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Bank of Japan

Toward Strengthening the Foundations for Economic Growth: Efforts of Financial Institutions and the Bank of Japan

Speech at Symposium 2010 on
"Cooperation among Finance, Industry, Academia, and Government"
organized by the Kanto Bureau of Economy, Trade and Industry

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1. Introduction

I am greatly honored to have been given the opportunity to deliver a speech at Symposium 2010 on “Cooperation among Finance, Industry, Academia, and Government”, organized by the Kanto Bureau of Economy, Trade and Industry. I am grateful for the valuable support given to the regional economy by so many participants from private companies, regional financial institutions, local governments, company-supporting organizations, and other stakeholders in the Kanto region. I am particularly thankful for being given this timely opportunity to talk about the Bank of Japan’s new initiative to revitalize the Japanese and the local economy, and also to discuss the efforts of those financial institutions that have responded to the Bank’s initiative.

The Japanese economy currently faces not only the cyclical problem of returning to a sustainable growth path with price stability, but also the structural problem of enhancing growth potential over the medium and long term. The challenge is formidable, I admit. However, it is absolutely necessary to address these problems squarely, in order to realize sustainable growth in the long run. To this end, it is essential that companies, financial institutions, and policymakers join forces and make steady efforts from their own respective positions in a cooperative way. This Symposium is particularly helpful in this context, as it provides an opportunity for the people involved to come together to further enhance partnerships.

As you know, in June of this year the Bank of Japan decided to introduce its “Fund-Provisioning Measure to Support Strengthening the Foundations for Economic

Growth" (hereafter, Growth Foundation Strengthening Facility, or GFSF). This measure provides long-term funds to financial institutions at a lower rate for a long period, on the condition that these financial institutions execute loans and investments that contribute to strengthening the foundations for economic growth. In fact, it is an unconventional measure for a central bank, because the funds are provided on the specific condition that investments and loans be made in growth areas. However, this initiative is aimed at financial institutions in the same manner as conventional measures: the Growth Foundation Strengthening Facility is designed to act as a catalyst inducing financial institutions to make substantial efforts to strengthen the productivity and competitiveness of their customer firms through appropriate lending and timely consulting activities. Accordingly, the framework of the measure is to provide broad support for financial institutions' various efforts in these areas. Moreover, recognizing that a substantial lead time is required to achieve the necessary strengthening of the growth platform, as typically indicated by research and development patterns, the Bank of Japan provides funds for a relatively long term, up to a maximum of four years. Judging from the developments that have followed since the introduction of this scheme, I consider that financial institutions have demonstrated a very active stance toward the Growth Foundation Strengthening Facility. Indeed, a substantial number of institutions have participated from across a wide spectrum of financial industries.

In the following sections, I would first like to briefly explain the current situation of corporate finance (Section 2), and then discuss the role that financial institutions should play toward strengthening Japan's growth potential (Section 3). I will then outline the

Bank of Japan's policy for strengthening the growth platform, and highlight recent efforts by financial institutions as evidenced by their use of the Bank's Growth Foundation Strengthening Facility (Sections 4 and 5). I hope what I am going to talk about now will provide useful material for your discussions at today's Symposium.

2. Corporate finance: Current conditions

The smooth provision of funds necessary for corporate activities is an essential premise not only for economic recovery, but also for strengthening the growth potential of the Japanese economy. Let me now examine the current condition of Japanese corporate finance from three perspectives.

First, let me look at banks' lending activities. Figure 1 shows a year-to-year comparison of bank loans. Looking back, we can see that the availability of corporate finance tightened rapidly in Japan, particularly in the wake of the failure of Lehman Brothers in the United States in September 2008. Specifically, even large-scale companies, which had previously had no problem raising funds in the capital market, now faced difficulties in issuing corporate bonds and CPs. As a result, companies rushed to secure liquidity through borrowing from banks by, for example, expanding or drawing from banks' commitment lines. Funding also tightened for small and medium companies, which used to depend mostly on bank loans. Thus, the general demand for bank loans grew significantly. As the chart shows, the volume of bank loans started to increase sharply on a year-on-year basis from the latter half of 2008. Growth in such precautionary demand for funds then settled down, and the need to raise funds from the capital markets gradually decreased. The rate of year-on-year increase in bank loans started to narrow. As long-term interest rates decline, large companies also actively shift their funding source from borrowing from banks to issuance of long-term bonds. In this way, the outstanding balance of bank loans has continued to decrease since the beginning of this year, compared to the previous year's level. Companies in general have ample liquidity and their demand for operating funds or funds for capital investment is rather weak as the economic recovery remains subdued.

Borrowers' demand for funds changes as economic and financial conditions change. What is important in corporate finance is whether borrowers can raise funds smoothly as their needs arise. Figure 2 shows the current condition of corporate finance from this perspective. It depicts borrowers' views about the lending stance of financial institutions. The chart on the left shows the percentage (diffusion index, or DI) of companies that consider the financial institutions' lending stance to be "accommodative", less the percentage of companies whose answer was "severe" (DI). A value in the positive territory means that the banks' lending stance is considered to be relatively loose, while a value in the negative territory means that the stance is perceived as being rather strict. Immediately after the Lehman Shock in the fall of 2008, DI values dropped into the negative territory at once, indicating that financial institutions as a whole adopted a very strict lending stance at that time. However, the situation started to improve gradually thereafter, and the DI value has now recovered to reach positive territory for large and leading medium-sized companies. The DI value is still negative for small and medium companies, reflecting the continued severe business environment, but the size of the negative value has started to decrease, albeit gradually. The right-hand chart in Figure 2 shows companies' assessment of their own financial position, and we can see that the position is improving after deteriorating significantly during the latter half of 2008, in a similar way to DI values. Recently, increased cash flow resulting from sales recovery also seems to have helped improve companies' assessment of their financial position.

Now, let me examine the current situation of corporate finance from the standpoint of banks. Figure 3 depicts the status of banks' lending policies. The positive values in the chart show that banks are taking an active stance toward lending, while the negative values mean that they have become more cautious. At one time in the latter half of 2008, banks became more cautious about extending credit to large and medium-sized companies, but since then they have gradually started to take a more active stance. Banks also seem to have taken a more active stance toward loans to small companies since the latter half of 2008. As one of the factors underlying such changes in banks' stance toward lending, we can point out that the emergency guarantee program by credit guarantee corporations, which was introduced in response to the financial crisis, bolstered banks' stance regarding lending. In addition, as shown in Figure 4, banks' loan rates have also fallen significantly since the beginning of FY2009.

As just described, to grasp the real condition of corporate finance, it is necessary to observe and analyze various indicators comprehensively, including data on both borrowers and lenders and the trends in loan rates, in addition to changes in the amount of loans. Judging from these data, we can see that the situation of corporate finance has in general become more accommodative, although the financial position of small companies remains severe and their views on the banks' lending stance toward them is still negative, issues which will require due consideration in further developments. However, it is another question whether corporate finance is currently succeeding in reversing the general declining trend of growth and thus enhancing the medium- and long-term growth potential of the Japanese economy. Let me put it differently: what matters is whether a financial function that enables positive and forward-looking activities among companies has been fully realized or not. So let me now focus on the crucial role of financial institutions, whose full functioning is essential to strengthening the growth potential of the Japanese economy.

3. Strengthening customer-companies' growth potential: The role of financial institutions

As I explained earlier, the Japanese economy is now confronted with a great challenge: a structural decline in growth potential. To address this challenge, companies have to identify areas of growth potential and launch or expand business in those areas. In reality, to respond flexibly to the abrupt drop in demand after the Lehman Shock, I understand that the first priority for company managements over the last year or two has been to restore the financial strength of their companies to be able to absorb economic shocks. As a result, the financial strength of companies has improved significantly. However, we can see that they have been taking a persistently "defensive" stance. Though the impact of the financial crisis has abated and operating cash flow has improved, we do not see signs even now that companies are reducing the ample liquidity accumulated immediately after the Lehman Shock, as demonstrated by the fact that the balance of corporate cash and deposits continues to grow at a higher level.

However, as corporate profits continue to improve steadily, some companies are shifting their priority from crisis management to proactive moves such as strengthening product development ability and mergers and acquisitions of foreign companies in order to get ahead of the competition amongst both domestic companies and companies in rapidly growing emerging countries. For example, moves to capture demand in emerging markets, particularly in Asia, are accelerating through technical alliances with foreign companies and expansion of distribution channels abroad. We have also seen more Japanese companies acquiring foreign companies due to the recent trend of the appreciation of the yen. Based on the outlook for the Japanese economy, companies also need to reestablish a system of supplying goods and services appropriate for the needs of a new age, with an eye to demographic changes such as the most rapidly aging population in the world, and the need for future environmental responsiveness.

In order to enhance the growth potential of the Japanese economy, it is important to provide financial support to those companies that aspire to grow in response to the new business environment. In other words, it is impossible for financial intermediaries to become a powerful enabler of these companies' efforts toward renewed growth unless their services are fully adapted to changes in the economic structure and business environment. Financial institutions are now required not only to respond to demand for funds from existing blue-chip companies, but also to have the ability to identify prospective loan opportunities and offer proactive proposals to smaller companies in particular. I would like to explore these points by focusing on the lending practices of financial institutions.

Return to Basics: Sharpening the "Expert Eye"

Japan has an indirect financial system where banks play a central role in finance intermediation, and small companies in particular rely on banks for most of their funding. From the period of economic reconstruction after the Second World War to the high-speed growth era, banks in Japan responded to strong demand for funds, using an "expert eye" to monitor closely the business performance of companies and examine their ability to meet repayment obligations; in other words the banks exercised their ability to produce "information." As time progressed, they started to focus on credit protection measures when extending loans to companies, characteristically in the form of real estate collateral and personal guarantees. It was an effective means of reducing the impact of a borrower's default, and formed the basis of the soundness of the Japanese banking system in those days. The balance between this "expert eye" and credit protection measures underpinned the proper fulfillment of the financial intermediation function in Japan.

However, as a result of the shift to an era of low growth, large companies began to accumulate excess funds and had less demand for bank loans, leading to an increase in bank lending to numerous smaller companies. This shift entailed a higher cost of exercising “expert judgment.” Japan also experienced the bursting of the asset bubble in the 1990s, followed by the disposal of non-performing loans over the long term. These changes induced more focus on the preservation of loan assets. Under these circumstances, the banks’ capacity to offer loans proactively through intrinsic expert judgment seems to have weakened substantially. This reflects multiple synergetic factors, such as large companies’ more cautious stance regarding corporate activities due to lower growth expectations, and a general decline in the earning power of financial institutions mainly due to sluggish demand for funds and a reduction in profit margins from loans. However, as I have just explained, lending practices that focused on real estate collateral and personal guarantees must also have had a profound influence.

Firstly, lending methods that rely heavily on real estate collateral and personal guarantees might weaken the ability to monitor the business cash flow that underlies a borrower's creditworthiness. In many cases, the value of real estate and personal assets pledged to banks as collateral bears no direct relation to changes in the business cash flow of the borrower company. If land prices start to decline, resulting in a lack of collateral, it will be impossible to provide additional loans even to companies with excellent skills, when they find a growth opportunity and need financial resources. As the economic environment develops quickly, there is also a risk that financial institutions may overlook changes in the cash flow of a borrower’s core business and suddenly be faced with its business failure.

Secondly, too great an emphasis on the protection afforded by real estate or personal assets raises another concern. Banks tend to focus on loans to large companies and companies with a long business history and abundant assets, rather than providing funds for new companies and new business areas. In particular, reliance on personal guarantees affects the vitality of small enterprises and their business succession. For instance, a business owner failing in business will lose almost all of their personal assets, and as a consequence, it will be very difficult for them to try another new business. In addition, from the viewpoint of the ability to provide personal guarantees, the successor to a business is usually limited to a person of means, typically a family member of the owner. However, with lifestyle changes, there are an increasing number of businesses that are not succeeded by a family member of the owner. In order to keep vigorous enterprises in business, it is of utmost importance to ensure firstly, that an employee with excellent skills and know-how is to be the manager of the business, regardless of his or her personal financial capacity, and secondly, that loans are provided continuously to these enterprises.

Covenants (Contract Provisions)

So what measures should banks take in extending loans under the present-day conditions of a dramatically changing business environment? Both the financial community and industrialists have put forward a number of recommendations regarding lending practice, and some of these recommendations have already been adopted into practice. Here, I would like to mention two notable examples.

The first recommendation is the use of covenants. A covenant is the provision of a loan contract, agreed between a bank and a borrower company. A good example of a financial covenant is the requirement to keep certain financial indicators such as liquidity at a certain level or higher. It is useful for a bank to have such a commitment because it helps them to maintain the borrower's cash flow and balance sheet at an appropriate level without relying excessively on collateral or guarantee at the time of extending the credit. To increase the effectiveness of covenants, it is necessary to keep monitoring and examining the development of a company's performance closely, and this in itself will improve the bank's ability to respond flexibly to changes in the business conditions of the borrower company.

Asset-based Lending (ABL)

Another innovation for loans is a method called asset-based lending. Under this method, a bank will take receivables and movable properties that are closely tied to the company's business cash flow, such as accounts receivable, goods in stock, and equipment and machines, as collateral for a loan. The amount of accounts receivable held by small companies in Japan exceeds 60 trillion yen, and the value of goods in stock is more than 40 trillion yen, while the outstanding balance of asset-based lending is currently estimated to be a tiny fraction of this, approximately 4-5 hundred billion yen. For that reason alone, there is great potential for their use as a financing source.

If a bank adopts this method, in addition to making collateral assessment of, say, accounts receivable and goods in stock upon extension of credit, the bank needs to keep track of subsequent changes in their value in order to control credit risk. The company is required to provide this information regularly to the bank. In this way, both the bank and the company incur costs in monitoring and providing information. However, this lending method, which finds value in corporate activities on their own terms, enables companies that do not own enough real or personal assets to raise the substantial financial resources necessary to run their business. This may also be used for the business succession of emerging small companies. It is true that this asset-based lending still needs infrastructure improvement with respect to collateral assessment and disposal. However, as shown in the chart in Figure 5, the fact that the outstanding balance in the Japanese ABL market is still very limited compared to that in the United States indicates greater potential for further expansion. Going forward, I expect this method to be utilized widely through active cooperation between financial institutions and companies.

So far, I have explained two innovative methods of lending that support a company's ability to respond to the changing business environment. Both lending methods incorporate ongoing examination and monitoring of the borrower's business performance, which may be positioned as tools that contribute to a re-strengthening of banks' "expert eyes" or their judgment abilities. In order to provide the financial support required to strengthen the growth potential of Japanese companies, I believe that ingenious practices such as these lending methods are essential, together with the determination of managers to use such methods in the practice of their lending business.

Providing loans to small companies is a burning issue not only in Japan. Overseas policymakers are also deeply concerned about the decrease in bank loans in the severe economic environment following the financial crisis, and have taken measures to facilitate fund-raising for companies. They maintain close contact with companies, financial institutions, and other relevant parties, focusing on resolving the practical challenges associated with lending from a medium- and long-term perspective. Before I move on to explaining the Bank of Japan's measures, I'd like to mention as an example some of the actions taken in the United States.

In the United States, a number of forums are held where small companies, banks, business organizations, government-related bodies, and regional development organizations across the nation come together under the initiative of the Federal Reserve System, the country's central bank, to discuss issues facing small business finance and solutions to such issues. These forums discuss the various problems of lenders and borrowers that have caused a decrease in loans to small companies, and the factors hindering the smooth functioning of small business finance are identified. Participants' views and opinions are compiled on improvements in government programs and tax systems as they affect small business finance, on measures taken so far by supporting organizations, and on banks' lending practices. For your reference, the views and opinions compiled this July are shown in Figure 6. The Federal Reserve System plans to continue holding meetings with relevant parties and to engage proactively in related research activities based on the information gathered.

4. Growth Foundation Strengthening Facility (Fund-provisioning Measure to Support Strengthening the Foundations for Economic Growth) : Outline

The Bank of Japan strongly recognizes the need to improve substantially the financial intermediary function of financial institutions and thereby strengthen the foundations for economic growth. To this end, the Bank of Japan decided to introduce in June of this year a "fund-provisioning measure to support strengthening the foundations for economic growth" (Growth Foundation Strengthening Facility, GFSF). This measure is summarized in Figure 7. To put it briefly, this is a measure to provide long-term funds at lower rates to those financial institutions that endeavor to strengthen the foundations for economic growth. The Bank of Japan provides loans to financial institutions at the policy interest rate, which is currently 0.1%. The duration of the loans is one year in principle, though this can be rolled over up to three times; to a maximum duration of four years. The total amount of loans provided by the Bank of Japan is not to exceed three trillion yen.

The first new loan disbursement under this measure was made in September this year, and we plan to hold rounds on a quarterly basis, or eight times in total over two years. We are expecting the second loan disbursement shortly. We also set the maximum total amount of loans available to each eligible counterparty at 150 billion yen, as we expect a broad range of financial institutions to use the scheme, including regional as well as major financial institutions.

Financial institutions that apply to use this GFSF must formulate a "plan" covering loans and investments directed toward strengthening the growth platform. This plan is then examined by the Bank of Japan to ensure it conforms to certain conditions established by the Bank, as shown in Figure 8. In this process, it is essential that the plan identifies the specific areas in which the investments and loans will be made. These are to be selected from a list of 18 specific areas proposed by the Bank of Japan, including "research and development" or "setting up a new business," and any other area that the financial institution believes to "support strengthening the foundations for economic growth." For each disbursement under the GFSF, the eligible counterparty provides the Bank of Japan with details of the actual new loans or investments executed under the above-mentioned "plan" during the most recent quarter. The Bank of Japan assesses whether the investment or loan satisfies the conditions for fund provisioning, and provides funds to the counterparty up to the amount of the loans or investments deemed satisfactory.

The Bank of Japan confirms whether the "plan" submitted by the financial institution and the individual loans and investments comply with the purposes of the GFSF. The most distinctive feature of the scheme is that it respects the independent efforts of financial institutions. The focus of the checking process performed by the Bank of Japan is placed on compliance with the objective conditions and financial institutions' internal procedures to ensure compliance. The Bank of Japan does not provide any guidance or instruction on allocation of funds to specific industries or companies; the Bank respects the business strategies of financial institutions and their assessment ability in selecting growth areas and specifying the purpose of an investment or loan. As I explained earlier, in addition to the 18 areas provided as examples by the Bank of Japan, financial institutions have the discretion to select certain growth areas that they believe support strengthening the foundations for economic growth. As we have seen, this is a scheme that fully utilizes the “expert judgment ability” of financial institutions.

As shown in Figure 9, the number of financial institutions that have applied to use the funds is increasing both in terms of counterparty category and geographically. While 66 financial institutions applied for the first disbursement in June, the number has since increased significantly, particularly the number of regional financial institutions, and the total has now reached 143. Participants include regional banks and 2nd-tier regional banks as well as credit associations and foreign financial institutions, and we also have one securities company among the eligible counterparties.

5. Efforts of financial institutions to support strengthening the foundations for growth

I would now like to discuss financial institutions’ substantive efforts to support strengthening the foundations for economic growth, as demonstrated in their “plans” and the results of individual loans and investments submitted to the Bank of Japan for the first and second disbursement under the Growth Foundation Strengthening Facility.

First, the plans of 127 out of 143 counterparties have already been confirmed as satisfactory by the Bank of Japan. These plans cover one or more growth areas, and the distribution is shown in Figure 10. Most of the financial institutions selected “medical, nursing care, and other health-related business,” “environment and energy business,” and “business serving the needs of senior citizens,” while other areas are also all covered by at least some eligible financial institutions.

Another notable point is that some financial institutions selected areas other than the

18 areas suggested as examples by the Bank of Japan. They are shown as “Other” in this figure. Specifically, they include support for firms’ business diversification and globalization. In addition, a number of institutions, particularly regional financial institutions, notably defined support for “maintaining and further improving core skills of (broadly-defined) manufacturing” to help stimulate their local economy.

Individual loans and investments executed under these “plans” also reflect financial institutions’ very positive stance toward strengthening the growth platform. As shown in Figure 11, the actual individual loans and investments confirmed by the Bank of Japan totaled 1,340 transactions amounting to 478.6 billion yen for the first disbursement at the beginning of September, and 4,313 transactions amounting to 1,056.4 billion yen for the second disbursement expected shortly, showing a significant increase both in terms of number and amount of transactions.

Figure 12 outlines the distribution of the amount per loan and investment transaction. The share of the “500 million yen or more” category decreased, and the average lot decreased to 240 million yen for the second disbursement, down from 360 million yen for the first disbursement. The size of individual loans and investments underlying the Bank of Japan’s funds became slightly smaller between the two periods. This reflects a substantial increase in the number of participating regional financial institutions in the second disbursement, with smaller loans accounting for a larger share, compared to major banks.

The following Figure 13 shows the distribution of loan and investment maturities. The average maturity was shortened to 5.8 years for the second disbursement, compared to 8.2 years for the first disbursement of the GFSF. This may be because many of the investments and loans now set the maturity in line with the maximum loan duration of four years offered by the Bank of Japan. At the same time however, the percentage of investments and loans with a duration exceeding four years reached more than 70%, with the large majority of investments and loans notably having a longer maturity than the maximum duration set in the Bank of Japan's GFSF. This indicates that financial institutions have offered additional duration under their own initiatives.

Figure 14 shows the results of individual investment and loan transactions by growth area. The "environment/energy business" area accounts for the largest percentage in terms of amount for both the first and the second disbursement, suggesting that demand for funds increased in this area.

Specifically, most of the funds were used for electricity generation equipment or oil exploration to secure and explore energy resources. Funds were also provided across industries for capital investment and research and development to promote cost-saving and carbon-reduction efforts at companies' plants. Some funds were used to construct waste-recycling facilities and to replace company cars with eco-cars.

"Environment/energy business" is followed by "development and upgrading of social infrastructure" and "medical, nursing care and other health-related business," showing that financial institutions are making positive efforts in these growth areas. Examples include loans to raise funds for expansion in the area of telecommunications services and funds for purchasing advanced medical equipment.

In addition, there is a notable increase in "investment and business deployment in

Asian and other countries" for the second disbursement under the GFSF that is expected soon. Funds are required to expand business in Asian countries with significant economic growth potential. They include funds for local capital investment and for acquisition or investment in local companies in Asia.

Additionally, for both the first and the second disbursement, loans and investments continue to be made in the "other" areas, those growth areas selected independently by financial institutions. Examples of funds for local versions of "maintaining and further improving core skills of (broadly-defined) manufacturing" include equipment funds for food-related industries that uses local products and for strengthening the platform for local "key industries". Others provide development funds for local industries, which are linked to the initiatives of municipalities. Finally, let me look at the "setting up a new business" category. Although it occupies the bottom rank in terms of amount, the number of loans, albeit small, is notable. Loans in this category have been made to provide funds to open new hotels and restaurants or to support the start-up of new businesses using venture capital, not only in the metropolitan area but also in local cities. Examples of these efforts are shown in Figure 15.

As just described, financial institutions are making more proactive efforts than ever to strengthen the growth potential of the Japanese economy, prompted by the start of the Bank of Japan's GFSF. Of course, financial institutions were involved in such activities even before the GFSF, but more and more financial institutions are now establishing new facilities and investment and loan programs to strengthen the foundations for economic growth, expecting to use the funds provided by the Bank of

Japan. Not a few financial institutions use this opportunity to demonstrate their active efforts to enhance the growth potential and solicit new businesses by disclosing their programs to the public.

Furthermore, we can see signs of change within financial institutions themselves.

Recognizing the inadequacy of previous information gathering, the commercial loan sales departments at the headquarters of some financial institutions have themselves begun to collect information on growth areas and growing companies. This information is then used, for example, to support the institution's branches in promoting their business. Other financial institutions have strengthened their group-wide collaborations with affiliated think tanks and investment companies to improve their ability to develop plans and proposals for loan sales in growth areas. Furthermore, in the environment-related and medical and nursing care areas, some financial institutions have started to re-examine their credit risk management, noting that these areas may have different business risk profiles from those subject to traditional credit assessment.

This is especially encouraging since these moves all lead to a sharpening of the "expert eye" of the loan officers at these financial institutions, and thus to the enhancement of their expert judgment ability. If we can build successfully on this momentum to involve the management level and develop wide-ranged lending strategies for growth areas, financial institutions will gradually start taking more positive and forward-looking actions toward growth, though they have tended to be over-cautious until now due to their painful experience of disposing of non-performing loans after the financial crises. This positive progress is exactly what we expect from the GFSF as a catalyst inducing financial institutions' efforts toward economic growth.

6. Conclusion

So far, I have outlined the Bank of Japan's GFSF and financial institutions' latest efforts, as indicated by their response to the measure. I have given an account of the vital role played by them both in supporting the growth of the Japanese economy. Since the Bank of Japan's measure has only recently been introduced, it is still too early to give a comprehensive evaluation of its effects. However, I strongly hope that the proactive stance developed among financial institutions will stimulate new demand for funds from companies, which will then lead again to positive lending activity in financial markets, thus creating a virtuous cycle.

To this end, it is important for each player to develop and maintain their strategic thinking to support strengthening the growth potential of the Japanese economy. It is essential for companies to make pre-emptive moves to enhance corporate values, with a view to the changes expected in the future business environment. Financial institutions must continue to refine their financial intermediary function to facilitate efficient allocation of funds, and avoid treating the current momentum as if it were merely a transient boom. In so doing, it is also important to recognize the obvious fact that increasing loan volumes by unreasonable allocation of cheap funds is unsustainable. The best way to provide a sustained and efficient financial intermediation function is to use the expert judgment ability and to make loans to viable companies and businesses at rates appropriate to the associated risk. The administrative and other authorities, together with business organizations and other support groups, must then concentrate their efforts on developing an environment that supports the efforts of these companies and financial institutions. Even in this case, it is those measures that consciously provide incentives to promote positive action from companies and financial institutions that are likely to be most effective, rather than measures aimed simply at reducing the burden on private economic entities.

For the purpose of developing strategies going forward, today's Symposium provides a great opportunity for relevant parties from the business world, the financial community, and the administrative authorities to come together, share their views on the issues confronted by corporate finance, and discuss steps toward their resolution. I hope you have fruitful discussions in the following sessions, and that the Symposium leads to the strengthening of future cooperation between industry and financial services. The Bank of Japan will continue its efforts as a central bank with resolve and determination, paying full heed to the frank opinions received from all related parties, in the hope that the Bank's GFSF, as I explained today, will prompt changes in the lending strategies and methods of financial institutions.

Thank you for your kind attention.

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Kiyohiko Nishimura
Deputy Governor of Bank of Japan

1. Introduction

Challenges faced by the Japanese economy

- Returning to sustainable growth path with price stability (a cyclical problem)
- Enhancing growth potential over the medium and long term (a structural problem)

It is essential that companies, financial institutions, and policymakers join forces and make concerted efforts

The Bank of Japan's fund-provisioning measure to support strengthening of the foundations for economic growth
(hereafter, Growth Foundation Strengthening Facility)

- Introduced in June this year
- An unconventional measure for a central bank
- Supporting financial institutions' efforts to strengthen the productivity and competitiveness of their customer firms
- Designed to act as a catalyst inducing such efforts

- The framework is to broadly support financial institutions' various efforts
- BOJ provides funds for a relatively long term , up to a maximum four years.

Today's Agenda

1. Introduction

2. Corporate Finance: Current Situation

3. Strengthening of Customer-companies' Growth Potential:
   The Role of Financial Institutions

4. Growth Foundation Strengthening Facility (Fund-provisioning Measure to Support Strengthening the Foundations for Economic Growth) : Outline

5. Efforts of financial institutions to support strengthening the foundation for growth

6. Conclusion

2. Corporate Finance: Current Situation

<Three Perspectives>

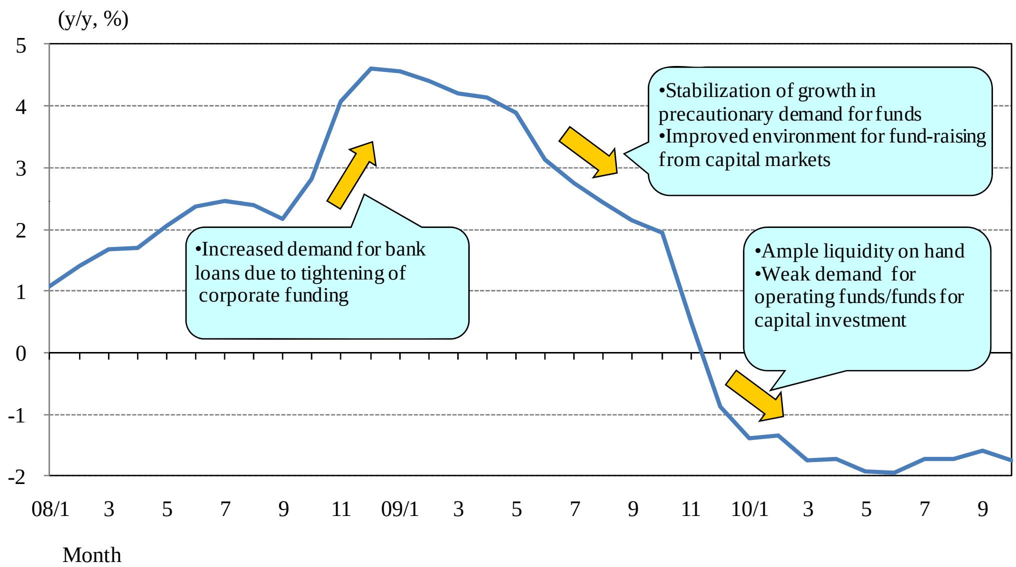
- Trend of private bank loans
- Situation of corporate finance from the viewpoint of companies
- Stance toward lending operations from the viewpoint of banks

(1) Private bank's lending activities

-- Increased after the failure of Lehman Brothers

-- Continued decreased compared to the previous year's level since the beginning of 2010

(Figure 1) Bank Loans and discounts



Note: Based on average balance adjusted for special items

Source: Principal Figures of Financial Institutions, Bank of Japan

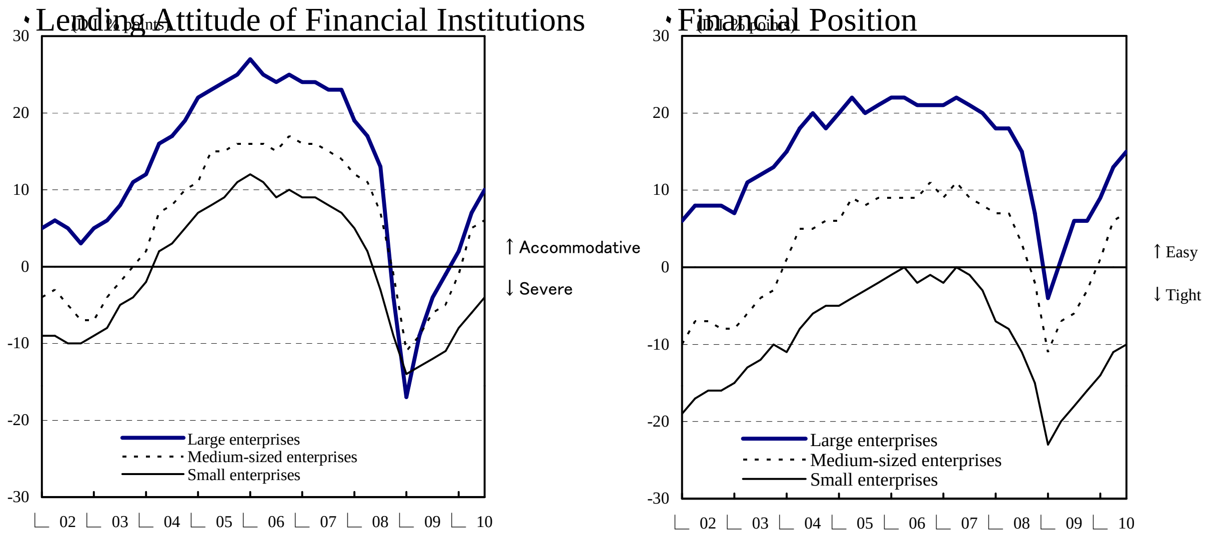
2. Corporate Finance: Current Situation (Three Perspectives)

(2) Corporate finance: Borrowers' view

-- Initially strict position by financial institutions; the situation is gradually improving.

-- The situation for small and medium companies is also generally improving.

(Figure 2) Current condition of Corporate Finance: Borrowers' View



Note: For all businesses

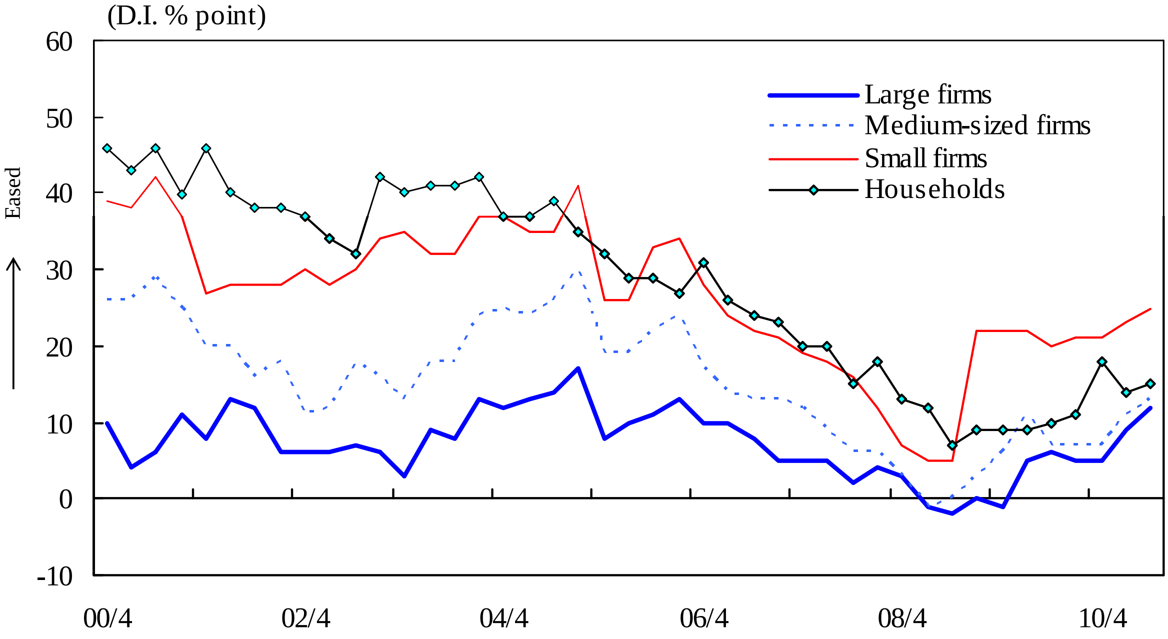
Source: Tankan Survey on Business Sentiment, Bank of Japan

2. Corporate Finance: Current Situation (Three Perspectives)

(3) Status of bank lending policies: Banks' view

-- In late 2008, banks became more cautious about extending credit, but a more active stance and gradual improvement since then.

(Figure 3) Status of bank lending policies: Bank's view



Source: Senior Loan Officer Opinion Survey on Bank Lending Practices at Large Japanese Banks, Bank of Japan

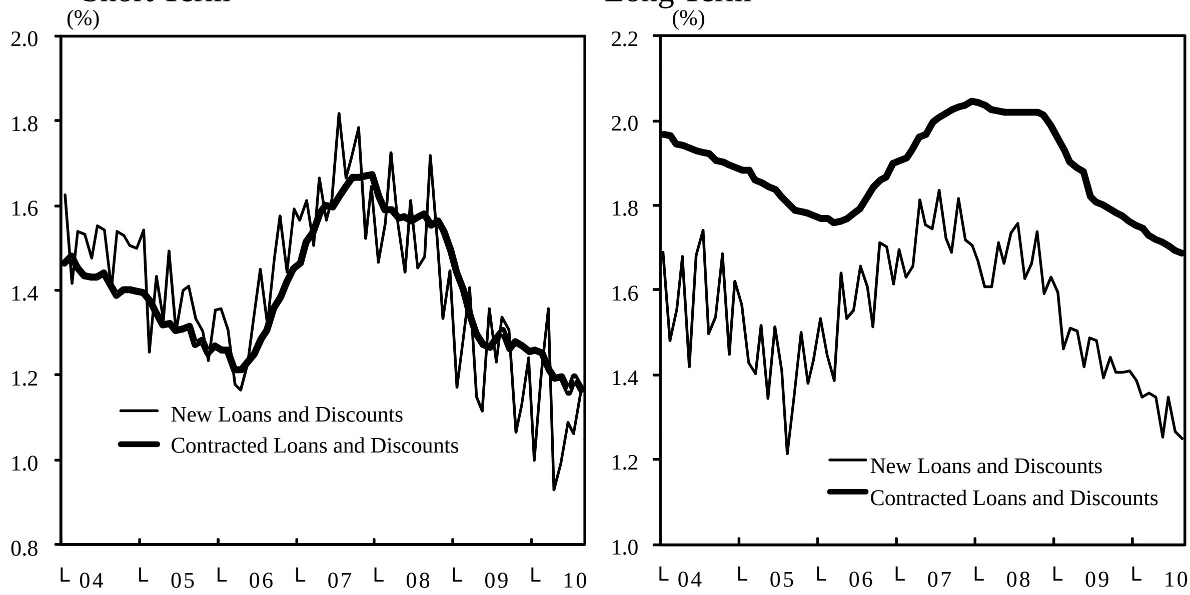
2. Corporate Finance: Current Situation (Three Perspectives)

(3) Status of bank lending policies: Banks' view (cont'd)

-- Banks' loan rates have fallen significantly since FY2009

(Figure 4) Interest Rates on Loans and Discounts

・Short Term ・Long Term



Source: Average contracted Rates on Loans and Discounts, Bank of Japan

2. Corporate Finance: Current Situation

To grasp the real condition of corporate finance

- Analysis of changes in the amount of loans
- Data on both borrowers and lenders
- Trend of lending rates

⇒ **Necessary to observe and analyze various indicators comprehensively**

Corporate finance: Current situation

- Although small companies' financial position and their views on the banks' lending stance toward them is still strict, the situation of corporate finance has become more accommodative in general

<Actions to enhance growth potential>

- A financial function that enables positive and forward- looking activities among companies has been fully realized?

⇒**What is the expected "role of financial institutions" toward strengthening the growth potential of the Japanese economy?**

3. Strengthening of Customer-companies' Growth Potential:
The Role of Financial Institutions

Financial strength of companies

- Improved significantly over the last year or two

  ⇒ Companies have ample liquidity (a persistent defensive stance)

Some companies are taking a more proactive stance

- Strengthening of product development ability
- M&A of foreign companies

◦ Capturing demand in emerging countries, particularly in Asia
◦ Needs of a new age, with an eye to the world's most rapidly aging population, and the need for future environmental responsiveness

In order to enhance the growth potential of the Japanese economy, it is important to provide financial support to those companies that aspire to grow in response to new business environments

＝ Importance of the role of financial institutions

Explore these points focusing on the lending practice of financial institutions

3. Strengthening of Customer-companies' Growth Potential:
The Role of Financial Institutions

Return to Basics: Sharpening the "Expert Eye"

Characteristics of the indirect financial system (during the high-speed growth era)

- Banks' ability to produce information ＝ using an "expert eye"
  ⇒ Responded to strong demand for funds
- At the same time, they started to focus on credit protection measures, characteristically in the form of real estate collateral and personal guarantees

Lower growth expectations

Decline in earning power of financial institutions

⇒ The expert eye is weakened and more focus is placed on preservation

Lending method that relies heavily on real estate collateral and personal guarantees

- Might weaken the ability to monitor business cash flow
- Might make it difficult to provide funds for new companies and new business areas

3. Strengthening of Customer-companies' Growth Potential:
The Role of Financial Institutions

Review of lending practice

(a) Use of covenants (contract provisions)

A loan contract, agreed between a bank and a borrower

[Not relying excessively on collateral or guarantee
Improve the Bank's ability to monitor the borrower company]

(b) Asset-based lending (ABL)

A loan secured by the receivables and movable properties held by the borrower company

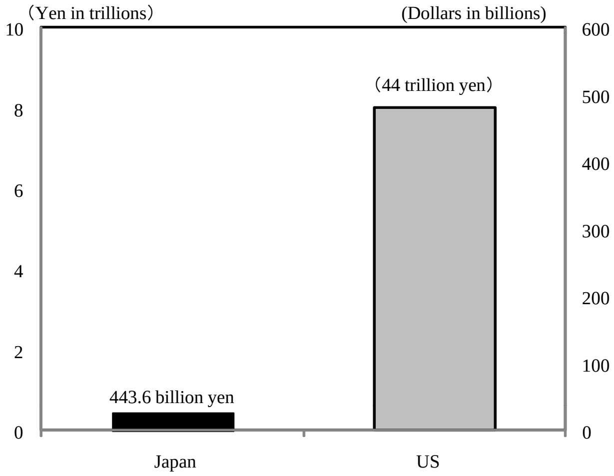
- A method which finds value in corporate activities on their own terms
  ⇒ Enables companies that do not own enough real assets to raise substantial financial resources . May be used for business succession.
- Great potential for further expansion

3. Strengthening of Customer-companies' Growth Potential: The Role of Financial Institutions

— The Japanese ABL market has great potential for further expansion

(Figure 5) Asset-based Lending Markets in the US and Japan

○ Outstanding Balance in the ABL Market in Japan and the US

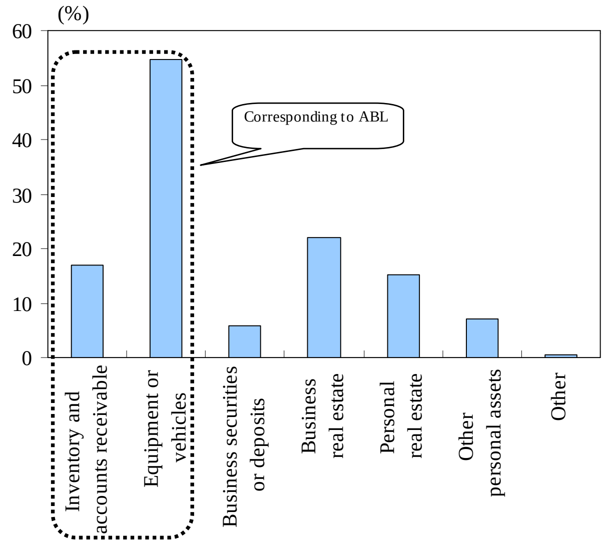


Note: Figures as of the end of March 2009 for Japan/as of the end of December 2009 for the US

Source: "Survey Research on Penetration and Use of ABL" Ministry of Economy, Trade and Industry

"Annual Asset-Based Lending and Factoring Surveys, 2009" Commercial Finance Association

○ Distribution of Secured Loans in the US by type of collateral



Source: "1998 Survey of Small Business Finance" FRB

3. Strengthening of Customer-companies' Growth Potential: The Role of Financial Institutions

Use of covenants/ABL ⇒ **Tools that contribute to re-strengthening of banks' "expert eye"**

Improving the ability to provide financial support to strengthen the growth potential of Japanese companies

⇒ Ingenious practices and manager's will are essential

<Loans to small companies> <u>Policymakers' concerns</u>

US

Measures taken by the Federal Reserve System (Figure 6)

- Discussions on the issues facing small business finance and solutions to such issues

Japan

Measures taken by the Bank of Japan

- Growth Foundation Strengthening Facility (GFSF)

  ⇒ Introduced in June 2010

  Strengthening the growth foundation through improvement of the financial intermediary function

3. Strengthening of Customer-companies' Growth Potential: The Role of Financial Institutions

(Figure 6) Measures toward improving Small business finance in the US

— Discussions at "Addressing the Financing Needs of Small Businesses," a forum organized by the FRB

○ Proposals for improvement offered at the forum

<Proposals for the government (regulation and legislation, etc.)>

・Need for Improved dialogue between financial institutions and regulators.

— Need for continued use of guidance that includes real-world examples and establishment of a means through which institutions can report concerns about or appeal an examiner's decision to the regulatory agency through a neutral intermediary such as an ombudsman, etc.

・Better tax breaks to promote investments in small and medium companies

— New Markets Tax Credit program more supportive of small business lending by establishing a safe-harbor provision

・Improvement of the guarantee system provided by the Small Business Agency

— SBA enhancements that increase guarantee limit and simplification of the process

<Proposals for banks>

・Financial institutions' use of "second look"

— to help ensure that viable applicants are not overlooked

・Financial institutions' need to receive complete and accurate documentation from small business loan applicants

— Items such as reliable financial statements and accurate tax identification numbers necessary so that loan decisions can be made in a timely manner

・Collaboration between banks and regional development organizations

— Banks and CDFIs set up more effective and consistent processes for banks to refer small business applicants whose credit needs they cannot meet to CDFIs

<Proposals for small and medium companies>

・Utilization of managerial skill assistance for small companies

— Increased use of the SBA Service Corps of Retired Executives (SCORE)

<Other>

・Need for research and data related to small business lending and .

— More frequent data collection, such as on a quarterly basis, etc.

4. Growth Foundation Strengthening Facility

(Fund-provisioning Measure to Support Strengthening the Foundations for Economic Growth) : Outline

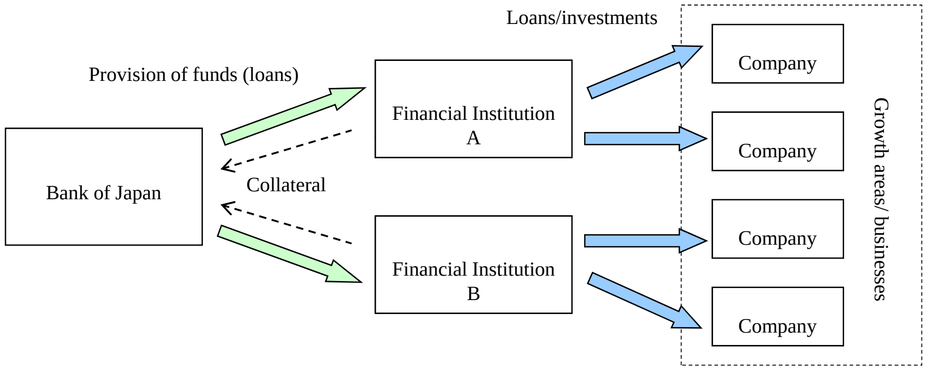
4. Growth Foundation Strengthening Facility: Outline

(Figure 7) Growth Foundation Strengthening Facility (GFSF): Outlines

Measure to provide long-term funds at lower rates to financial institutions that endeavor to strengthen the foundations for economic growth

- Users of the scheme: Broad range of financial institutions, including regional financial institutions
- Duration: Four years maximum (one year in principle, which can be rolled over up to three times)
- Loan rates: the policy interest rate, which is 0.1% at the moment
- Total amount of loans: the maximum total amount of the loan is three trillion yen, maximum amount for each eligible borrower is 150 billion yen)
- Application deadline: end of March 2012

- The Bank of Japan expects the GFSF to act as a catalyst inducing financial institutions' efforts toward economic growth.
- The Bank of Japan does not provide any guidance or instruction on allocation of funds to specific industries or companies.



4. Growth Foundation Strengthening Facility: Outline

(Figure 8) Submission of a Plan for the Efforts and Record of Individual Loan/Investment Transactions

Financial institutions that apply to use this GFSF shall formulate a "plan" concerning loans and investments to strengthen the growth platform and the individual loans and investments under the plan, which is confirmed by the Bank of Japan for certain conditions established by the Bank as shown below.

(Use of funds)

1) Research and development
2) Setting up a new business
3) Business reorganization
4) Investment and business deployment in Asian and other countries
5) Science and technology research at universities and research institutions
6) Development and upgrading of social infrastructure
7) Environment and energy business
8) Business for securing and developing natural resources
9) Medical, nursing care, and other health-related business
10) Business serving the needs of senior citizens
11) Business in the content creation industry
12) Tourism business
13) Regional and urban revitalization business
14) Agriculture, forestry, and fisheries business; Business linking agriculture, commerce, and industry
15) Business that supports the creation of housing stoc
16) Disaster prevention business
17) Employment support and human resource development business
18) Childcare service business

- Funds may also be used in areas not listed above as long as their use supports strengthening of the foundations of economic growth.

4. Growth Foundation Strengthening Facility: Outline

(Borrower/Investee)

Domestic residents and foreign corporations with a business establishment in Japan and conducting business in the areas identified as contributing to strengthening the foundations of economic growth

(Maturity of lending or investment)

One year or more

(Others)

The Bank of Japan shall be under no obligation to provide funds where, for whatever reasons, it considers this to be inappropriate.

4. Growth Foundation Strengthening Facility :Outlines

— The number of eligible financial institutions increased significantly, particularly regional financial institutions

(Figure 9) Number of Eligible Financial Institutions by Business Category (1st round ⇒as of the end of November)

(Number of Institutions)

	Institutions Selected for the 1st Round	Newly Selected Institutions	Total
Major banks (12)	12	-	12
Regional banks (63)	33	27	60
Second-tier regional banks (42)	8	29	37
Shinkin Banks (263)	6	19	25
Others	7	2	9
Total	66	77	143

Note: The figures in brackets are the total number of institutions by business category.

5. Efforts of financial institutions to support strengthening the foundation for growth

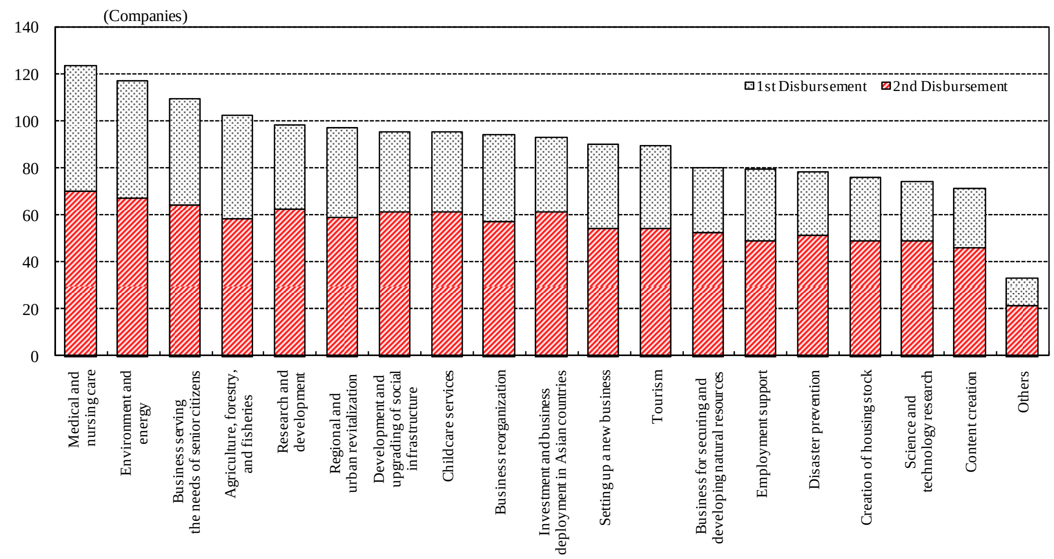
5. Efforts of financial institutions to support strengthening the foundation for growth

Across a wide variety of areas including "medical and nursing care," "environment and energy," and "business serving the needs of senior citizens."

— In addition, in areas other than the 18 areas listed by the Bank of Japan.

(Figure 10) Distribution of Eligible Growth Areas Listed in the Plans

Number of financial institutions identified as eligible based on the plan:127



Note: Arranged in descending order of the number of eligible financial institutions for the growth area for the 1st and 2nd disbursement (accumulated total)

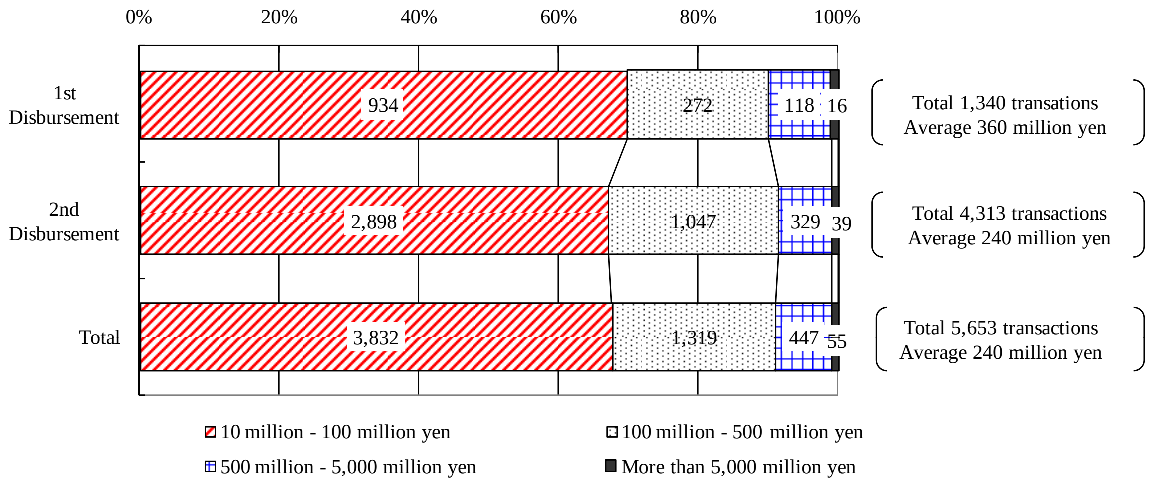
5. Efforts of financial institutions to support strengthening the foundation for growth

(Figure 11) Actual Individual Investment and Loans Confirmed by the Bank of Japan

- First disbursement: 1,340 transactions / 478.6 billion yen
- Second disbursement: 4,313 transactions / 1056.4 billion yen

— The average amount of individual investment / loan became slightly smaller.

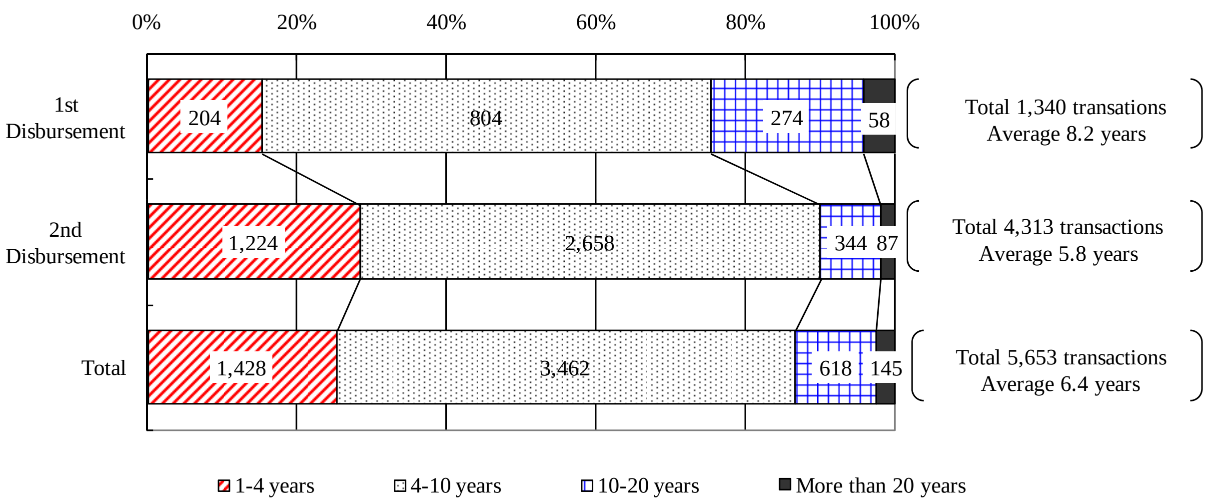
(Figure 12) Distribution of the amount per loans and investments (based on the number of transactions)



5. Efforts of financial institutions to support strengthening the foundation for growth

— The average maturity of individual investment/loan transactions was shortened

(Figure 13) Distribution of Individual Loans and Investments maturities (based on the number of transactions)

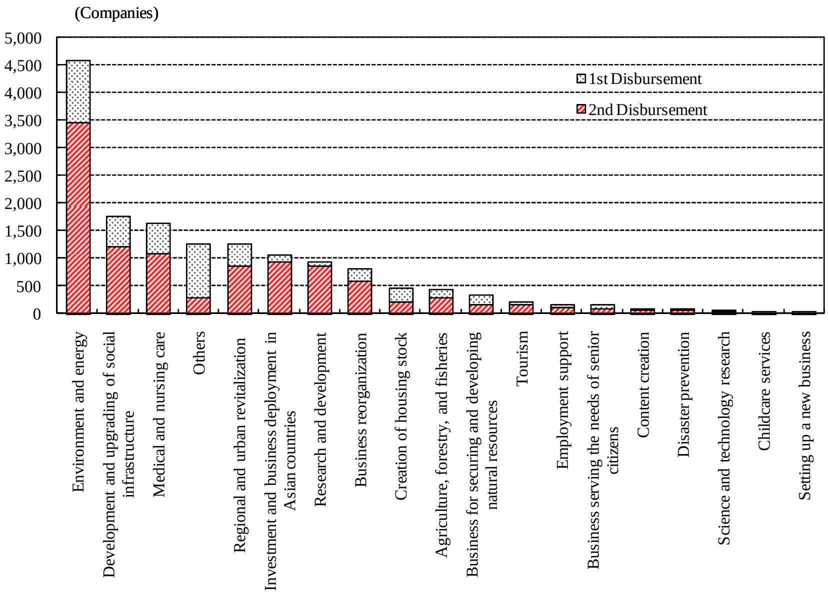


5. Efforts of financial institutions to support strengthening the foundation for growth

-- The “environment/energy business” area accounts for the largest percentage in terms of amount

-- Notable increase in the “investment and business deployment in Asian countries” area in addition to “development and upgrading of social infrastructure” and “medical and nursing care.” A stable increase in the “other” area selected independently by financial institutions.

(Figure 14) Distribution of Individual Loans and Investments by Growth Area



Note: Arranged in descending order of the number of eligible financial institutions for the amount of the individual investment and loan transactions for the 1st and 2nd rounds (accumulated total)

5. Efforts of financial institutions to support strengthening the foundation for growth

(Figure 15) Examples of Efforts

Key growth area	Examples
Setting up a new business	・Support for setting up a new business using venture capital ・Assistance with the establishment of new service businesses including hotels and restaurants ・Funds provided to a transport company to start the manufacturing operation and launch of new products
Business reorganization	・Company acquisition to expand the scale with a view to survival in the industry ・Management buyout of a subsidiary to respond smoothly to changes in the market ・Funds required for reconstruction of business facilities for consolidation of locations, etc.
Investment and business deployment in Asian countries	・Enterprise funds for strengthening production and expansion of distribution channels in China and other Asian countries (construction of a new/additional plant, establishment of a subsidiary, etc.) ・Funds for establishment/acquisition of a joint venture for business expansion, e.g., a partnership with a local company, etc.
Development and upgrading of social infrastructure	・Funds for installation of telecommunications cables and expansion of areas in which telecommunications service is provided ・Funds for creation, reconstruction, and repair of the regional transportation network ・Funds for refurbishment/installation of gas and other supply systems
Environment/ Energy	・Equipment funds for electricity and oil development ・Equipment funds to improve energy conservation at the plant ・Funds for construction of waste-recycling facilities ・Funds for replacing cars with environmental friendly vehicles such as eco-cars

5. Efforts of financial institutions to support strengthening the foundation for growth

（(Figure 15 <cont’d>) Examples of Efforts

Key growth area	Examples
Medical/ Nursing care	･Funds for constructing new medical and welfare institutions ･Funds to purchase advanced medical equipment (CT scanners, MRI equipment, etc.)
Business for senior citizens	･Funds for construction of new private nursing homes, day care centers, etc. and for improvement of services
Tourism	･Funds for new construction, upgrading, or refurbishment of facilities with a view to effectively using the tourism resources in the region (scenic areas, hot springs, etc.) ･Funds for refurbishment of restaurants/shops at traffic facilities ･Funds for refurbishment of Japanese-style inns and hotels to increase the number of tourists and improve convenience
Regional and urban revitalization	･Funds to open new shops and distribution centers to create new jobs/demand in the region ･Urban area redevelopment funds by a securitization scheme to facilitate fund-raising ･Funds to open stores using vacant outlets /spaces in the central district that has become hollowed out
Others	･Equipment funds for food-processing companies using local products with a view to improving productivity ･Funds for equipment and operation to strengthen the platform for local basic industries (manufacturing, retail, etc.)

5. Efforts of financial institutions to support strengthening the foundation for growth

More proactive efforts than ever by financial institutions

- Establishment of new facilities and investment/loan programs
- Information gathering on growth areas and growing companies
  - ⇒ Use of such information to support branches in promoting their business
- Strengthening of group-wide collaboration
- Re-examination of credit risk management

Encouraging moves, all leading to a sharpening of the “expert eye”

More proactive and forward-looking actions by financial institutions

＝ Exactly what we expect from the GFSF as a catalyst inducing financial institutions’ efforts toward economic growth.

6. Conclusion

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