Upsurge in Alliances and Mergers among the Financial Institutions

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There is an upsurge in tie-ups and mergers among Japan's financial institutions. In this report, we will first take a look at an outline of these movements and then attempt to make an evaluation and forecast future developments.

1. Various types of alliances involving Japan's financial institutions

From 1998, there has been an active upsurge in tie-ups and mergers among Japan's financial institutions. This has included the following announcements: in June The Nikko Securities and Travelers Group announced a tie-up, in July Daiwa Securities and Sumitomo Bank announced a strategic alliances, in September four Mitsubishi Group financial sector firms announced joint operations and there was an announcement of a strategic tie-up between Tokai Bank and Asahi Bank, and in October Dai-Ichi Kangyo Bank Group and J.P. Morgan announced a comprehensive alliance in the area of investment trust operations.

The linkages which have emerged transcend sectors such as banking, securities and insurance and they also cross borders. Japan's financial institutions are seeking to make massive changes in their nature simultaneously at a pace never previously seen.

The first full-scale tie-up movement after former Prime Minister Ryutaro Hashimoto announced Japan's Big Bang in November 1996, was in April 1997 and took the form of a business tie-up between Nippon Credit Bank and Bankers Trust. This tie-up involved 1) improving the liquidity of assets and their securitization, 2) Bankers Trust was to take over Nippon Credit bank's overseas operations in the areas of providing loan financing, leasing, project finance operations and M&A operations.

This tie-up took the form of support of Nippon Credit Bank's operations by Bankers Trust in view of the seriousness of the bad debt problem of Nippon Credit Bank and the continuance of operations in the wake of Nippon Credit Bank's withdrawal from overseas operations. An analyst at a major securities firm expressed the opinion that the tie-up between these two firms was evaluated as support for the restructuring plans of Nippon Credit Bank through the help of Bankers Trust rather than a strategic operation in line with Japan's Big Bang.

In this sense, the tie-up between Long-Term Credit Bank of Japan and SBC [*1] announced in July 1997 also had a similar nature. Both parties to this tie-up agreed to establish LTCB-SBC Warburg

*1 On December 8, 1997 SBC announced a merger with UBS.

Securities,[*2] a joint venture securities firm and LTCB-SBC Brinson Investment Advisory,[*3] a joint venture created to manage assets. In addition, measures to strengthen the equity capital of LTCB were also included.

Regarding the measures to strengthen the capital of LTCB, SBC agreed to be the lead manager for a capital procurement operation implemented by LTCB equivalent to 200 billion yen (preferred stock - 130 billion yen, subordinated bonds - 70 billion yen) and SBC acquired up to 50% of the issued preferred stock. Thus, a comprehensive cooperation operation was implemented.

Yamaichi Securities voluntarily went into liquidation, and prior to this in the autumn of 1997, the firm make strenuous efforts to enter into mergers and alliances with its main bank and foreign firms to try to save itself. If it had succeeded, it would have been a major rescue involving a realignment of the financial sectors.

In 1998, too, there were numerous cases of alliances and mergers forced by the need to strengthen corporate positions as in 1997. However, a major feature of 1998 was that there were many announcements of positive tie-ups and mergers in response to Japan's version of Big Bang as well as some tie-ups designed to reinforce the operational foundations of firms after injection of capital.

From here on, this report will examine several major alliances involving links between domestic and foreign firms as well as some between domestic firms.

1) Alliances between a Japanese firm and a foreign firm

(1) Strengthening of corporate fabric through the introduction of foreign capital

In Feburary 1998, it was announced that Toho Mutual Life Insurance and GE Capital entered into an alliance to establich a joint venture company and that the operations of Toho Mutual Life Insurance were transferred to the new company.[*4] This announcement was paid attention to as a tie-up to strengthen the fabric of the firm through the introduction of foreign capital. The newly formed JV is called GE Capital - Edison Life Insurance which started operations in April 1998. The company’s proprietary capital totals 144 billion yen, of which 72 billion yen are shareholders’ equity and 72 billion yen are subordinated loans. Although the amount invested by both companies is equal (72 billion yen), the capital with voting rights is apportioned 10% for Toho and 90% for GE Capital. Thus, in terms of its capital breakdown, the new JV became a 90% owned subsidiary of GE Capital. In addition, the sales network and sales assets built up by Toho were all transferred to the new JV. Toho itself dedicated its efforts to the management of existing contracts and asset management operations.

*2 LTCB Warburg Securities implemented a capital increase in the form of allocation of new shares (common stock) to third parties such as the UBS Group. As a result, the rate of investment in LTCB Warburg Securities by LTCB changed from 40% before the capital increase to 33.33%. (News release of September 22, 1998) Subsequently, on October 30, LTCB decided to sell all its stock (33.33%) in LTCB Warburg Securities.

*3 LTCB sold all its stock holdings (50%) in LTCB UBS Brinson Investment Advisory to the UBS Group, and it dissolved its joint venture in asset management operations. (News release September 22, 1998)

*4 For Details, see, "Alliance between Toho Mutual Life Insurance Co. and GE Capital", Takeshi Inoue, *Capital Research Journal,* Spring 1998

For Toho, which had fallen into difficulties in continuing its operations and new contract sales had become sluggish, this tie-up can be seen as a move to boost its strength.

In November, negotiations emerged regarding a tie-up with Daihyakyu Mutual Life Insurance and Manulife Financial of Canada. This tie-up is similar to that between Toho and GE Capital. In view of the details of this tie-up which include the establishment of a joint venture between Daihayku and Manulife during FY 1998, the JV would receive the sales network and sales assets of Daihyaku, and subsequently Daihyaku would cease to seek new contracts and engage in operations relating to existing contracts. However, Mr.D'Alessandro, the president and CEO of Manulife commented that[*5] the negotiations are still at the initial stage and there are many important problems to be solved. Thus, this tie-up is still unclear in many areas.

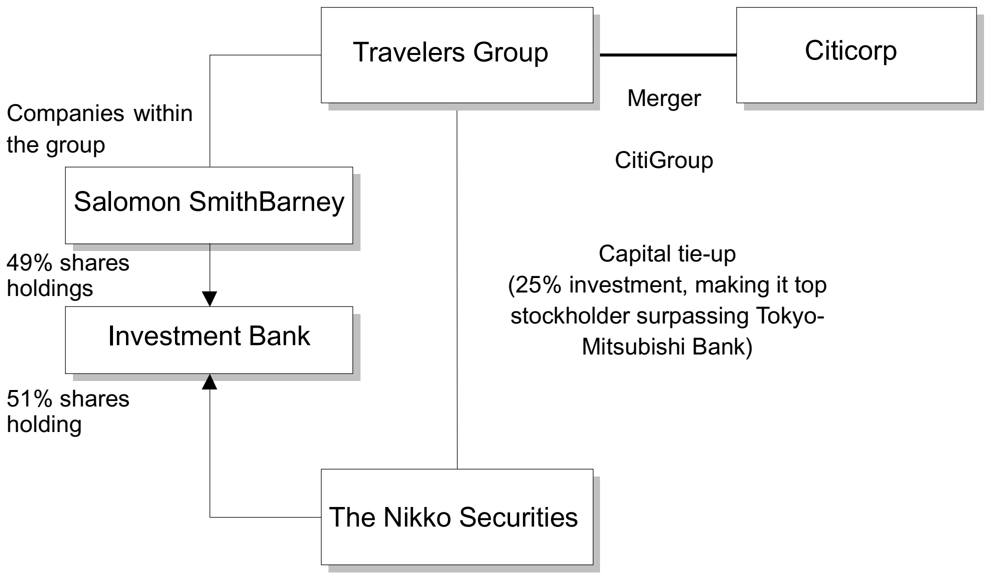
(2) Comprehensive Alliance

In terms of being a different type of development to the alliance formed to boost strength through the injection of foreign capital, attention was focused on the agreement on the establishment of a joint venture (Nikko Salomon SmithBarney) and capital tie-up between The Nikko Securities and Travelers Group announced in July 1998.

Nikko Salomon SmithBarney is scheduled to start operations in January 1999. The investment bank division, customer products division and Nikko Research Center (excluding some operations) currently within Nikko Securities will be handed over to the new JV as will the operations of Salomon Smith-Barney Securities (excluding the dealer basis transactions section). Regarding the strengths of the new JV in terms of trading operations and market making operations, Managing Director ... Mr, Asakawa,the managing director of the Nikko Securities commented that "The JV will be able to connect up supply and demand across borders". Mr. Weill, chairman and chief executive officer of Travelers places special emphasis on the Japanese corporate customer list held by the Nikko Securities, commenting that "If there had been no alliance with the Nikko Securities, even if we worked at it for ten years, we would only be able to acquire a small portion of the corporate customer list we now have.[*6]

*5 Manulife Financial's press release " Manulife and Daihayku Mutual Life Insurance ", November 19, 1998
*6 Wall Street Journal, June 2, 1998

Figure 1 Travelers and The Nikko Securities



Global alliances backed by the world's largest-sale sales capabilities and trading

1) Establishment of the joint venture Nikko Salomon SmithBarney Securities which will undertake trading, market making, underwriting, product creation and research operations.
2) Capital alliance --- Capital investment in the Nikko Securities by the Travelers Group
   About 220 billion yen (about 70 billion yen in common stock and about 150 billion yen in convertible bonds)
   Capital investment in the Travelers Group by the Nikko Securities
3) Integration of the Nikko Securities overseas offices with Salomon Smith Barney

(3) Asset Management Strengthening Type

Following on from the alliance between the Nikko Securities and Travelers, in July The Mitsui Trust and Banking and The Prudential Insurance Company of America announced their agreement in principle to jointly establish an investment trust management company in Japan. The new company, named Prudential-Mitsui Trust Investment Company, is a joint venture between these two firms established in October 1998.This is engaged in the creation, operation and sales of investment trust products.

Mr. Nishida, President of Mitsui Trust & Banking commented “It is very gratifying that we can offer investment trust products responding to the needs of customers in a joint operation with Prudential, a firm which is one of the world's largest integrated financial companies and has attained a secure position in the field of investment trust operations.” Thus, he is placing expectations on the know-how of Prudential in the area of investment trust products. Mr. Ryan, Chairman and CEO of Prudential commented as follows. “We are interested in operations aimed at Japanese customers. Mitsui Trust possesses an existing sales network and a customer base, and Prudential has the ability to create products and the world's largest asset management capabilities. We consider that this combination will enable us to supply products rapidly and in a short period of time in the age of swift changes due to Japan's Big Bang." In addition, it has become clear that both firms consider defined contribution pension plans (Japanese version of 401(k) pension funds) to be one form of asset management business and they are considering to engage in this sector through a joint venture at some time in the future.

In October, a comprehensive alliance was announced between Dai-Ichi Kangyo Bank and J.P. Morgan in the investment trust sector. In detail, this tie-up mainly involves the joint operation of an investment trust management firm established by Dai-Ichi Kangyo Asahi Investment Trust and Advisory and J.P. Morgan Investment Management. The emphasis will be placed on the establishment of joint brands in the areas of product development and sales.

Mr.Hosaka,Secnior Managing Director of Dai-Ichi Kangyo Bank(DKB) commented "that the DKB and J.P Morgan have a common way of thinking on the outlook for an expansion of the investment trust market and the importance of asset management operations in view of the advent of Japan's Big Bang. President Keith M. Schappert of J.P. Morgan Investment Management commented that, "this alliance is a major first step in terms of global-scale operations through a partnership with DKB, one of the world's top ranking providers." [*7]

In November 1998, a comprehensive alliance was announced in the area of asset management between Nippon Life Insurance and Deutsche Bank. This alliance includes 1) the sale of investment trusts developed jointly by both firms through Nippon Life's sales offices in Japan from December, 2) through its European offices, Deutsche Bank will sell Nissay Asset Management Investment Trust's products (an investment trust and advisory firm within the Nippon Life insurance Group).

Although the main stream of alliances is to facilitate the provision of foreign products in Japan, the provision of the products of Japanese financial institutions to overseas customer is a new feature found in this alliance with Japanese financial institutions looking overseas for markets to sell their products.

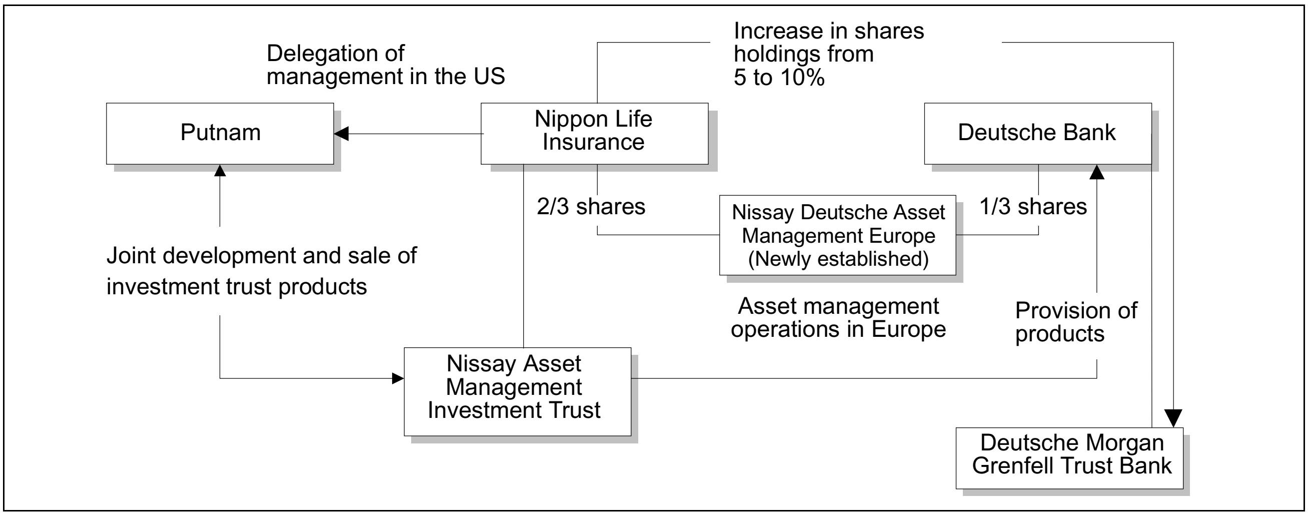
Nippon Life is not only engaged in the investment trust sector, but it is also poised to establish an investment advisory firm (Nissay Deutsche Asset Management Europe - tentative name) in London in a joint venture with Deutsche Bank, and it intends to farm out part of its own insurance and pension fund management operations to this JV. In June 1997, Nippon Life announced an alliance with Putnam Investment (a major US investment trust and advisory firm) in the areas of financial product development, asset management and an exchange of personnel. In combination with the alliance with Deutsche Bank, this will result in a management system covering Europe and the US.

The alliance between the Nikko Securities and Travelers was an attempt to achieve an overall strengthening of the corporate fabric by introducing foreign know-how in the wholesale sector and injecting capital into the retail sector and boosting both sectors. However, the following three alliances can be seen as movements to expand the investment trust market in Japan. These alliances between Japanese and foreign financial institutions have the advantage of allowing Japan's financial institutions to benefit from the know-how of the West in the areas of the establishment, operation and development of investment trusts. On the other hand, the foreign financial institutions seek to gain a foothold in Japan's market in view of the fact that the US mutual fund market is reaching maturity and

*7 "Comments by both firms on this alliance", supplement of Dai-Ichi Kangyo Bank news release, October 1, 1998 so they want to reach out to the new market of Japan. Thus, by forming alliances with Japan's major financial institutions, they seek to acquire sales channels without spending much time on this and to enhance awareness of their presence in Japan.

It appears that, in addition to its investment trust strategies, Nippon Life seeks to strengthen its global management abilities in view of the shift of clients engaged in the management of pensions to investment advisory firms as a result of a drop in interest rate that can be expected in the management of pensions by life insurance firms.

Figure 2 Nippon Life Insurance, Putnam and Deutsche Bank



2) Alliances and mergers among domestic firms

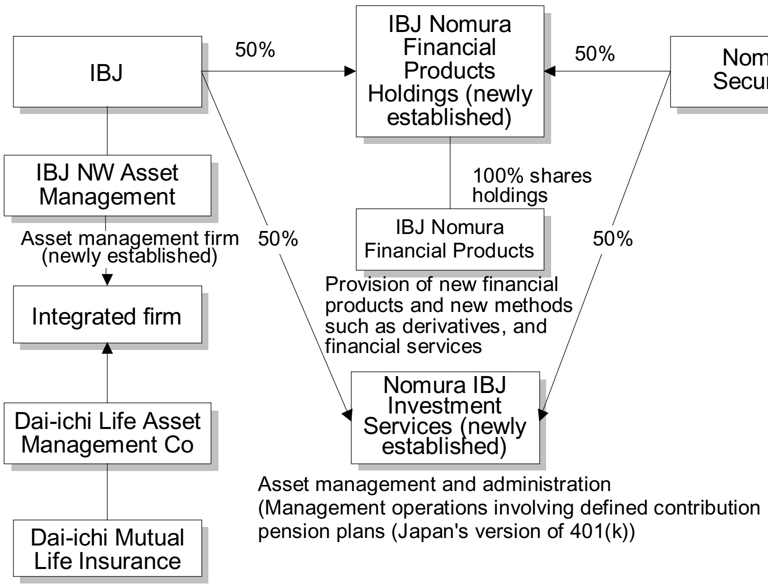
(1) A movement transcending sectors

In 1998, the alliance forming activities of Japanese firms transcending sectors showed considerable activity. In May 1998, joint operations by Nomura Securities and Industrial Bank of Japan involving derivatives and asset management sectors were announced. Regarding this, Mr, Junichi Ujiie, President of Nomura Securities and Mr. Shozo Nurishi (appointed as chairman of IBJ Nomura Financial Products, a joint venture), Industrial Bank of Japan commented that this will integrate Nomura's equity know-how and IBJ's credit analysis capabilities. In addition, Chairman Nurishi commented that up to now both firms have had excessively large organizations and have not been able to effectively respond to the needs of customers and so missed business chances. However, with its highly maneuverable organization, the new JV can respond effectively. This means that, by selectively choosing the operational areas and specializing in the relevant operations, the JV can respond to customer needs rapidly and flexibly.

In July, a strategic alliance was announced between Sumitomo Bank and Daiwa Securities in the area of wholesale securities operations, derivative operations and asset management. According to comments by Mr.Nishikawa, president of Sumitomo Bank, "there are limits to what a single entity can do" and this alliance is aimed at "achieving a spin off of a capital market operations firm". In this way, the object is to provide the optimal financial services.

In October, the full-scale business tie-up was announced between the Industrial Bank of Japan and Dai-ichi Mutual Life Insurance. It was also announced that as one aspect of this alliance, in November IBJ would implement a third party new shares allocation (issuance of 100 million shares) (to Dai-ichi Mutual Life Insurance) to the value of 67 billion yen.

Figure 3 Nomura Securities, IBJ and Dai-ichi Mutual Life Insurance



[Nomura Securities and IBJ]

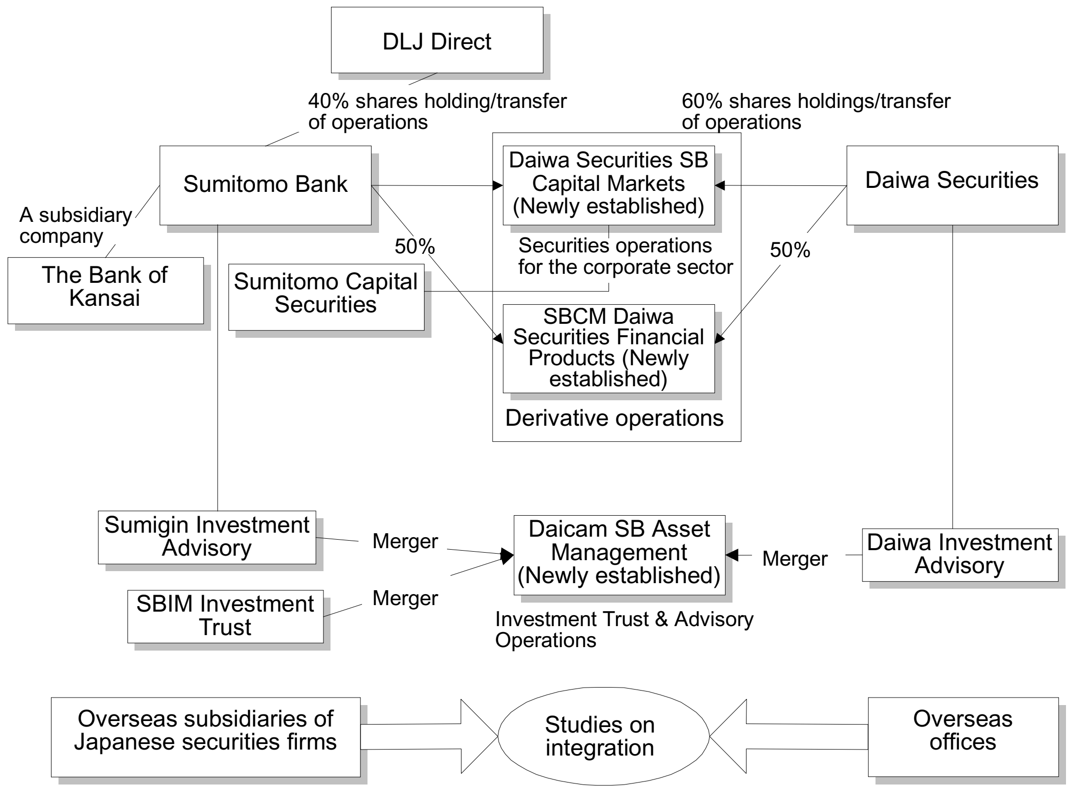
1) Global Financial Products operations - Provision of new financial products and new methods such as derivatives--- Establishment of joint venture, IBJ Nomura Financial Products
2) Asset management and administration - Provision of diverse management products such as investment trusts and corporate pensions and total control services
   • Establishment of Nomura IBJ Investment Services (tentative name)

[Alliance between IBJ and Dai-ichi Mutual Life Insurance]

Comprehensive alliance aimed at the creation of a strong cooperative relationship in all operational areas from the medium- to long-term.

1) Mutual augmentation of financial products and services in response to customer needs as well as their development and provision.
2) Asset management and administration operations
3) Establishment of a joint venture with the purpose of product research and development of new technology in the finance and insurance sectors
4) IBJ will implement third party new share allocation (issuance of 100 million shares) (to Dai-ichi Mutual Life Insurance) to the value of 67 billion yen. Dai-ichi Mutual Life Insurance will receive a subordinated loan from IBJ worth 100 billion yen.

Figure 4 Sumitomo Bank, Daiwa Securities and Sumitomo Trust & Banking



[Sumitomo bank and Daiwa Securities]

Strategic business alliance in the wholesale area

1) Joint ventures in the wholesales securities operations ---Daiwa Securities SB Capital Markets
2) Joint ventures in derivative operations---SBCM Daiwa Securities Financial Products
3) Joint ventures in asset management operations---Daicam SB Asset Management established to engage in investment trust and advisory operations in a joint venture.
   Studies will be made on infrastructure development such as system development and call centers etc. and product marketing toward the introduction of a defined contribution pension plan.

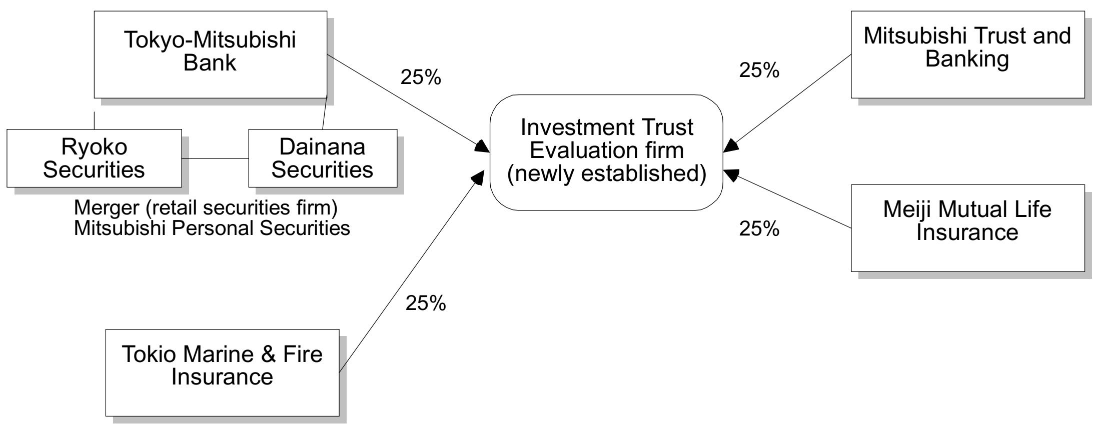
[+Sumitomo Trust & Banking]

- Sumitomo Trust & Banking has adopted the stance of full participation in an alliance with Sumitomo Bank and Daiwa Securities. It will be mainly engaged in system development work for defined contribution pension plans.

(2) Former Zaibatsu (Financial Conglomerate) Groups

There is a marked movement towards strengthening the cooperation systems existing among the former zaibatsu groups such as the Mitsubishi, Mitsui and Fuyo groups. For example, the joint operations of four Mitsubishi Group financial companies (Tokyo-Mitsubishi Bank, Mitsubishi Trust and Banking, Tokio Marine & Fire Insurance and Meiji Mutual Life Insurance) announced in September 1998. The details of this arrangement are as follows 1) joint establishment of an investment trust evaluation firm, 2) joint development of systems in view of the introduction of a defined contribution pensions plan (Japan's version of 401(K) pension plan), 3) cooperation system in the area of investment banking operations. This appears to be a move to achieve an efficient distribution of group assets by reinstating the system of close cooperating formerly existing among the zaibatsu group companies in new areas.

Figure 5 Mitsubishi Group



Joint operations of four Mitsubishi Group financial companies (Tokyo-Mitsubishi Bank, Mitsubishi Trust and Banking, Tokio Marine & Fire Insurance and Meiji Mutual Life Insurance).

1) Joint establishment of an investment trust evaluation firm--- This firm will undertake evaluation and selection as a screening process for sales through its own sales network ,covering all the investment trust products sold in Japan.
2) Joint operations in the area of defined contribution pension plans --- This firm will undertake joint development of system infrastructures for customer administration operations (record keeping, etc.) It will investigate the possibility of joint operations in the area of defined contribution pension plans.
3) Investment banking operations. --- The intention is to develop a securities company that can adequately respond to the needs of customers. This firm will center on Tokyo-Mitsubishi Securities, Tokyo-Mitsubishi International and Mitsubishi Shin Securities.

(3) Alliances within the same sector

A movement has appeared toward full-scale alliances being formed within the banking sector. For example, in September 1998, a full-scale alliance between Asahi bank and Tokai Bank was announced. In addition, in November 1998 a strategic alliance between Dai-Ichi Kangyo Bank and Fuji Bank in the area of trust business was announced. The alliance between Asahi Bank and Tokai Bank was the first such to take place among city banks (nationwide commercial banks) and they are engaged in a common operational strategy of concentrating operational assets in the areas of medium-standing and smaller firms and individuals. They are aiming at the establishment of a new financial group (Multi-regional bank) through an affiliation of financial institutions by region and sector. [*8]

*8 "On the Strategic Alliance between Asahi Bank and Tokai Bank", news release, September 28, 1998

Up to now, Japan's city banks have served a broad spectrum of customers covering everyone from individuals, medium-standing and smaller firms to the large firms. It is a new departure for such city banks to clearly launch out into specialization in the retail sector.

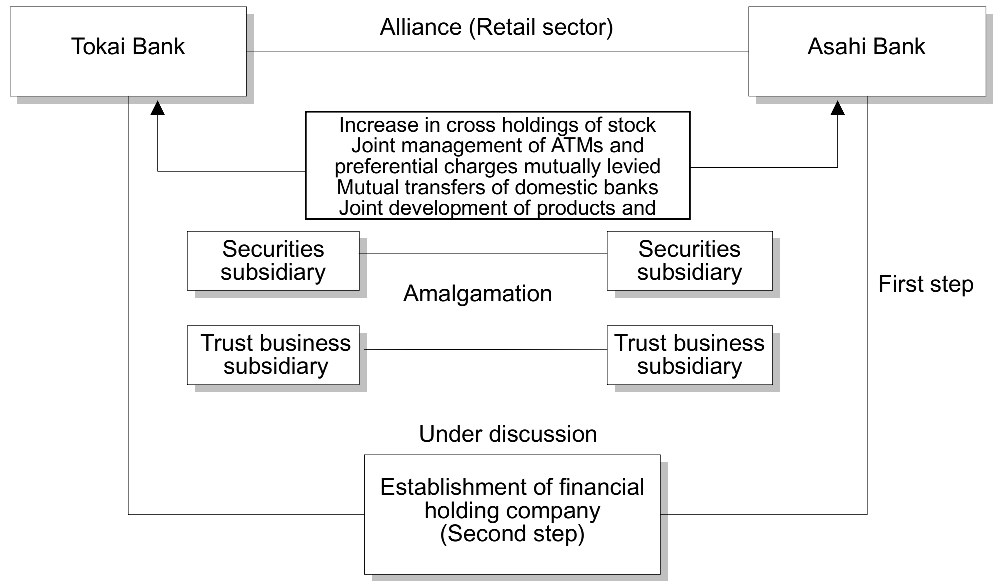
President Hideo Ogasawara of Tokai Bank commented that they have used the example of the NationsBank of the US in this alliance. The home territory of NationsBank is North Carolina, and it is a major regional bank with a network of about 3,000 branches and 7,000 ATMs serving the District of Columbia and 12 states. [*9]

This bank posts about 70% of its income from traditional banking operations. Thus, it becomes clear that Asahi Bank and Tokai bank are seeking to be a regional bank. Mr. Ito, president of Asahi Bank commented that it is better if we cover the areas not covered by the other bank in the alliance. This is not limited to areas, and we must also consider if it is necessary to complement each other's customer groups, too. And this indicates their commitment to retail customers.

Daiwa Bank also entered into an alliance with Bank of Kinki in October, and as in the case of Asahi bank and Tokai Bank, this shows that Daiwa Bank has taken the path to regional banking. That is to say, Daiwa Bank is strengthening its retail operations in the Kansai area and has engaged in a strategy to specialize as a super regional bank. Through the alliance with the Bank of Kinki, it is able to expand its branch network in a short period of time and achieve a competitive edge in terms of providing convenience to customers. In view of the adverse financial climate affecting Japan's financial institutions, both of these alliances place emphasis on effectively utilizing scale merits of the economy, rapidly building up their domestic networks and scaling down their overseas operations.

*9 NationsBank, Summary Annual Report (1997)

Figure 6 Asahi Bank and Tokai Bank



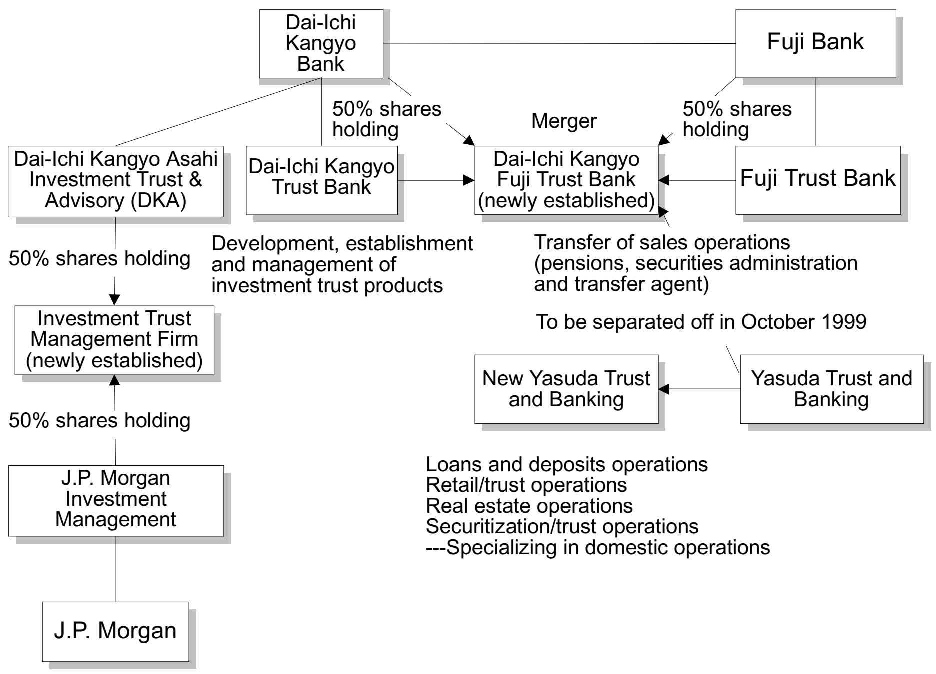
[First Step]

1) Improving convenience for customers --- Preferential ATM charges
2) Implementation of capital tie-up --- cross holding of stock, etc.
3) Concentration of sales assets --- mutual transfer of domestic branches, joint sales operations, reorganization and alliances in overseas branch operations and fund securities operations, reorganization and linkages among subsidiaries and affiliates.
4) Improvement in efficiency through joint development and joint operation of systems
5) Strategic response to Japan's Big Bang (private banking and investment trust operations, etc.)

[Second Step]

Creation of a new financial group centering on common financial holding companies with the participation of other prime financial institutions and other sector financial institutions.

Figure 7 Dai-Ichi Kangyo Bank Group/J.P. Morgan and Fuji Bank Group



[Dai-Ichi Kangyo Bank Group and J.P. Morgan]

Development and provision of top class investment trust products with outstanding brand power

Provision of continuous counseling services for investment trust customers

1) Establishment of investment trust management firm ---Development, establishment and management of investment trust products
2) Development of alliance relationships --- to be studied if both Dai-Ichi Kangyo Bank and J.P. Morgan Investment consider it necessary

[Dai-Ichi Kangyo Bank and Fuji Bank]

- Merger of trust bank subsidiaries of both banks and implement a strategic alliance in the area of trust business
- Transfer of sales operations of asset management division (pensions, securities administration and transfer agent) from Yasuda Trust and Banking
- Studies on a multifaceted alliance between the new Yasuda Trust and Banking and Fuji Bank

    Mutual use of ATMs
    Alliance in private banking operations
    Total transfer (consignment) of bill clearing to Fuji Bank
    Implementation of virtual banking by Fuji Bank, Yasuda Fire & Marine Insurance, Yasuda Trust & Banking, and Yasuda Mutual Life Insurance
    Joint management of back office operations

2. Evaluation and Outlook

The movements outlined here are all based on press releases and publicly released information such as newspapers and magazines. There may well be hidden intentions, circumstances and plans lying behind this series of mergers and alliances. Due to these limitations, we will discuss in general the significance of these alliances and mergers under the current circumstances and we will avoid pinpointing particular cases.

1) A response is needed to the unprecedented structural changes taking place

The environment which Japan's financial sector faces today means that Japan must cope up with various tasks simultaneously which the US financial sector has progressively faced and dealt with over the past few decades.

In the banking sector, the problems to be dealt with include the solution of the bad debt problem, the need to move away from the traditional form of banking operations in the form of making a profit on loans and deposits upon which Japan's bank are heavily dependent, and a response to the wave of deregulation. The US banks faced the problem of bad debts at the beginning of the 1990s, but they make a rapid recovery. The role of the securities market became important and operational regulations were relaxed. Under these circumstances, the US banks undertook various strategies including an expansion of commission business, entry into the trading and investment bank sectors, entry into the sale of investment trusts area, a strengthening of global business and banking operations transcending state boundaries. In the period from 1997 to 1998, in particular, there was an active upsurge in alliances and mergers transcending sectors. Japan's banks are obliged to cope with all these changes simultaneously.

The securities sector is in the same position. The US securities sector experienced the deregulation of commissions in 1975. From 1996 onward, due to the active use of Internet transactions, they face a situation where commissions are falling dramatically. In Japan's securities sector, the deregulation of commissions and the use of the Internet are occurring simultaneously. At the same time as these changes take place, there is a shift to a registration system and the operational scope of securities subsidiaries of banks is expanding, there are many new firms entering the sector, and intensive competition is expected.

Looking at the insurance sector, at the beginning of the 1990s the second tier US insurance firms got into operational difficulties and the major insurance firms had to deal with bad asset problems. This was due to a set back brought about by the sale of products stressing return rates and investment in high-risk products. In addition, they were also plagues by litigations concerning sales practices. Today, the US insurance firms have escaped from this crisis situation and the focus has shifted to a response to the reorganization of the financial sector in the approach to the 21st century. Looking now at Japan's insurance firms, as well as having to deal with the bad asset problem and the problem of high return lump sum pensions payment in the past, they also have to move forward to a reorganized financial sector.

Thus, Japan's financial institutions are facing major structural changes. If they make mistakes in their strategies, they may lose a large amount of their market share. At the same time, an increase in the overall size of the market pie cannot be expected due to the protracted nature of the sluggishness prevailing in the stock market, the loss in confidence in financial institutions and the reduction in the availability of credit. The background to the occurrence of numerous alliances and mergers in Japan, previously unthinkable, can be found in the very limited range of options available to Japan's management.

2) Evaluation of the alliances and mergers

Looking at these alliances and mergers in detail, in many cases they do not appear to be geared to achieving the objectives of extracting themselves from the current difficult situation and developing sufficiently to function properly in the new age of finance in the 21st century.

For example, alliances in the asset management businesses are much in evidence at the moment. It is true that in this age of Japan's Big Bang it is important to strengthen asset management business centering on investment trusts. This is partly because the ban on the sales of investment trusts by banks was lifted in December 1998, and partly because positive discussions are emerging on the subject of introducing defined contribution pension plans.

However, in terms of the selection of the area of investment trust business they should focus on, the strategies employed should differ according to the firm involved. For example, if the sale of investment trusts is the main core of operations, the firm should select the best possible lineup of products from outside. Restricting sales of investment trust to those developed by their own affiliates is a rather outdated approach. The financial institutions which make the sale of financial products their main line of business show a movement towards seeking to strengthen the management firms in their own groups. However, it is doubtful if they are paying sufficient attention to these points.

In the area of asset management, there are some alliances aimed at the introduction of defined contribution pension plans. However, it is interesting to note that in many cases they are establishing system and administration firms. If the group already has a firm which is highly competitive in the area of systems and back office processing, and thus, has an established reputation in the area of asset management, it is easy to understand such kind of movements for acquiring a reasonable share in this sector. Thus, it would be meaningful to engage in the establishment of firms engaged in systems and administration work. However, for a financial institution with no such track record, it is reasonable that it should concentrate on its core operations and outsource operations outside this area.

As foreign financial institutions are strong in the area of management know-how, many Japanese firms decided to tie-ups with them. However, it is perfectly obvious that it is not possible to acquire management know-how by just investing capital or exchanging several personnel. The differences between Japanese management firms and their European and US counterparts such as in corporate culture, employment systems and the surrounding social environment reflect the differences in management know-how. If the main parent company in Japan is not engaged in overall reforms in structure, even if it sets up alliances, it is not likely to get the success it expects.

There is some doubt as to if the firms making commitments to investment trusts and business operations related to defined-contribution pension plans are carefully measuring the potential demand. It is often said that, in theory, Japan's Big Bang will result in an expansion of investment trust business. However, as the market continues to be sluggish, it is by no means clear to what extent this hazy hope will be realized. From 1997 to the first half of 1998, there was an increase in the sale of foreign investment trusts in Japan. However, since the autumn of 1998, due to the appreciation of the yen, the situation has undergone a change.

With regard to defined contribution pension plans, no clear and concrete decisions have been made as to what kind of plans will be introduced and no decisions have emerged on the timing of this either. It is highly laudable that some firms filled with the spirit of venture should emerge to take up the challenge at this stage in this sector fraught with uncertainties. However, it is extremely difficult to understand why various firms from differing backgrounds should engage in measures to strengthen themselves in this sector and announce alliances and mergers all following in exactly the same pattern.

In the wake of the UK's Big Bang in 1986, there was a movement for UK clearing banks to enter the securities businesses by buying brokers. In addition, numerous European and Japanese financial institutions set up shop in the City and entered into tie-ups and mergers with local financial institutions. However, in the subsequent five years, stock prices in the UK continued to be sluggish. As a result, an over capacity situation arose in which there were too many players considering the scale of the market. Consequently, many of the new entrants had to withdraw from the UK market. Anxiety is felt about the possibility of this kind of Big Bang euphoria emerging in Japan.

Many different kinds of approaches to retail and wholesale operations can be seen in this series of alliances. One such is an approach in which retail and wholesales operations are handled by different firms. Looking at the US, with the exception of a few areas such as derivatives, there are only a few securities firms truly dedicated only to wholesale operations. The reason for this is that in the securities sector, the area serving the needs of individual investors such as investment trusts has been expanded. However, the flow of business with wholesale customers has suffered a decline in profitability due to intensive competition. In addition, there is an increase in the risk factor due to major changes in stock prices, interest rates and exchange rates.

As a result, as can be seen in the merger between Salomon Brothers and Smith Barney, and the subsequent contraction of the trading division, and in the merger between Morgan Stanley and Dean Witter, there is a movement underway for securities companies engaging only in wholesale operations to merge with retail securities firms, and these operations appear to be under review.

Amidst this flow, looking at the high-risk, high-return areas in investment bank operations, boutiques have achieved growth rather than the divisions of massive organizations. These boutiques include hedge-fund type trading houses and derivative houses and personnel from major investment banks have moved over to the boutiques.

In this sense, in the current series of alliances occurring in Japan, the movement to strengthen investment banks with no retail operations is the reverse of the trend in the US. When it comes to what to do with [surplus] personnel, some people suggest that it would be better to form separate companies. However, it is not impossible to have several employment systems in operation in the same company. In Japan, it is by no means rare to find that even if a division is spun off as a separate firm, the employment conditions remain the same. Moreover, as there is a feeling in Japan that firms should not casually lay off staff, even if the financial institutions of Japan which are subject to these limitations form separate companies for high-risk, high-return business, the problem is how far the parent firms should commit themselves.

There are also some alliances aimed at strengthening retail operations. Here, the important factor is that the conventional Japanese banking, securities and insurance sectors, the method of conducting retail operations is undergoing major changes right now. Up to now, there were only minor differences in the products and services provided by these firms and the prices involved, and in many cases, the products were virtually the same over the entire sector. It used to be thought that financial institutions would never fail, and the awareness of personal responsibility on the part of the consumers was low. However, from now on, each firm will have to offer original products and services and set their own price scales. The consumers have become sensitive to the risks involved in dealing with financial institutions and products, and so sophisticated advice is important. In addition, as is the case in other industries, the various marking methods must be further refined.

There is a sudden increase in the range of technologies that can be used such as the Internet and call centers. There is a possibility that some of the services traditionally carried out at branches and by actual people can be taken over by these new technologies. Thus, when we consider that retail operations are facing major changes, although the conventional retail networks are comprehensive it does not follow that other firms will want to enter into alliances with these networks. Thus, although by combining two such conventional retail networks, the resultant network will be much larger in scale, it is still not good enough. The reason is, the key factor is in what way the nature of the network will change.

3) Japan's response to change -- A comparison with US financial institutions

The US financial institutions were allowed ample time to respond to changes but the Japanese financial institutions are faced with an immediate need to respond to many changes, and the basic question is whether they are able to make an effective and sufficient response. The alliances and mergers we have looked at so far are merely one aspect of the efforts the financial institutions are making to achieve reform. However, for alliances and mergers it is necessary to have a counterpart and it requires the injection of a substantial amount of corporate assets and so these linkages should be the main core of these reform efforts. However, the above question still looms on the horizon.

In many cases of alliances and mergers, it is by no means clear to what extent an increase in ROE or cash flows can be expected. Generally speaking, corporate strategies are as follows. If revenues do not increase and it has a low share, the firm withdraws from the market. When revenues do not show much growth but it had a large market share, the firm seeks to maintain its position. When there is an expectation of growth in revenues and the firms has a large share in the sector, it seeks to strengthen its position. When there are expectations of revenue growth but it has a small share in the sector, it seeks to increase its share.

The firm has to achieve a solid understanding of the four sectors involved, and decide which sectors require withdrawal, maintaining position, strengthening and seeking an increase, and implement strategies matched to each case. The corporate assets of each firm are different and the areas they wish to challenge are also different. Nevertheless, in the case of Japan's financial institutions, each firm is engaged in exactly the same behavior pattern like strengthening its asset management sectors. The question arises as to if they have come to this conclusion based on a close examination of their corporate assets or not. When the contents of the alliance involve areas closer to systems operation rather than financial operations, another question arises in terms of just how many firms will be able to gain meaningfully advantages from these alliances. As previously mentioned, when we look at the current market situation in Japan, it is very difficult to determine just how long it will take for investment trusts and defined contribution pension plans to become growth areas. Japan's financial institutions must respond effectively to Japan's Big Bang. However, in reality Japan's banks and life insurance firms continue to be burdened by the problem of how to deal with the bad debt issue.

Regarding this problem, let's look back at how the US financial institutions recovered from the bad debt problems they suffered from, taking Citibank as an example. In 1990, Citicorp held 10 billion dollars in bad debts, and in its settlement in 1991 it posted a loss of 457 million dollars. The net worth ratio fell to 7.5%. Citicorp's stock fell in value from the 20 to 30 dollar level to the 8 dollar level. Its rating fell to almost the "not worth investing in" level. Chairman John Reed decided that the period from 1991 to 1992 was a two-year period to decide if the firm was to live or die. Thoroughgoing selection and contraction of operational areas was undertaken. Through this process, the firm was reborn as the Citibank of today with tremendous strengths in global corporate finance and global individual finance sectors.

The transformation of Citibank was carried out under the impetus of massive bad debt holdings. Japan's financial institutions are facing both a bad debt problem and the need to respond to Big Bang. It most certainly appears reasonable for the Japanese banks to engage in more radical strategies. It is worth noting that Citibank did not receive an injection of public funds and it got no cash flow support from the central bank. Japan's banks are receiving various forms of public sector support to help them recover and they should be engaging in strategies that result in visible results. However, many of the announcements of alliances and mergers are only a partial response and are thought to be merely symbolic establishment of new firms just to express friendly relations with their partners.

4) Alliances and mergers are a test of management leadership

In the case of Citibank, an important factor is that it was able to realize its own strengths and carry out a major shift in the direction corporate assets were channeled. Naturally, this required powerful leadership. Sometimes there is a conflict between management's leadership and the strategies involving alliances and mergers, and it is necessary to be aware of this. In the case of alliances and mergers, if one side is showing clear leadership, there is no problem. However, if the question of leadership is unclear, this leads to undesirable results.

During the time Sandy Wale, the Chairman of Travelers, showed a strong personality and brought a number of financial institutions into the Travelers Group, this was all well and good. However, in the merger with Citicorp, as Citicorp itself is a massive financial group, there are many problems in channeling the synergies of both parties, and recently there are cases of resignations of top executives.

In the case of NationsBank, when it was still NCBC , expansion strategies got underway when Hugh McCall became the chairman. In the period from the latter part of the 1980s to the beginning of the 1990s, NCBC actively purchased S&Ls that were in danger at the time. However, in the merger on equal footing with Bank of America in April 1998, a smooth consensus of opinion was said to be not achieved regarding the choice of a single brand name and the positioning of Bank of America's overseas business.

There are very few cases of clearly expressed leadership being shown in the alliances and mergers announced in Japan. In most cases, the major financial institutions merely symbolically shake hands.

If the act of entering into alliances and mergers results in management leadership becoming more difficult to exercise, and as a result the financial institutions are unable to undertake the actions now required of them such as highly selective choice of operations and reallocation of corporate assets, the alliances and mergers themselves become meaningless and cause damage to the participants.

Rather than being a strategy to deal with bad debts and to facilitate a response to Japan's Big Bang, this series of tie-ups and mergers may well have shown that many of Japan's financial institutions have not yet been able to develop clear strategies to cope with these structural changes.

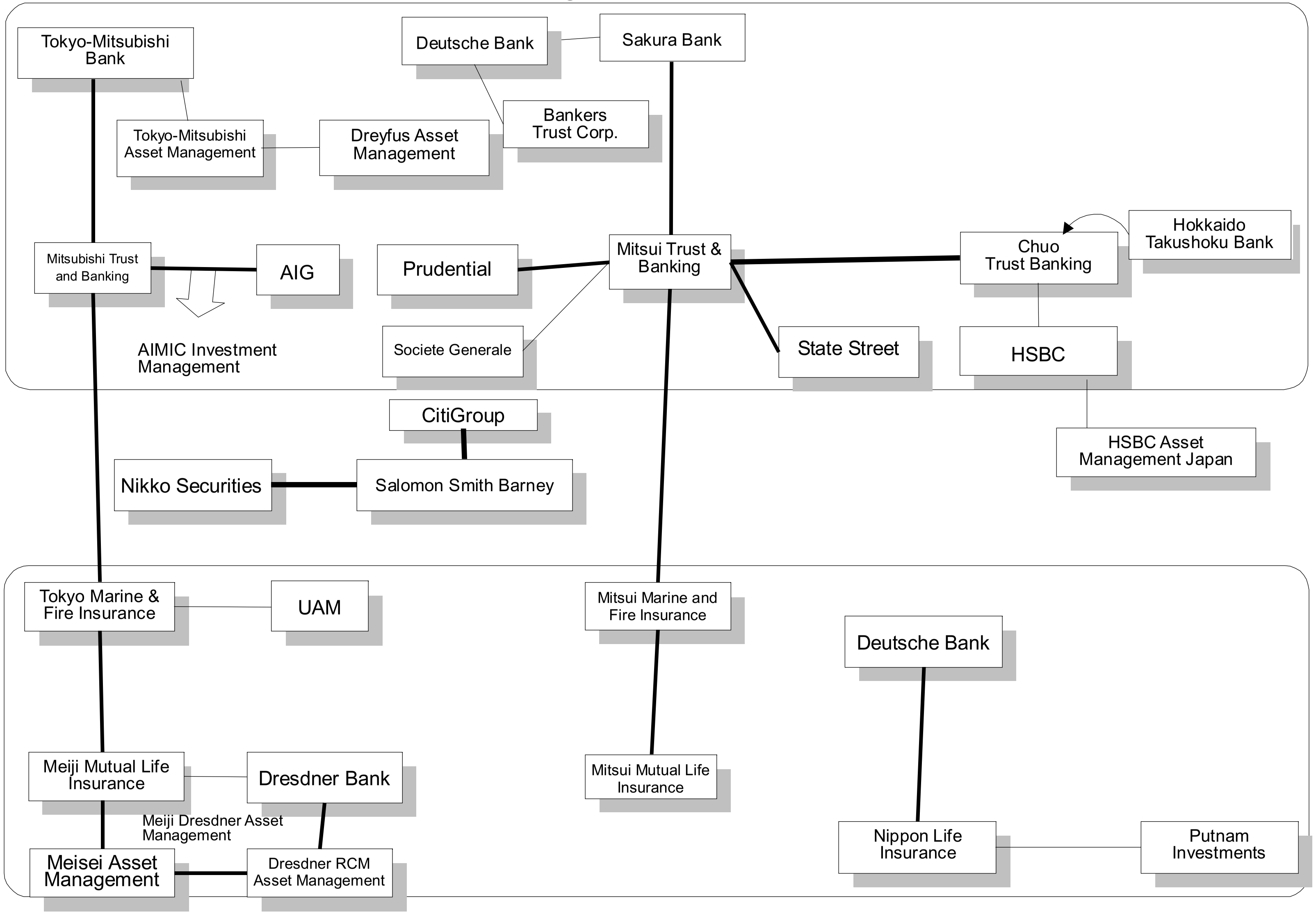
The fact that strategies to carefully select operational areas have finally begun to appear in some banks such as a withdrawal from overseas operations, a review of securities operations and specialization in retail operations is naturally very laudable. At the same time as this clear move to withdraw from overseas operations, the banks are required to demonstrate in concrete terms to what extent revenues increase by injecting corporate assets in areas that need strengthening or areas where the banks seek to take up new challenges. Basically, alliances and mergers should be one part of a strategy in the process to achieve a clearly defined objective, and used only if necessary. Such alliances and mergers should not just be a process in which the act of union is first decided and then the details are worked out at a later date.

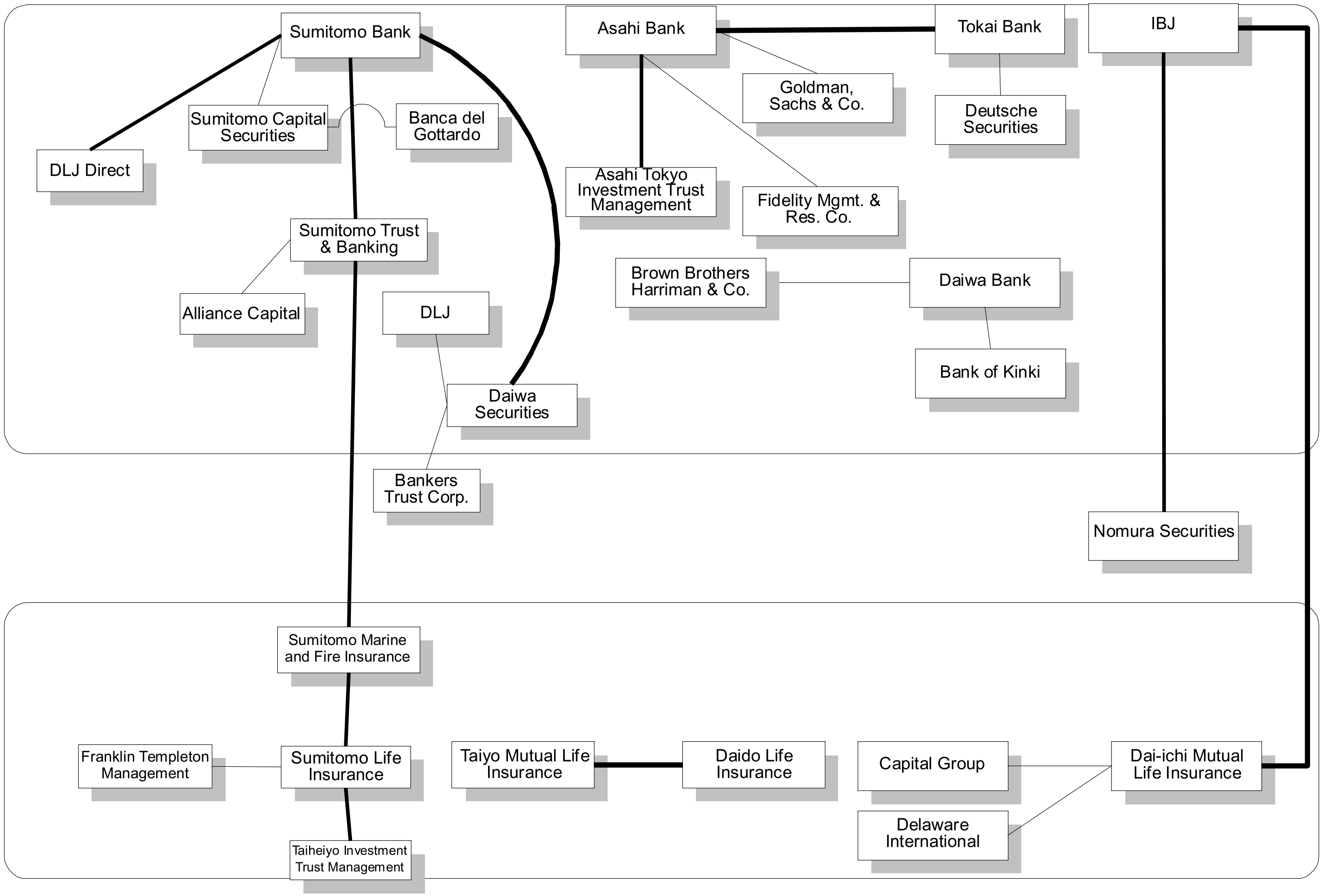
Another movement which has emerged recently is a series of far reaching major alliances and mergers which are thought to reflect the demands for a rationalization of management operations made by Japan's Financial Reconstruction Commission as a qualification for an injection of funds into to the major banks.

It goes without saying that alliances and mergers do not necessarily lead to a rationalization of operations and a reduction in the number of banks operating in Japan will not lead to an alleviation of the problems facing the nation's economy. However, in view of the fact that public funds are being pumped into the banks (financial institutions), unless outstanding, concrete and bold measures are implemented by the private sector, it is inevitable that the public sector will take the leadership into its own hands.

After this series of superficially brilliant alliances and mergers which in reality had almost no substance or meaning, attention will now focus on to what extent Japan's financial institutions will engage in the real-term strategies to respond to the unprecedented structural changes occurring.

Alliances among Financial Institutions in Japan

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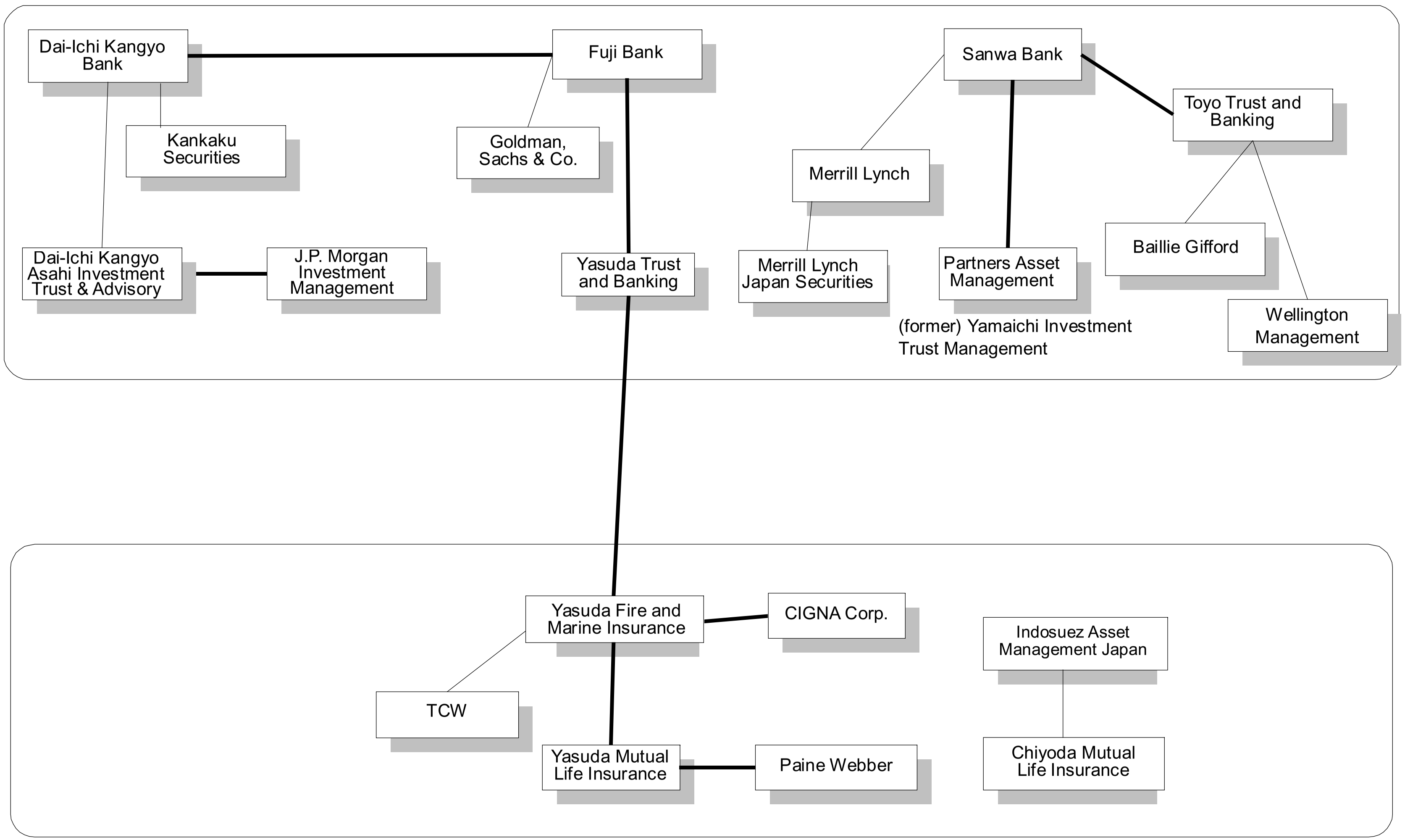

Note: As of the 21 January, 1999
Source: Nomura Research Institute