



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”
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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

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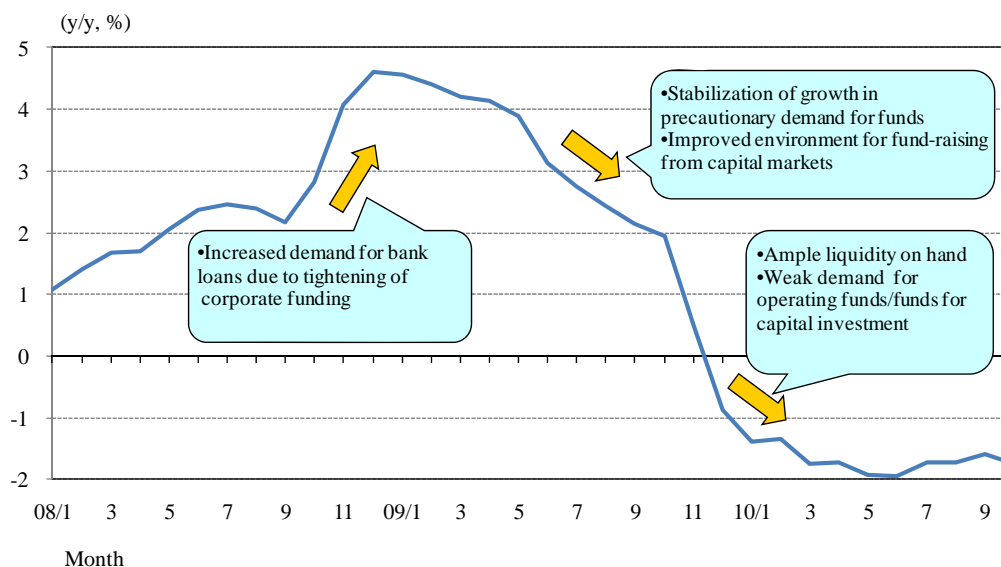
2. Corporate Finance: Current Situation (Three Perspectives)



(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



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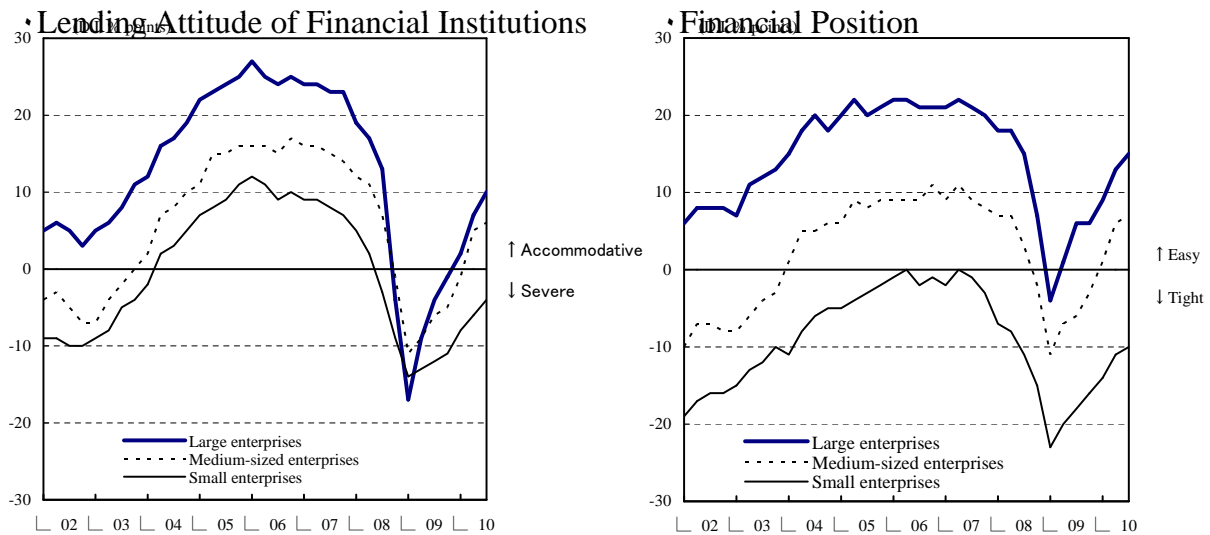
2. Corporate Finance: Current Situation (Three Perspectives)



(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

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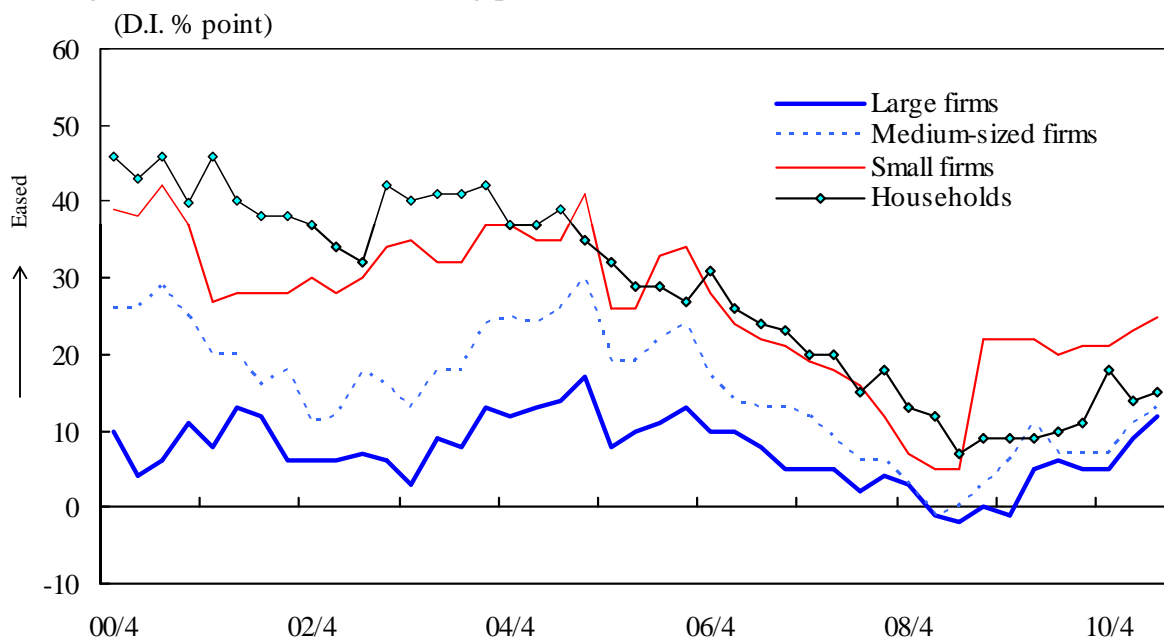
2. Corporate Finance: Current Situation (Three Perspectives)



(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

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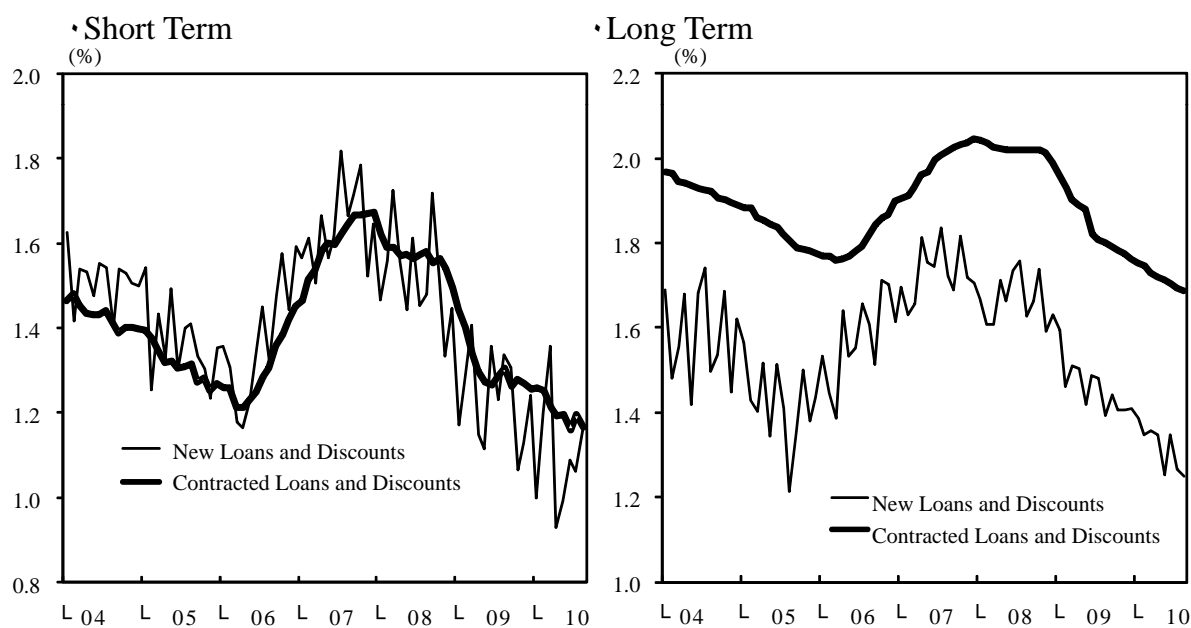
2. Corporate Finance: Current Situation (Three Perspectives)



(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



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

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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?**

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

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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

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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 ¹²

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

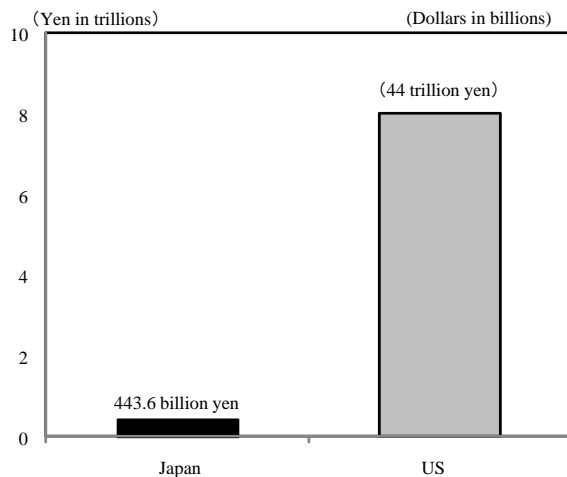
3. Strengthening of Customer-companies' Growth Potential: The Role of Financial Institutions



— 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

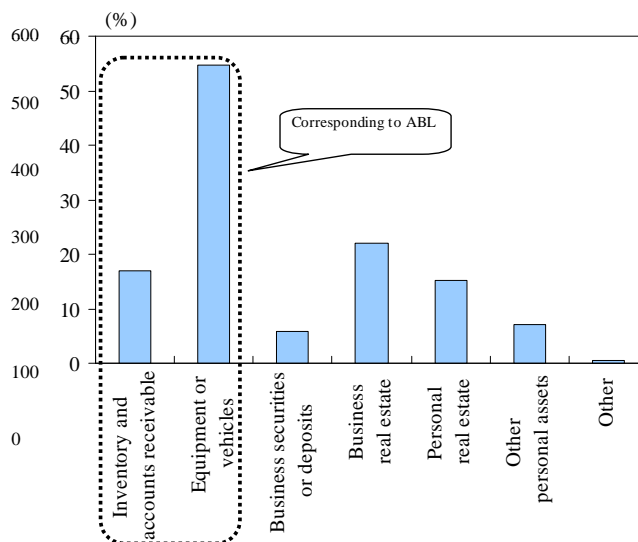


Note: Figures as of the end of March 2009 for Japan/as of the end of December 2009 for the US

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

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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> Policymakers' concerns

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

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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.

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4. Growth Foundation Strengthening Facility

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

4. Growth Foundation Strengthening Facility: Outline

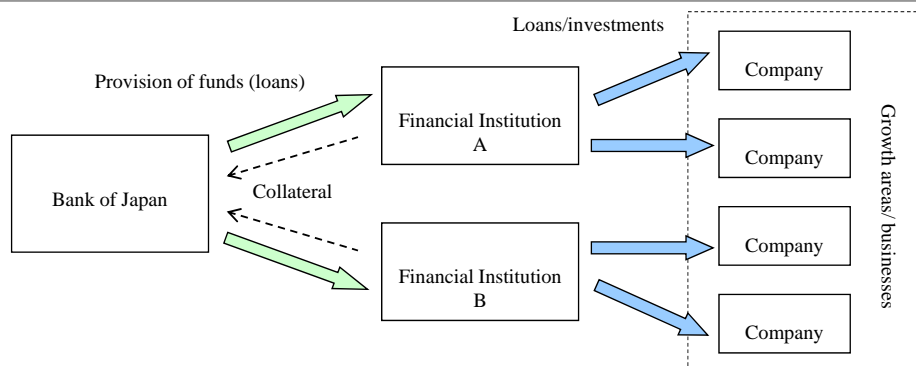


(Figure 7) Growth Foundation Strengthening Facility (GFSF): Outlines

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.



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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;
- 15) Business linking agriculture, commerce, and industry
- 16) Business that supports the creation of housing stock
- 17) Disaster prevention business
- 18) Employment support and human resource development business
- 19) 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.

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(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)

	Institutions Selected for the 1 st Round	(Number of Institutions)	
		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

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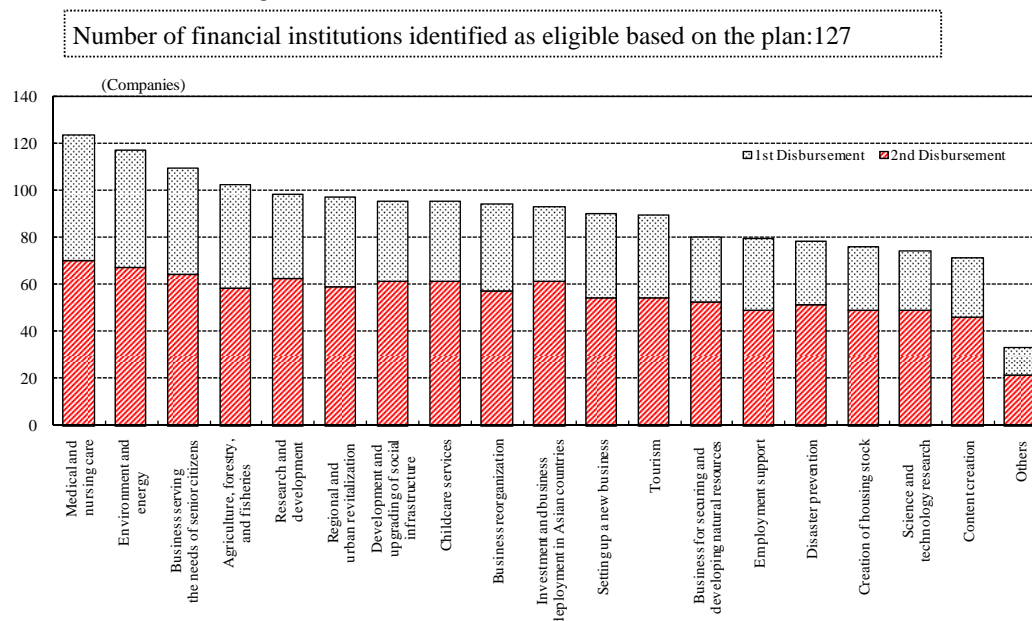
5. Efforts of financial institutions to support strengthening the foundation for growth



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



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

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

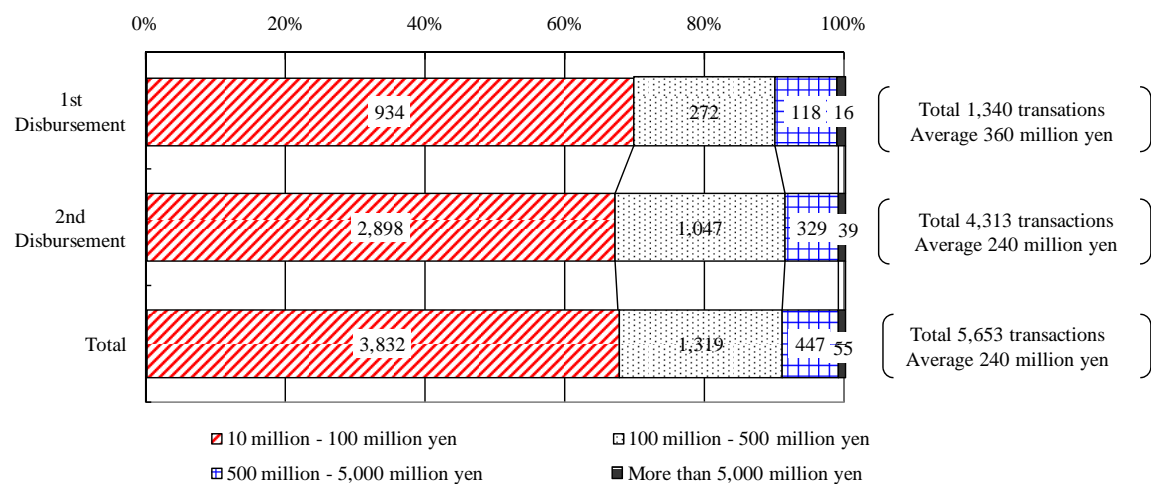


(Figure 11) Actual Individual Investment and Loans Confirmed by the Bank of Japan

- 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)



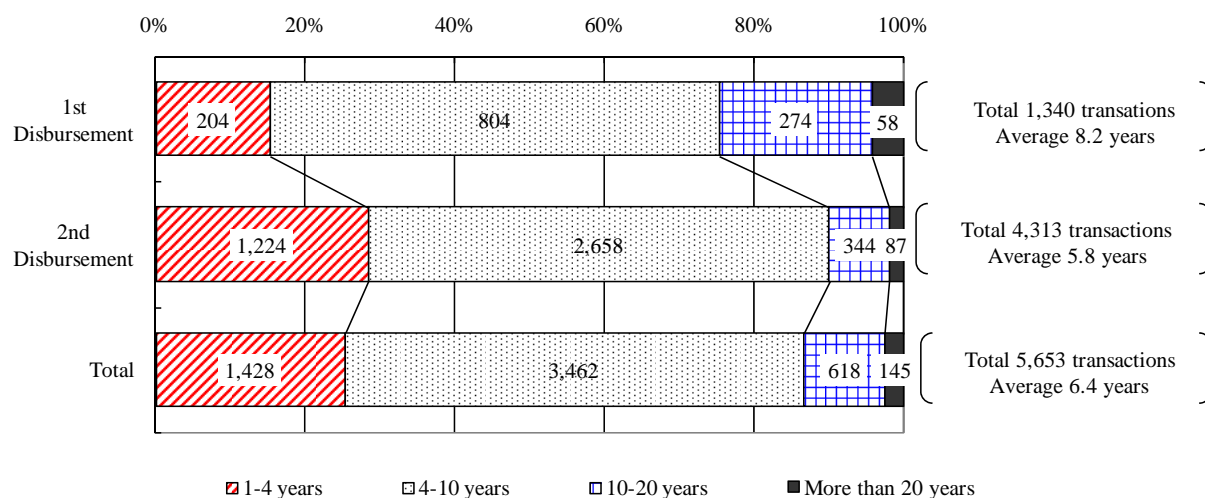
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5. Efforts of financial institutions to support strengthening the foundation for growth



— 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)



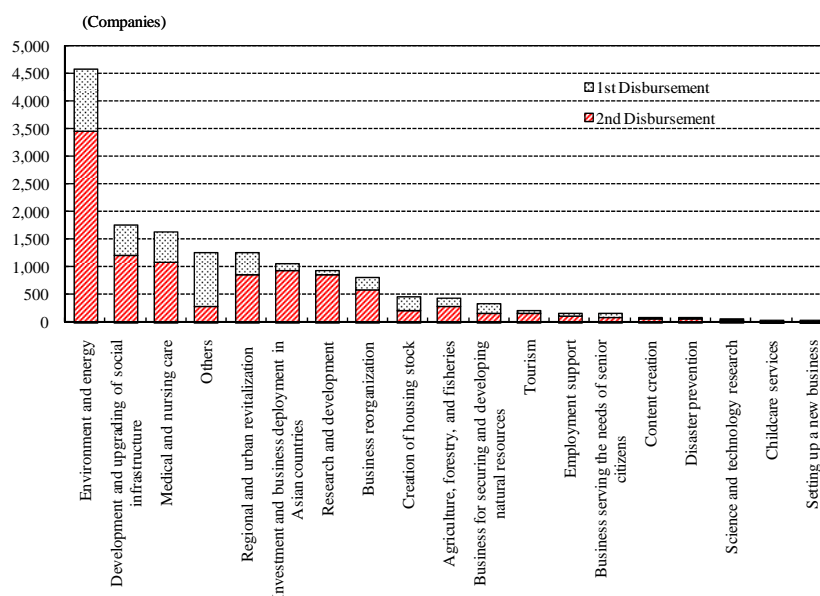
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5. Efforts of financial institutions to support strengthening the foundation for growth



- 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)

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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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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

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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	<ul style="list-style-type: none"> • Funds for constructing new medical and welfare institutions • Funds to purchase advanced medical equipment (CT scanners, MRI equipment, etc.)
Business for senior citizens	<ul style="list-style-type: none"> • Funds for construction of new private nursing homes, day care centers, etc. and for improvement of services
Tourism	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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.)

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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.

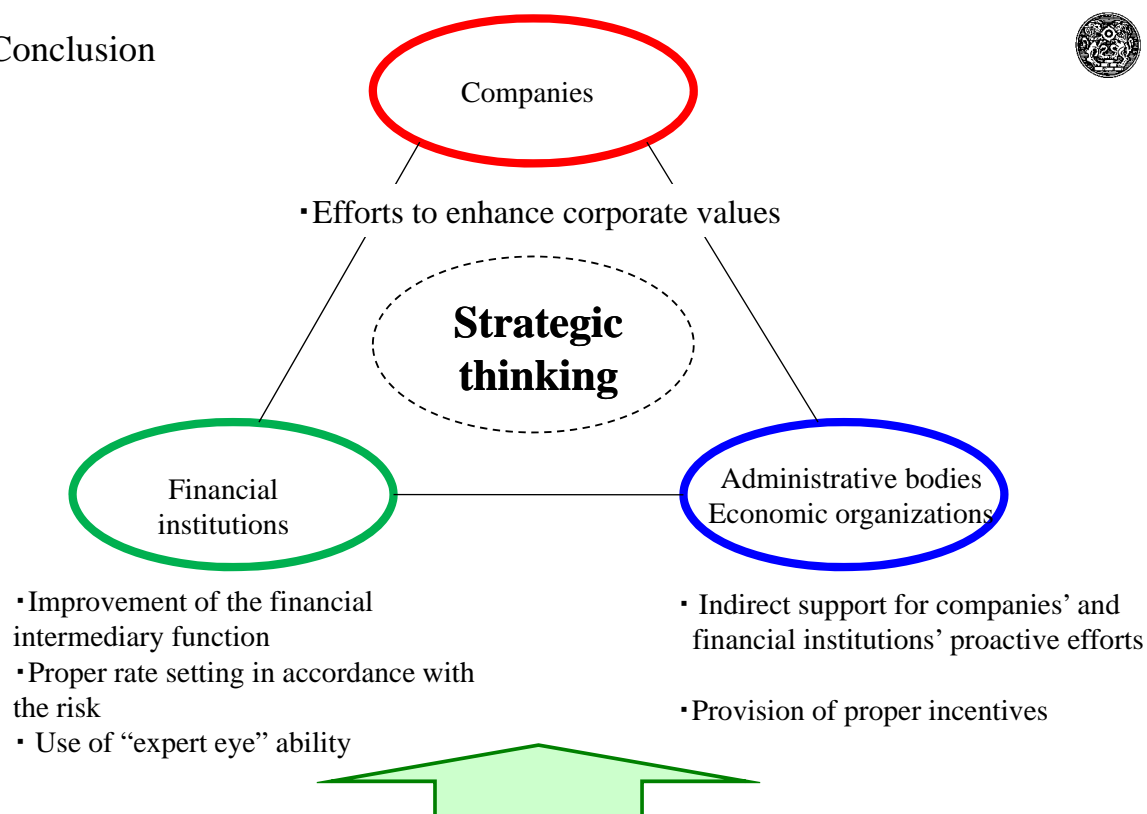
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6. Conclusion

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The Bank of Japan’s Growth Foundation Strengthening Facility

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