.

massive economic growth through delivering funds, in convoy, from earnest savers to the borrowers who eagerly continued to invest in equipment. Services and rates of financial institutions were regulated to be uniform to avoid "excessive" competition, though, they were proud of safe and secure delivery.

Bubble economy in late 1980s means that the convoy had significantly deviated from its original course. When the stock and land prices started to soar in response to the countermeasures for economic slowdown that was caused by strong Yen, financial institutions achieved their freedom in part under the calls for liberalization and internationalization. Enjoying the freedom, they expanded direct and indirect finance for landholdings while seeking to increase profits as well as market shares. Higher returns mean higher risks. Despite of that simple truth, financial institutions kept on bearing their platform that fitted to the convoy system. As the result, they focused on higher returns at hand without being fully aware of their risks. This led to equally excessive loan expansion across the industry.

Consequently, current situation is that the convoy started to deviate from the course, and many of its vessels are faced with imminent crash into a huge iceberg. Indeed, there were opportunities to correct its course in early 1990s, i.e., at the time when some credit associations started to collapse, or when the authorities began to deal with the problem of housing loan companies. Regretfully, Japan postponed the resolution. Since it was optimistically expected that rebounds in land and stock prices would automatically correct the course in some day. In other words, although some small vessels ran into much smaller icebergs, the whole convoy failed to regard the accidents as a serious warning. Thus they failed to make necessary decisions for causing a drastic change in their course, basically wishing for another favorable wind to blow.

In reality, the course was never corrected. Now the crash into iceberg is imminent because of adverse winds in 1997 including deteriorated economy due to consumption tax hike and heavier social insurance burden, bank's restrictive lending policies in view of prompt corrective action, crisis in Asian currency and economy, and adjustments in the U.S. stock market. Some vessels already crashed into the iceberg, and others suffered from too heavy damages to continue the voyage on their own. Anxiety prevails among the passengers onboard the rest of the vessels, and the uneasiness increasingly hinder smooth operation of the vessels that are expected to avoid the crash.

Once the day for the Big Bang has dawned, individual vessels would compete with each other through lower freight or better services. They do allow the credit after assessing accompanying risk. Therefore, the course may differ by vessel, there will be no danger of taking a wrong course and heading for an iceberg. Though some vessels may deviate for some reasons, hereafter the captains would promptly receive the orders for correction from the supervising body according to its prudential policies. That is what is going to happen after the implementation of prompt corrective action system.

But the iceberg is before their eyes now. In addition, inertia interferes with individual vessel's turning around using their own engines. Even worse, their decisions of cautious lending policies, which are taken in preparation for prompt corrective action measure, have reinforcing effect on the adverse wind, or weakening economy, that blows them into the iceberg.

Three measures for escape

There are three possible measures that would help us to escape from the crisis. The first action is to save the passengers who are onboard the wrecked vessel and are in peril by sending rescue boats. That means providing necessary protection to the depositors through deposit insurance. Until March 2001 remedies are provided for all the passengers onboard the vessels now, as they got on the deck under the confidence that the vessel is safe and seaworthy, in addition to insufficient explanations about its seaworthiness due to insufficient disclosure system. This may cause shortage of funds to build and dispatch additional rescue boats, so the authorities provided official back up of Yen 10 trillion worth government guarantee and Yen 7 trillion worth government bonds for the rescue operation of depositors.

Commentator said that let the deviated vessel crash into the iceberg as that's the reality of the Big Bang, and that only the passengers should be rescued. Some vessels are still seaworthy; however, with most of the crews have experience, expertise and capabilities to sail a ship although captain and some officers were to blame. Besides, when the vessel goes down, its consignees, or the companies that used to rely on the cargo (funds), will suffer from damage even though the passengers are to be rescued. The consignees should found themselves in difficulty to rely on the other vessel in the heavy current of prevailing restrictive lending policies. Thus the collapse of financial institutions will be a big problem not only for depositors but also for financing parties. In addition, the social cost for the lost vessel itself and its crews is not negligible. In view of these factors, opinions that focus on the countermeasures to send tugboats so that the vessel would leave from the iceberg gain strong support. More specifically, it's the argument of permitting the banks to issue preferred stocks or permanent subordinate bonds and buying them by officially backed up funds. This method naturally invites criticism that why should we save the failed financial institutions. Nevertheless, the authorities opted for providing total Yen 13 trillion (Yen 10 trillion worth government guarantee and Yen 3 trillion worth government bonds) in preparation for the rescue operation.

The third measure is to send favorable winds to help the convoy leaving the iceberg, as they were originally blown into that dangerous spot by adverse winds. Corporate tax cut and Yen two trillion worth special tax cut proposal were considered in this line. Additional proposals are also on the table, as one of the main drivers of adverse wind stands for the introduction of prompt corrective action policies on banks. These proposals include flexible application of prompt corrective action policies that is to be implemented from April 1998, appropriate actions to allow the financial institutions to have options in purchase cost principle for stock valuation or implementation of special tax treatments to facilitate the reevaluation of real estate holdings.

2. Dawn of the new era: macro-economy goes sideways with micro-economic earth-breaking changes

Imminent depression?

As mentioned at the beginning of this article, we are in an unprecedented situation where many Japanese financial institutions are on the verge of wreckage and three fires of credit contraction are catching simultaneously. Accordingly, it is no wonder impeding sense of crisis is produced as if the financial sector depression may break into overall economic depression. But we must keep our heads as we are not in the 1930s but in the age of much sophisticated monetary systems.

Although each of the above mentioned three countermeasures may be controversial in respect to the content, timing of implementation and overall scale, we should reconfirm that these official intervention would enable us to escape from whole economic crisis, refraining from producing unreasonable sense of crisis.

One of the reasons that caused disputes in the argument is insufficient consensus in regard to the judgement for the level and direction of economic activities in Japan. If we are heading for depression, extraordinarily large-scale actions should be taken. On the contrary, if we were in a stall under relatively strong economic activities, it would be of no use to make a big fuss. At this point it is clear that Japan has another problem, since both of official and private views separated in these two extremes.

Then what was the reason behind this? It seems that authorities, who were undoubtedly not fully aware of actual situation of the economy as well as occurrence of unprecedented financial crisis, has led to produce anxiety and sense of crisis among the private sector. The situation is clearly symbolized by the fact that Japanese government kept on announcing rather optimistic figure of 1.9% for estimated real GDP growth for FY 1997 for too long.

It means that the state, even though they have the most vital tool for the escape, would not be able to exploit it as long as they hold arbitrary judgement for the economic situation. Another lesson of current occasion may be that Japan needs to build up the system that allows the state to perceive its economy with calm and objective eyes.

It goes without saying that the other view, which alleges that Japan is heading for overall economic depression, is an extreme argument built on premise where the state constantly fails to take effective actions with continuous support of its people. For example, Japanese economy in 1930s contracted by the scale of 20% or 30% in terms of nominal GDP. But we can hardly find the signal for similar development now. Besides, it is unreasonable to assume that both the state and its people would not try to make a change in the adverse development until the arrival of catastrophe.

Japanese Economy Research Group at NRI (Nomura Research Institute) expects that nominal GDP growth of FY1998 (0.0%) will be lower that that of 1997 (0.8%). The growth rate is lower than the previous year, though, the figure reflects that the economy is going sideways in terms of nominal GDP, which situation is far from depression where the rate collapses by the scale of 20% or 30%. Further, looking at the real term reveals that expected GDP growth of FY1998 (0.7%) will be slightly higher than that of FY 1997 (0.0%).

Management under zero nominal growth economy

Zero growth in nominal term surely means that it changes little from the previous fiscal year. The story is, however, for macro-economic point of view. It should be noted that micro-economic point of view, which focuses on individual industries or companies, sees the other picture: the age of earth-breaking changes.

So-called financial Big Bang will have enormous effects not only on financial industry but also individual company management. Of course the company in general will have benefits of lower cost, better products and improved services in dealing with financial institutions which will be put under real competition. It should be pointed, however, that when the financial institutions are driven to act on the basis of competitive principle or market principle, they are also forced to change their inter-depending relationship between the industrial firms. Those companies that are unable to cope with such changes in the business environment may be left behind, as the government's countermeasures for economic and financial crisis should be designed to provide the protection exclusively for the companies that have inherent strength to survive from extra damages.

In these consequences, current movements for restrictive lending and dismissal of interlocking stockholding should not be regarded as temporary phenomena under three fires of credit contraction. We should consider that they are likely to stay with us as part of the common principles in Japanese financial and capital markets after the collapse of convoy system.

Some companies grow while the others are on the decline. Thus the overall nominal growth may show no change from the previous year as we aggregate both of these companies' added values. In fact, the gap between the winners and losers are increasingly expanding. Therefore, it is inevitable to believe that, unlike the good old days of overall growth for year after year, the performance depends on management proficiency to the large extent.

Japanese economy in cyber-sphere is booming

It is certain that some business area shows massive growth even in the context of zero growth. Take quick look into current development of electronic commerce will provide clear evidence for that. Virtual shops on the cyber network recorded 7500 outlets at the end of 1997, which is more than twice for the previous year[1]. Indeed, 400 or 500 new shops have opened per month in and after

---

1 Source: NRI Cyber Business Case Bank (http://www.ccci.or.jp/cbcb/) presented by Cyber Infrastructure Research Center of NRI (1997.12.25).

the last summer. The traditional statistics of Japanese newly opened business entities suffer from decrease, but there are no signs of weakness in the growth of entrepreneur's activities on the cyber network market. In this connection, it is not too much to say that cyber network version of Japanese economy is entering into the era of rapid growth.

The sophistication of those cyber shops' web sites is continuously enhancing. Digital images, sounds, moving pictures and this and that of high-tech features enables even the amateurs to design excellent web sites on the Internet. Supporting tools, including digital camera and a variety of software products, are rapidly spreading. Thus such Phenomena in cyber economy will lead to positive effects on the real economy. As we can see, Japanese children are absorbed in taking care of their favorite Pocket Monster electronic game character to turn into stronger one, or in modifying Mini-4WD model racing cars to run faster. Similarly, the situations of new breeds of business men and women in the cyber economy compete in building more sophisticated homepage may be a best fit for Japanese sense of creativity. In this connection, current lower PC price, in reaction to the boom at one point, may invoke genuine demand for it hereafter.

The year 1998 would be the first year for us to become familiar with electronic money and electronic payment system. In fact, large-scale experiments will take place in busy shopping streets in Shibuya, Omiya and other location for electronic money system that uses IC card as medium. Also, four major firms of Mitsubishi corporation, Toyota Motor Corporation, Nihon Sekiyu and Family Mart Co., Ltd. have already allied together to start issuing electronic money. Inventions of small payment system via Internet appears one after another. To name a few: Cyber Chip System (managed by Pega Japan Inc.) and Acosis (by Acom Co., Ltd.) that debuted in 1996 are followed by NET-U (by U-Card Inc. of NTT Group), QQQ (by Fuji Software ABC Inc.), BitCash (by Aprix, KDD, Topan Printing, Marubeni Corporation, Sumitomo Metal Industry, Sumitomo Bank and Trust, with additional investment from Avex Trax, NEC and others), P-Click (by Nomura Finance and NRI) in 1997. Experiments for E-Cash of DigiCash, also started (by NRI). In this year we expect to see further development, spread and establishment of these electronic transaction system. Moreover, SET (Secure Electronic Transaction) will be implemented in full scale in 1998 Spring. SET is a new security system that ensures safe and secure credit card and bank transaction on the net. Consequently, we can enjoy shopping at the virtual shops on the cyber network more easily and safely than before.

As such, electronic money and electronic payments are no longer the sanctuary of bank. Indeed, they already start to develop involving many non financial firms as mentioned above. Taking the opportunity of the working group on electronic money and payments, Ministry of Finance set forth their policy that they will not limit this business to conventional banks on the basis of mindset for financial Big Bang. It should also be noted that customers frequently use new payment methods for Internet shopping, that bypasses traditional bank system, including on-line payment, cash-on-delivery collection by the forwarders, and payment at the convenience shop counters.

In short, we are about to see the birth of new economic and financial field where the same old orders or vested interests are meaningless. Now a certain part of economic activity is already substituted by the cyber network which is booming. It is very likely that there will be increasingly wider gap between those companies and financial institutions that successfully take a ride on this new wave and those who failed to do so.

3. 1998: Challenges for financial institutions and markets

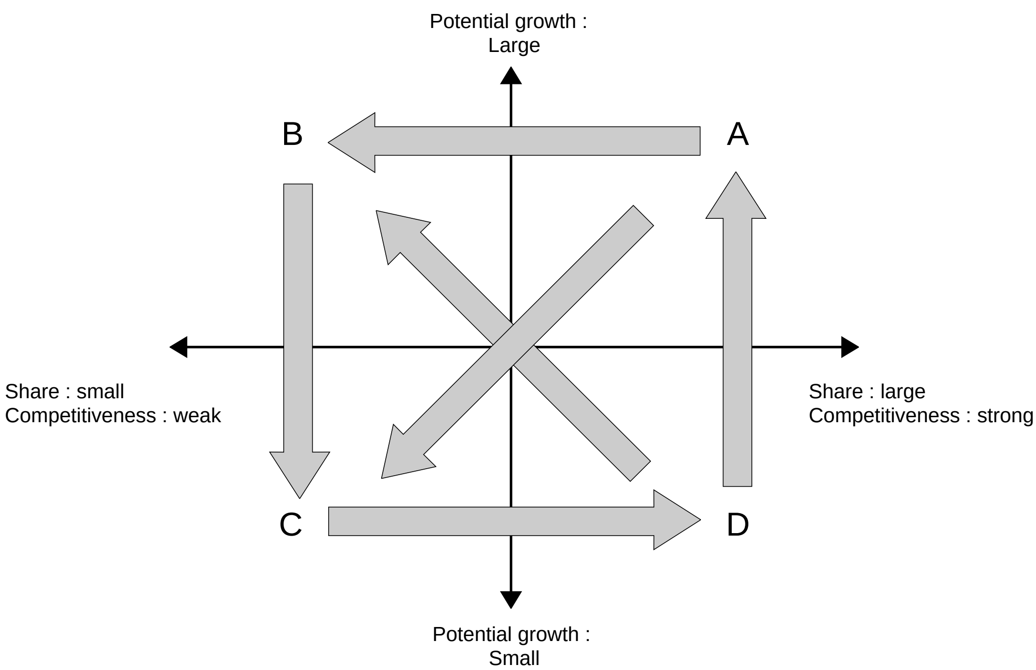
Let's get started with recovery of confidence

It is not easy to have clear perspectives that allow us to determine what type of business or services to do in the age of earth-breaking changes. Conventional management strategy theory usually tells us that we should 1) establish and maintain our core competence area (A in Figure 2) in the rapidly growing area, 2) keep on securing "cash cow", or cash-flow in the apparently competitive area with lower growth potential but higher market share namely (D), and 3) boldly enter into smaller market share or less competitive area with greater potential growth (B).

In reality, for example, banks used to exclude other businesses and earned a certain amount of cash flow in low-growth Area D business such as transaction and remittance. Then came electronic money, electronic payment system and many new entrants under amended Foreign Exchange Law. Consequently, now the banks find that Area D may turn into Area B business where they are not sure about their strength. As well, once banks thought that they needed to reinforce the equities business, considering it as a growing business, or Area B business. However, lifting of fixed commission and rapidly spreading Internet may drive (at least) simple brokerage business into a "loser's business" or Area C business with lower growth and smaller share. Moreover, even in the competitive area with larger market share (i.e., Area A and D business), many participants may suffer from collapsed competitiveness or market share as the banking, securities and insurance sectors are entering into each others' business operations, with scores of new entrants from foreign companies and non financial sectors. In short, there may be no scope for existing map of industry structure to remain unchanged in the Big Bang era.

Thus we are required to comprehend potential growth of the markets and operations as well as our own resources more than ever before, since we are in the age of uncertainty. Nevertheless, at

Figure 2 . Risks in the business portfolio under the age of earth-breaking changes



Souce: Nomura Research Institute.

least many of the Japanese financial institutions have to apply certain management strategies without fail. Those who concerned must acknowledge that it might be too early to talk about entries to other business areas before successfully implementing the strategies. In other words, current situation questions the most fundamental part of financial institutions that refers to their significance of existence. That is, they must first show clear evidences that can win depositor's confidence for safe and secure fund management.

Customer protection as management strategy: not regulatory mandate

In fact, both of households and companies are increasingly shifting their fund to seemingly more safeguarded financial institutions since late 1997. That means that, at the same time, it is the best time for those financial institutions that can safely keep customer's asset in custody with credible management to appeal these strengths.

To our regret, many of Japanese financial institutions are merely bent on achieving designated BIS's target capital adequacy ratio or prompt corrective actions policies, all of which are established by the authorities. What is more, many supportive actions are introduced, including flexible implementation of prompt corrective action policies, change in accounting practices for the valuation of stockholding, and further special tax treatments to facilitate reevaluation of real estate holdings. Similar actions were already introduced to life insurance companies. But we should not forget that prompt corrective action policy is a preventive measure that provides health checks for financial institutions in the earliest stage so that any troubles can be fixed immediately. In some cases ill-managed institution should be sent straight to the hospital for rehabilitation under strict supervision of doctors. In this connection, so called "flexible" implementation is nothing but permissive criteria for hospitalization, which is basically far from positive treatment. Nobody could expect, however, that loosening criteria for high blood pressure would cure the patient suffering from high blood pressure. From the viewpoint of customers, it is natural to select healthier financial institution that parallels to the athletes in Olympic Games or the National Athletic Meet rather than those who stand on the borderline for hospitalization.

One of suggestions would be that it is important for the financial institutions to take a new standpoint that lead them to achieve their own solid criteria so that they can discipline themselves without being suspended in between the optimism and pessimism brought by arbitrarily adjustable criteria of the authorities. In fact, currently announced amendments of the Capital Adequacy Directive deploy the new concept of "internal model approach". The approach encourages the bank to assess them for the risk by using the most appropriate model for that bank, and urges the authorities to acknowledge it. Thus there should be no uniform risk assessment formula nor forced uniform standard figures. Further, more progressive concept of "pre-commitment approach" is already proposed by FRB. These new concepts are produced on the basis of a simple, common notion that private sectors should naturally be well equipped than the authorities in terms of expertise for grasping the risks in financial business and responding properly against that. Also, not a few U.S. securities firms provide more protection for the investors than provided by SIPC by having agreements with private insurance companies at their expense.

Similarly, it would be worthwhile for Japanese financial institutions to achieve such mindset not only as a defensive strategies to cope with current crisis but also as an aggressive strategies to gain customer confidence and market share.

The same story goes for securities firm. In the industry now there are arguments for more stringent legal system that mandate completely separate management of clients' assets. Rather than implementing it reluctantly by the force of the law, individual firms should take this occasion to introduce it proactively as part of their strategies.

Now it is clear that those firms that, as financial and/or capital market professionals, proactively carry out greater customer protection measures than required by the authorities should win significantly large customer confidence as a result, although they have to absorb considerable amount of cost in short term.

Proactive movements to meet official standard earlier than the competitors are frequently observed in other industries, i.e., appealing the new product that pioneers in meeting some ecological standards. But Japanese financial industry, which tends to be bound by the sense of uniformity, has lacked such perspective.

The most fundamental factor to survive through heavy competition in the Big-Bang era is neither a matter of new product nor the implementation of new service. The customers want credible banks and/or securities firms to do business.

Time to build capital market in the true sense of the word

On the other hand, one of the main themes of 1998 for Japanese capital market is to create the market in the true sense of the word from scratch. It has been 120 years since stock exchanges were established in Tokyo and Osaka. However, Japan hardly had stock market in the true sense of the word. The stock market in Japan was for speculation with bulk of transactions were in the form of futures on individual shares with far less liquid cash market before 1945, when World War II ended with the old order. In turn, post-war stock market in Japan virtually had no real competition as the authorities and the players adopted convoy system. Then, here comes the dawn of Big-Bang era, which brings in competitive principle. Thus we are about to stepping into the new age when, for the first time in the history of Japan, we have to create the stock market in the true sense of the word.

In other words, what is required for us is not to "restore" but to "innovate" the market. Those who address to restore the stock market often tend to focus on the recoveries of stock price or turnover. No matter how high the stock price rises or how large the turnover grows, it is quite another story for the definition of the right market. It is reasonable for the market to move downward, for example when the economic and corporate situations are deteriorated, properly reflecting these factors.

Nevertheless, it appears that the authorities increasingly opt for taking superficial countermeasures to push up declining stock price since the last year, partly due to concerns on accounting profits on financial institution's stock holdings, which are partially regarded as Tier II capital in the calculation of capital adequacy ratio. Undoubtedly, such maneuvering should lead to spoil the market in turn. The stock prices should reflect economic and company situations. Accordingly, necessary countermeasures are the ones that can improve such fundamentals. Definitely, recoveries in stock prices or turnover should be neither direct objective nor means of economic policies.

Needless to say, it is our substantial task to create the stock market, in the true sense of the word, that exactly reflects economic and company situations. Therefore, the actions for reform that launched at the dawn of the Big Bang must be implemented in compliance with underlying spirit. That should be another important subject of 1998 for us.

Meanwhile, full-scale development of CP and corporate bond markets should contribute to alleviate the current credit crisis issued by Japanese firms. The restriction on the usage of proceeds of CP and corporate bond issues are lifted for non-banks in 1998, and another restriction, which is placed in order to delay Euro yen bond being purchased by Japanese investors, is also to be lifted in April. At present, CP and corporate bond markets are not sufficiently matured to complement restrictive lending policies of financial institutions, although the deregulation process is advancing. That is because Japanese financial systems have long been too dependent on indirect financing through banking system. So we have to pay the cost of it by providing solutions for some outstanding problems in our system, to allow the issuers, brokers and investors to take the actions that pay more attention to actual market rates, and to maintain necessary market infrastructure.[2]

4. The state and businesses: intrinsic value in question

Flight to credibility

One of major goals of the Big Bang is to correct the money flow mechanism in Japan, which was biased to prefer fixed and low risk instruments, to expand the share of instruments with varying returns based on the performance of firms and projects. But so far all the participants have taken more risk averse actions, shifting funds to safer financial institutions or to financial instruments. Now is hard to find the investors who take risks for funding those businesses that have huge potential in the coming century.

Japan's Big Bang is meant to lead Tokyo markets to become comparable with the Wall Street or the City of London. Then what has happened this 12 months after Japan's explicit commitment for the Big Bang? In reality, Japanese financial institutions turned out to be troublesome as implied by a series of failures. Meanwhile U.S. and European financial institutions actively transforming themselves through series of merger and acquisitions in view of enhanced competitive environments surrounding financial industries toward 21st century, widening the gap between foreign and Japanese financial institutions. Furthermore in this 12 months, contrary to the goal of strengthening Japanese market, there seems to be the growing trend among Japanese investors to shift their Yen denominated assets to Dollars, causing Yen to be weaker.

In other words, the financial crisis has inclined the people not only to focus on low-risk financial assets, but also to encourage them to increase Dollar denominated assets, which means that they are not necessarily selecting assets based on the risk measured in terms of the variances of returns. Both of these trends in domestic markets, namely the trend to seek safer assets and preference to Dollar, have been brought by nothing but weaker confidence in domestic financial markets. People flee for seemingly more credible financial institutions in the domestic financial markets, whereas they also flee for Dollar as they give more confidence to Dollar than to Yen, or to American politics and economy rather than to Japanese politics and economy. In any way, the situation clearly demonstrates that people are in flight to credibility.

---

2 *For CP market issue*s, see Takeshi Inoue "Challenges in Japanese Commercial Paper Market", *Capital Research Journal*, Nomura Research Institutes, Spring 1998.

In this case, the familiar phrase of “flight to quality” may not be fit to the situation, as the people are not sure whether their destinations have higher quality. They are just stampeding into more credible objectives. As a matter of fact, established financial institutions and financial instruments have proved to be distrusted in domestic scenes, we can also observe new products including commodities funds, that are aggressively promoted by trading houses and non-banks after deregulation, are sharply growing. Therefore it should be noted that the funds are not necessarily heading for the destinations with higher quality. People shift their money because of credibility rather than safety or quality, appreciating the fact that their destinations are different from the established financial institutions or financial instruments whose images are badly tainted these days.

Establishing a reputation: From credit creation to credibility creation

As mentioned above, the top priority for Japanese financial institutions is to recover the credibility. However, that is their normal task as a matter of course. Meeting the requirements of prompt corrective action policy may well mean that the financial institutions need no hospitalization, but they are only allowed to stand at the starting point. Needless to say, the real competition is yet to start.

To win the race in the Big Bang era, it is certain that they should reassess their business operation as a consumer-oriented industry and focus on marketing and other related strategies accordingly. Also, they are required to invest in their information technology resources so that they can successfully stride through the tough business environment where financial industry transmutes into information technology industry. These processes naturally call for reviewing their own strengths and weakness and reallocating the resources as according to the priority, which may inevitably involve restructuring of the organization.

The entire processes mentioned above, however, can only be materialized on the premise that they recover and maintain the credibility. Furthermore, it is not enough just to recover and maintain the credibility. It is important to create the credibility. This creation of credibility means new added values that may become potential resources to win the competition.

Usually it is necessary for a financial institution to spend a considerable length of time before their customers and shareholders can find intrinsic value of it and feel OK to do business constantly and incrementally rather than thinking of it as apparently credible. In other words, the process of the credibility creation demonstrates the establishment of “reputation”. It is not easy to establish a reputation. It may not be difficult for some institutions may apparently announce to go for drastic business development or restructuring. These actions must, however, be properly reflected in actual routine activities of the institutions and even among their rank and file employees, so that customers and shareholders can confirm repeatedly through usual direct contacts. Otherwise no such actions will lead to a reputation. The word “reputation” originally came from a Latin word “reputare” or “think repeatedly”. A bit of etymology indicates a fact that a financial institution could establish its reputation for the first time only after it experiences repeated inspections by its customers and shareholders.

Currently the entire industries tend to focus on marketing. As well, financial institutions also become aware of brand strategy. Even those institutions that are rumored to be in a critical condition are highly geared for marketing activities. “Brand image” and “look like” may be added through marketing activities to some extent, however, enhancing “reputation” is quite another story.

What will happen after the flight to credibility is subsided? People would take a further look into the intrinsic value of a financial institution, and may seek to do business with the financial institution that has gained a reputation in any area. In this sense, foreign financial institutions are currently rather too highly assessed on the basis of impression, to some extent, that they gave to the Japanese. As the year unfolds such foreign financial institutions may well be reassessed. Further, foreign financial institutions will be challenged for their intrinsic value in regard to the quality of human resource as well as their business style for routine operations. So far nobody can tell whether a foreign financial institution may establish a reputation in Japan, which implies a further challenge. In that sense, both of foreign and established domestic financial institutions are standing at the starting point on an equal footing in this year.

It is also important for financial authorities and industry leaders to have a perspective for establishing a reputation for Japanese financial and capital markets as a whole. As a good example, the City's major policy targets include "maintaining a reputation" as well as "providing safeguards for investors". Financial institutions are required to act so that the reputation of London market is ensured[3]. Back to Japan we can see that the authorities expect that, taking advantage of the Big Bang, they upgrade Tokyo to become international financial center that is comparable to London and New York by 2001. Then we should learn such attitude by UK authorities. However, building a market with reputation is not an easy job, which cannot be accomplished just by changing laws and regulations. With deeper contemplation of this reality, the authorities as well as the players must take efforts to improve the quality of basic routine administrative procedures and business operations, hoping to accomplish their goals.

The state's confidence and reputation at stake

1998 will also be important in terms of confidence and reputation of the state. As mentioned in the beginning of this article, now the state renders, unlike the great depression days of 1930s, more sophisticated monetary controls. But such controls only effective when the state maintains the confidence of its people.

For example, Asian financial crisis demonstrates that shaky confidence in the state has extraordinarily strong impact on the economic and financial system. But again we are now prepared to offer the solutions, through the framework of post-war managed currency system: IMF takes a role of the central bank for the entire world economy by supplying international liquidity, even though its policies need some modifications these days

Apart from other Asian countries, Japan is one of the largest creditor countries. Coupled with constantly increasing current account surplus, Japan has no concern, for the time being, to become insolvent due to domestic financial crisis. Though as such, its favorable current account structure may well change in the long term depending on the policies at present.

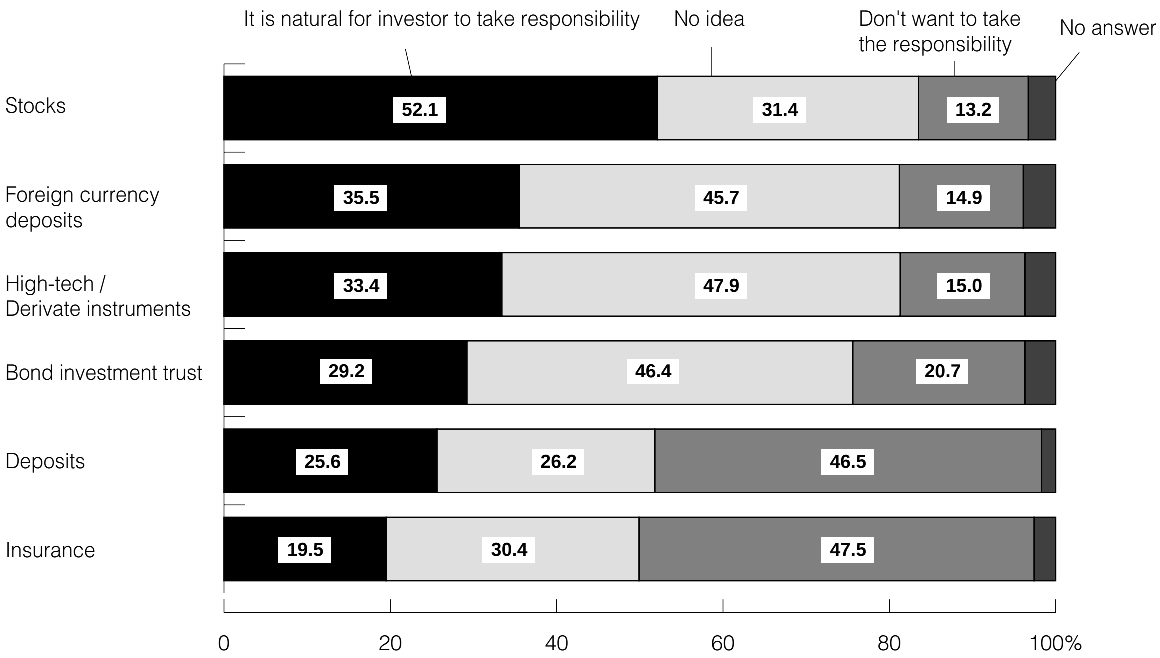
In this connection, it is certain that solutions, including special loans by the Bank of Japan, reinforced fiscal backup line and overall stimulus, are essential to prevent further deterioration of crisis. The question is, however, the matter of controllability. We must pay attention so that the government keep those measures under control to avoid, for example, to rescue private sector too

3 For instance, the expression of "reputation of the markets in London" frequently appears in "The London Code of Conduct", rules for wholesale financial institutions set forth by the Bank of England, i.e., "All firms (core principals and brokers) should ensure that they and, to the best of their ability, all other parties act in a manner consistent with the Code so as to maintain the highest reputation for the wholesale markets in London."

loosely.

In this aspect, it is highly concerned that, as illustrated by "Public Opinion Survey for Savings and Consumption", Japanese individuals have surprisingly weak sense of responsibility in their financial decision making (See Figure 3).

Figure 3. Sense of responsibility at the selection of financial instruments



Souce: "Public Opinion Survey for Savings and Consumption" by Central Council for Saving Promotion (1997).

If the Japanese politics caters to these people who might make reckless investments by keep providing government guarantees or various safety nets, we may well have to cope with further difficulties including piles of bad loans in the central bank's asset portfolio and additional increase of fiscal deficit.

Or otherwise, there may arise arguments to put too much of the burdens, or the cost of protections for depositors and investors, on private financial institutions instead of the Bank of Japan or fiscal budget. In this case, Japanese financial service industry would lose still more competitiveness. Even if private financial institutions had to carry some of the burdens, they should be requested to do so to the extent that prevailing law system permits. Obviously, the players in the world would determine Tokyo as a local market and perfectly withdraw from the new entries to Japanese markets when they find that Tokyo might suddenly impose them more contingent claims than that are explicitly notified.

The problem of confidence in the state may occur in short term. Japan would be distrusted if discussion and/or approval for the Big-Bang bills were delayed because of political disorder, or if the government repeatedly opted to ease the standard just in order to get out of a difficult spot (as they did when they reviewed prompt corrective action measure). Indeed, it seems that already weak Yen sends a signal for shaky confidence of global financial community in Japan.

In addition, Asian financial crisis should cast dark shadow over Japanese economy in full scale in this year, representing clearer impact in every aspect. Although it is still uncertain that how, or in what style, the impact spreads to currency, finance and real economy, there are several tasks that we have to do in order to minimize the negative effect. The top priority for us, needless to say, is to avoid distrust for Japan. As well, we will be required to consider what we can do, as a leading Asian country, for the recovery of confidence in the region. Thus the reputation of Japan will be a key point of 1998 in a double meaning.