Japan on the Upswing

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Why the Bubble Burst and Japan's Economic Renewal

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Preface

The groundwork for the bubbling Japanese economy of the late 1980s was laid in 1987 by none other than the Bank of Japan, which lowered the prime rate to as low as 2.5% and kept it there for two years and three months until 1989. This made the economy chug along with steaming hot "bubbles."

You will learn the reasons, in Part 1, as former Prime Minister Miyazawa explains. After the economy zoomed upward, that guardian of financial sanity called the Bank of Japan took a very anti-conservative step in raising the rate from 2.5% to 6% in a matter of 15 months. It was May 1990.

This was like calling out the Forestry Department to douse a small campfire — it was overkill, and the "bubble" broke in 1992. As if to give the coup de grace to a gasping patient, a measure called "Soryo Kisei" — the Total Amount Reduction — was introduced to squeeze the flow of money down to a trickle. It was also May 1990.

This could have been a commendable action, had it been applied gradually over some extended period of time to cushion any sudden impact on the economy. But the Bank of Japan did it with the single-mindedness of a samurai. The flow of funds was nearly halted, economic activity hit a wall, and the recession set in.

As the market turned feverish, then quickly cooled, Japanese banks and other financial institutions played a major role in creating the real estate bubble (the first alarm was issued by Prof. Y. Noguchi in the fall of 1987). They pushed their employees to get more deposits from their customers. The money thus collected was quickly turned over in real estate loans. As long as their customers had land, they were happy to provide loans on any piece of property put up as collateral, since land prices were soaring. They made money as the value of the collateral shot up. Many corporations and manufacturers climbed onto the band wagon for land buying before taxes bit into their huge profits.

In 1992, the "bubble" burst as stock prices went down and so did land prices. The United States experienced this sort of bubble in the 1970s when the savings and loan associations went belly up, one after another. But the US government took a hands-off policy.

On the other hand, the circumstances were quite different this side of the Pacific. Major commercial banks, trust banks, and regional banks, to say nothing of small credit unions and credit associations, were all involved in the land-buying spree. Mega banks took active part in lending, and soon loans were going sour. Japan could not very well let these mega banks, saddled with enormous bad loans, go bankrupt. That would have caused worldwide repercussions.

The measures taken by the government were not successful; they were too little, too late. Most of the policy-makers thought that things would return to normal in a matter of a few years, since there was a belief in the ever-growing trend that had marked Japan's economy since the end of the World War II.

By the year 2000, it was clear that the decade-old recession must be resolved by all means. The key was to force the banks to declare accurately the amount of uncollectible loans and to clear such loans (at taxpayers' expense). Because the ruling party was quite in debt to the financial world, this was not earnestly undertaken until Prime Minister Jun-ichiro (meaning pure + first son) Koizumi took office in April of 2001. In critical situations, he does not mind twisting arms. Believe it or not, he is Japan's savior.

Koizumi is a cut above his predecessors; he is doing a superb job of revamping Japanese politics and economy. He is not as good a talker as Margaret Thatcher, but he gets things done. Furthermore, he is clean, a quality that is rare among his peers.

He is not a reform-centered, righteous, raving samurai. He knows what he can and cannot do because of his years of experience in politics. He likes music, Kabuki, and art. He likes opera, too. On top of all that, he has a good sense of humor, probably acquired from his association with British students while attending the University of London in his 20s.

Koizumi flunked twice in the race for premiership but made it at the third try in 2001, despite a popular Japanese saying, "What happened twice will happen thrice." Actually, there is another proverb, better known in the US: "The third time is the charm."

Koizumi and the indefatigable Bank of Japan Governor T. Fukui and State Minister Heizo Takenaka worked to clear up the mess of bad loans. Takenaka is as hard-nosed as Harry S. Truman: "The buck stops here." Thanks to Takenaka's uncompromising techniques, and the Financial Services Agency backed by its team of veteran inspectors skillfully applied to prod powerful bankers, Japan's economy began gearing up in the second half of 2003.

This was especially good news to the stockbrokers, foreign and domestic investors, as well as bankers. All 19 stockbrokers listed in the Tokyo Stock

Exchange were having a field day, reporting figures in the black in 2003, 2004, and 2005, and their employees received handsome yearend bonuses.

My analysis of these events is based on a familiarity with America as well as the Japanese system, and a background in business as well as technology: I graduated with a B.A. in mathematics from the University of Wisconsin in 1959 with a minor in English. It was during the Eisenhower Administration and it was the time of recession, as well. Upon graduation, I worked as a low-temperature biophysicist at a biological research lab in Madison for nearly two years, and then I returned to Japan.

Japan in the early 1960s was still in the stage of taking off to join the group of industrialized nations, and jobs were hard to find. The exchange rate was fixed at ¥360 to the US dollar. I made ¥35,000 (a little under $100) net per month, which was then considered good money. Advertising was a new field, and I was able to find work in Tokyo and Osaka as an account executive and marketing planner from 1962 to 1968.

Above all, I enjoyed working for Dentsu Advertising. It was the world's largest advertising agency in billing in those days with an A-1 clientele. My experience there gave me firsthand knowledge of the leading corporations and manufacturers such as Toyota and Panasonic.

From 1968 to 1972, my interest switched to the marketing aspect of Hong Kong tourism, which was a burgeoning trade. Then, after the oil crises, the 1970s turned out to be a period marked by a shortage of technical translators into English. Actually, it was a niche in Japanese industry, and my science and engineering background came to life.

Since 1972, I have been working as a business consultant as well as a technical interpreter and translator. In the past ten years, my work has centered on translating into English contracts and patents for Japan's major manufacturers of information technology including computers, semiconductors, and telecommunications.

Working all these years since 1961, one thing I have consistently practiced — reading the *Nihon Keizai Shimbun*, which is Japan's counterpart of the Wall Street Journal, and a host of business and popular magazines and journals to keep abreast of what is going on in Japanese business and industry on many levels.

In the present discussion of the Japanese financial condition in the post-"bubble" years, I detail, in Part 1, from the standpoint of a consumer and an individual investor, how Japan wound up with bad loans of astronomical proportions, first estimated in 1995 as ¥10 to 15 trillion ($115 to 172 billion, at the prevailing exchange rate of ¥87/$1) and later mushrooming to ¥100 trillion (some $830 billion, ¥120/$1) or more.

My aim is to present the qualitative aspect as well as the human side of business life rather than giving a scholarly discourse on the state of the Japanese economy. For example, Chapter 8 is a brief introduction to some aspects of racketeers in business. I have tried to stay away from using too many charts and tables except when analyzing the promissory notes and bills section of the balance sheets of 10 companies, big and small, such as Toyota, Nintendo, and Starbucks. Little tips, anecdotes, stories, and incidents make up something of what is Japanese economy.

I am not an academic scholar. My understanding of economics, finance, advertising, marketing, investments and other aspects of business comes largely from talking with consumers, reading, and experience. My marketing experience includes preparation in Japanese and English of scores of marketing recommendations in Japan and the United States. Whenever it became difficult to read between the lines, my friends and acquaintances offered a helping hand with their expertise.

From conversations with many Americans and Europeans, I sensed a need to include some details on how business is conducted in Japan. For example, promissory notes are a common form of payment in Japan, so you don't get cash payment immediately. In case of a 3-month note, it takes at from three months to, very often, five months to see the money (details in Chapter 3).

Whenever I show figures in Japanese yen, I present, I present approximate values in US dollars. These dollar figures are approximations only, and the Japanese figures represent the actual values.

Part 1 also describes how Prime Minister J. Koizumi and Minister H. Takenaka, together with dedicated politicians, government officials and Bank of Japan officials, have tackled nearly insurmountable difficulties, practically halving the bad loans by March 2005. The American reader will see that Minister Takenaka played hard ball to get the situation under control.

Further, Part 1 details the background, education, and other factors that go into the selection of the elite officials of the almighty Ministry of Finance. To my knowledge, this is the only book available in English to cover this material.

Part 2 introduces, among other things, internationally known corporations and manufacturers — Panasonic, Sony, Seiko-Epson, Canon, Seven Eleven Japan, and other companies that make up the driving force behind Japan's upswing.

I would like to express my sincere appreciation to Morse Saito and Dr. Earle Labor for the constant encouragement and support offered to me at every step of the way for five decades. My thanks are also due to Y. Sato, C.P.A., Y. Inoue, Esq., T. Okano, financial research economist now retired, A. Ocdaira (now deceased) of Kanematsu Corporation, and a host of friends and acquaintances in advertising, finance, and business for the many tidbits of information that fleshed out this presentation.

This book is dedicated to Prime Minister Jun-ichiro Koizumi with deep appreciation for his grit, integrity, and leadership in putting Japan back on its feet.

Part I. Misguidance and Miscalculations from 1990 to 2002

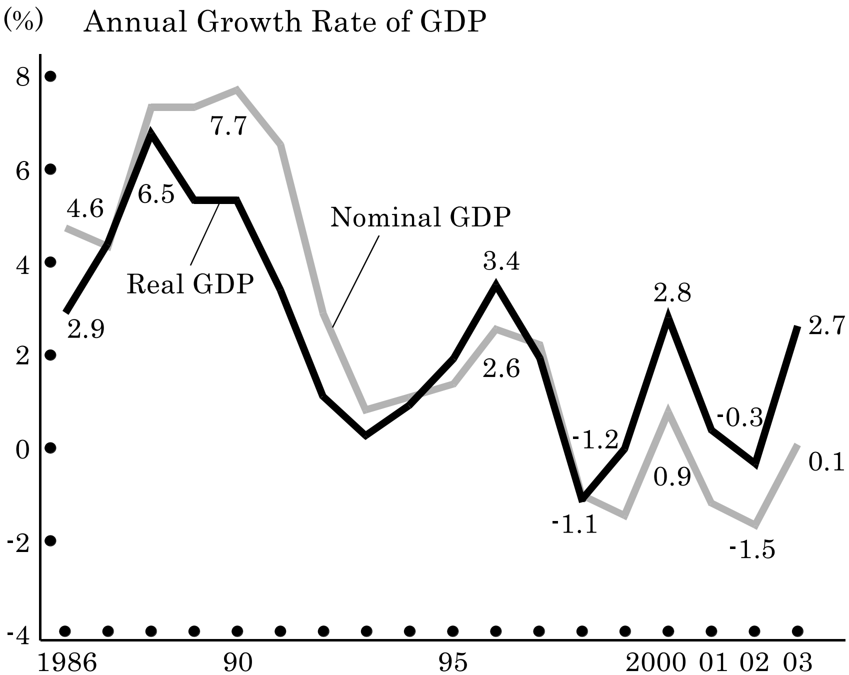
Let's find out which parties are responsible for making mistakes and miscalculations as well as taking questionable actions while the Japanese economy was walking a tight rope. Since the state of the economy began looking up in the second half of 2003, we will focus on what took place from 1990 to 2002, but first, let us look at what actually took place in macro- and micro-economic terms over the past 20 years.

Too much of the past discussions on Japan and on Japanese economy have been deductive; but to present an inductive analysis you must have enough details to form your conclusion, and this is a difficult task. Still, going over some selected details gives us a chance also to look at many facets of Japanese business practice which may be useful.

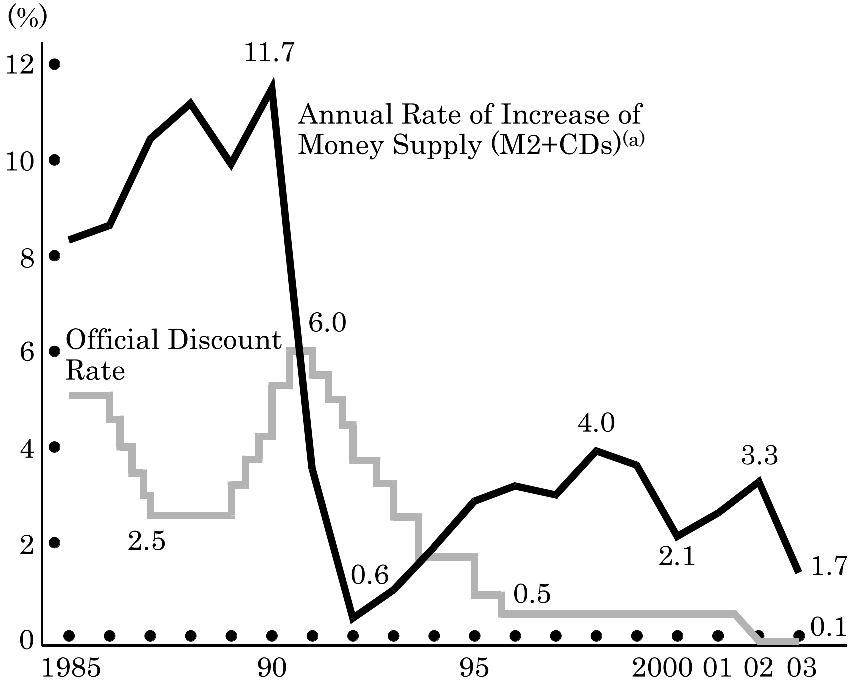
Since 1985, Japan has been at the mercy of the ups and downs of its economy — GDP, money supply (M2+CDs), land prices, as well as unemployment rates. The following four charts have been prepared by Keizai Koho Center, working in cooperation with Keidanren or the Japan Federation of Economic Organizations, illustrating how the country prospered and suffered.

Figure l-l The Rise and Fall of the Japanese Economy

A

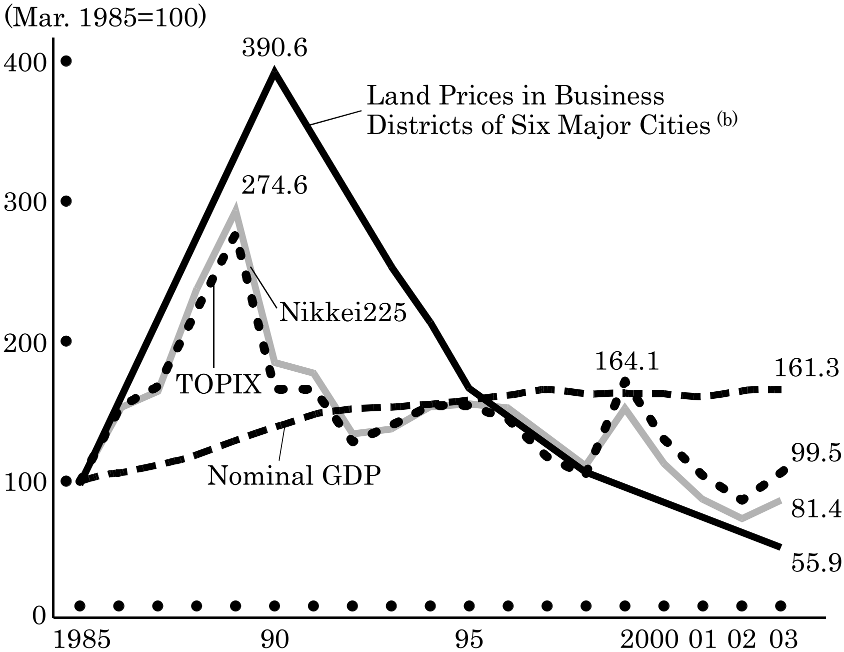


B



Note: (a) Average outstanding

C



Sources: Tokyo Stock Exchange; Japan Real Estate Institute; Financial and Economic Statistics Monthly, Aug. 2004, Bank of Japan; and OECD Economic Outlook, 75, June, 2004.
Note: (b) Tokyo, Yokohama, Osaka, Nagoya, Kyoto and Kobe; TOPIX stands for the Tokyo Stock Price Index.

Chapter 1. 1990-2002: What Happened in Japanese Finance

As a result of excess liquidity, a strange creature showed up in the Japanese financial world in the early 1990s. It had no banking license, yet it was doing what any other financial institution was doing — lending money to any individual, corporation or organization seeking loans after being rejected by bona fide banks as too risky. Since the money-making opportunities were there regardless of the risk factor, the commercial, trust, and regional banks, as well as affluent corporations, began setting up subsidiaries commonly called "Non-banking Institutions." In Japanese, they are simply called "non-bank affiliates" or NBs.

NBs, A New Financial Institution

In the early 1990s, it was known that the NBs, already a third major force, were rapidly making headway in the Japanese world of finance. Some officials of the Ministry of Finance (MOF) sensed that something was going on in their field of jurisdiction. A project team was organized to investigate.

In March 1992 the MOF listed about 21,800 companies in 12 diverse trades — street consumer loan firms, finance companies set up by major commercial or trust banks, credit associations, even brokerage houses, leasing companies, installment sales companies, etc.

What is astonishing is that, as of March 31, 1992, the outstanding loan balances of these NBs amounted to over ¥98 trillion (about $980 billion), up 22.6% over the prior year. The total amount of loans extended by the 64 regional banks as of March 31, 1991 came to about ¥117 trillion ($1.17 trillion), only ¥19 trillion ($190 billion) more than the total amount of loans extended by all NBs. Most of the loans extended by the NBs were financed by major commercial and trust banks at interest rates much higher than those offered to their corporate accounts.

About this time, the Bank of Japan (BOJ) did its own investigation regarding the strange creature called the NB — to find out what had enabled these bastard financial institutions to gain strength in the second largest economy of the world. While the BOJ is revered in the financial world, its efforts to learn about the NB encountered a Berlin Wall of resistance. All the banks contacted by the BOJ replied that they were absolutely in no position to ask their NB affiliates or subsidiaries what client firms they were dealing with, due to confidentiality agreements.

To the regulatory agencies, all the commercial and trust banks even refused to provide data on the kind of financial services they were providing to their NB subsidiaries. It took the BOJ and the MOF months to build up a comprehensive picture of what turned out to be a behemoth.

In the first half of the 1980s, Japanese bank lending activities were not particularly geared toward real estate. Real estate loans were just 5–6% of the total loans and bills discounted.

Former branch manager Akira Yamashita of Sumitomo Bank[1] recounts how he got the Konica account while he was working at one of the Shinjuku branches in Tokyo, by introducing a new sales route. Early in the 1980s, he was working at one of the six Shinjuku branches of Sumitomo Bank (currently Sumitomo Mitsui Bank), looking for prospective corporate customers. Yamashita found out that Konica, world-famous manufacturer of cameras and photo films, was mainly selling its videotapes at discount store chains selling appliances, TVs, and audio/visual products, where price busting was the name of the game. Shinjuku was full of them. He also learned that Konica was looking for other sales channels.

NEC happened to be a member of the Sumitomo Group, so he talked to NEC and worked out an OEM deal whereby Konica could supply its videotapes to NEC, bearing the NEC brand name. Naturally, as a result of this deal, Yamashita succeeded in getting the Konica account.

In the early 1980s bank salesmen in business centers such as Shinjuku arranged these sales channels and assisted in product sales to get new corporate accounts. In the mid-1980s this sales method was gradually taken over by the high-powered approach involving real estate.

Soaring land prices that began the first half of the 1980s were a forerunner of the "bubble." At the same time, the demand for funds by major corporations started declining. Real estate loans involved huge sums of money and the borrowers could afford to pay interest; thus the banks shifted their loan portfolios

1. Yamashita, Akinori, *Crimes of Major Banks* (Dai Ginko no Hanzai), Tokyo: The Masada, Inc.,1996.

— from lending primarily to major corporations and manufacturers, to providing real estate loans.

Since money is the bank's merchandise, what the bank itself can finance, it will. However, some deals are beyond financing by the bank. For example, the amount may be too great, there may be a problem on as to how the funds are to be used, the repayment terms may be longer than usual, or the collateral offered may be difficult for the bank to accept. If any one of these creates a stumbling block, the deal is introduced to other financial institutions.

If a loan could not be extended under any terms, then it would simply be refused.

However, any money-making opportunity is hard to let go, and if one wishes to keep on having a say in the matter, one finds a way to "arrange" the money. In that case, prior to the "bubble," introductions were often made to Japan Trade Credit Co. (currently, Nichiboshin Ltd.) as well as to foreign banks.

At about the time of the "bubble," this method was changed to financing by way of introduction to "Jyusen" and to non-bank affiliates.

What Did Borrowers Say About This?

Three borrowers appeared on a TV talk show on Channel 4 in Tokyo, on June 18, 2003. What they said was somewhat contrary to the position shown by Banker Yamashita during the "bubble."

One borrower was N. Kojima, president of Kyowa Estate, the real estate dealer and developer who once boasted sales of ¥300 billion ($3 billion). He gave his experience with the leading commercial banks during the "bubble" as follows: "I wanted to borrow ¥1 billion ($10 million) during the bubble with collateral. One banker came and proposed a loan of ¥700 million ($7 million) for the collateral."

Kojima then called another bank and it was willing to provide a loan of ¥800 million ($8 million). The third bank decided to offer a loan of the entire sum of ¥1 billion, 100% of the value of the collateral. He was curious to see what else he could find, so he called a local credit union. "Amazing! They said they would provide ¥1.3 billion ($13 million)."

There is a catch to this true story. After the "bubble" collapsed, he worked hard to repay the loans and succeeded in paying back ¥290 billion ($2.9 billion). But he still owed ¥10 billion ($100 million). The ¥10 billion was the principal he had borrowed some 10 years ago. So he asked the bank to accept the collateral and write off the debt.

The bank said "No Way," because by then the collateral value had dropped to 20% of the original value. He was shocked, thinking, "what is the collateral for? It is exactly for a situation like this. You take it, and we are even." The bank would not budge. Stories like this became typical.

The bank juggled to put together a hilarious but bona fide arrangement whereby Kojima is paying back ¥10,000 ($80 to $100, depending on the exchange rate) per month. For how long? For the next 8,333 years. At least, that is what the bank agreed to, on paper, to keep the loan solidly registered as "collectible" in the eyes of the government inspectors.

More on Real Estate Loans in the 1980s

In 1986, the ratio of loans to the real estate industry rose to 7% to 8% of the total loans and bills discounted. In addition, there were other loans through nonbanking financial institutions (NBs) in the form of roundabout loans charging 12% or more per annum.

Also in 1986 the amount of loans and bills discounted by Japanese banks increased by about ¥22 trillion ($122.2 billion at ¥180/$1) in new loans. Nearly 30% of the new loans or ¥6.3 trillion ($35 billion) were for real estate dealers and companies, agents as well as developers. Since loans to financing companies and insurance firms were mostly for NBs, if we consider the ratio, they came to a little over 20% or ¥4.6 trillion ($25.5 billion). Altogether, over 50% of the ¥22 trillion for new loans went to real estate firms and associated financing companies, which are mostly NBs investing in property.

Lending to Real Estate — A Magic Wand

When there is too much cash around, or excess liquidity, lending to the real estate industry provides a convenient outlet. In the mid 1980s major corporations and manufacturers, instead of relying on bank loans, obtained funds directly from the stock market. The real estate business was a promising lending field for the bankers and they fed real estate firms with ample loans. Land values bought by the real estate firms with these bank loans soared. Thus the collateral value of the land was increased. Using the appreciated land as collateral, real estate firms were able to borrow more and more, thus creating a snowballing effect.

Former Billionaire Sasaki's Fortune

An illustrious case is the company called "Togensha," headed by Kichinosuke Sasaki. After graduating from Keio University School of Medicine, one of the top medical schools in Japan, Sasaki opened a clinic at Tokyo's Toranomon close to Kasumigaseki, home of Japanese government offices. Many of his patients happened to be elderly realtors and individuals connected with real estate who recommended a good buy whenever there was choice land available for sale.

A Lot Purchased in 1964 Shot up 300 Times

In 1971, Kichinosuke Sasaki decided to go into real estate business himself, so he set up a company. After the first oil crisis, good land was cheap, for those who still had money. For example, one lot he bought in Tokyo's Roppongi in 1964 cost ¥40 million ($111,111) and as the land prices soared, so did the value of this lot. In 1987, it showed a 300-fold increase, with a price tag of ¥12 billion (probably $85.7 million). By 1987, Togensha had 38 buildings, large and small, and was doing fine with hidden profits reputed to be ¥50 billion to ¥500 billion (probably $350 million to $700 million at that time, ¥140/$1).

Sasaki could have gone on that way, leasing, buying or selling property, as many realtors are successfully doing today. But he had a dream — to conquer the unconquerable. On March 30, 1987, Sasaki's Togensha participated in the bidding for a 1.2 acre site (1,450 tsubo) owned by former Japan National Railway. His bid of ¥65.7 billion ($469 million) won. It was talk of the town, then. Actually, eleven banks, an insurance company, and NBs including leasing companies had chipped in to finance the project, backed by a little less than 10% or ¥5.7 billion of Togensha's own funds.

Wheel of Fortune Goes the Wrong Way Round

The story of Sasaki's success was covered by Forbes magazine in 1989 and Sasaki was listed as the world's 15th billionaire with assets of $3.5 billion. Fortune Magazine followed suit and placed him in 12th position in the world. But the bubble was just then hitting the fan, and according to Sasaki's account, the wheel of fortune began turning the other way round. His main bank, the Japan Industrial Bank, together with his contractor, Kajima Construction, started legal proceedings to take over a building under construction at the site he won in the 1987 bidding. On May 1, 1996, he was summoned as a witness to a Diet session.

Many still remember his sullen look on the witness stand, as he himself probably wondered why he should be there — all he had done was to legally borrow from "Jyusen" companies. In May 1996, he was arrested on charges of perjury, and he was later sentenced to two years in prison.

However, on appeal, the Higher Court acknowledged the breach of trust committed by the Japan Industrial Bank and reduced the irrevocable sentence in March 1999 to two years with a three-year suspension of his sentence.

He writes in his book, Record of the Kamata War[2], published in October 2001, that in the past eleven years he sold all the sellable real estate holdings for a total of over ¥200 billion (probably $2 billion or so). But that was not enough.

2. Kichinosuke Sasaki, *Record of Kamata War* (Kamata Senki), Tokyo: *Nihon Keizai Shimbun* BP, 2001.

Loans of some ¥390 billion ($3.54 billion) in fiscal 1994 must have grown, in Sasaki's estimate, by 2001 to ¥900 billion or ¥1 trillion ($9 billion to $10 billion) including default interests.

At his peak, his assets were estimated to be ¥900 billion ($9 billion), and with the wheel of fortune spinning the wrong way, he calls his current loans of ¥900 billion or $9 billion, in self-mockery, "unsecured remaining loans," another name for the bad loans.

In 2005, he was asked by a TV interviewer what he thought about the state of the economy. His ominous reply was that in five years, around the year 2010, much of the hidden bad loans would surface and he would like to see what would happen then.

"Jyusen" Companies

Let us briefly examine what "Jyusen" companies did, working alongside NBs in providing funds. That word was very often heard in 2001 for the Jutaku Kinyuu Senmon Kaisha or "Jyusen" companies (Housing Finance Corporations) jointly set up by many commercial and trust banks, brokerage houses, and the Japan Long-Term Bank, primarily to provide home mortgage loans for individuals. There were seven companies of this type. The first "Jyusen" company, Nichijyukin (Nihon Jutaku Kinyu, meaning Japan Home Loan) was established in June 1971 by a consortium of nine banks.

A look at these "Jyusen" companies reveals that six of the seven companies were initially headed by former high ranking MOF officials. Parent banks include Sanwa, Sakura, and a host of other commercial, regional, and trust banks. The third oldest company, Jyuso, was backed by seven trust banks, while the fourth company was backed by 72 second regional banks (former mutual banks) that were members of the Second Regional Bank Association.

Japan Long-Term Credit Bank and Nomura Securities backed up another "Jyusen" firm, while 64 regional banks and 25 life insurance companies were behind still another outfit. Even brokerage houses founded the youngest "Jyusen" company, established in 1976.

Funds from Agriculture/Forestry-Related Sources

Another outstanding feature of these "Jyusen" companies is the fact that 40% to 50% of their funds for lending activities were provided by agriculture/forestry-related financial institutions. The leader, Nichijyukin, borrowed ¥892.3 billion ($11.15 billion, ¥80/$1) from these sources. That was 38.0% of the total funds borrowed from financial institutions. Number 2 firm had the highest ratio, 51.0% or ¥861.6 billion ($10.77 billion) of such funds.

As you can see, these "Jyusen" companies procured funds by borrowing from two sources, bona fide financial institutions and other financial institutions related to agriculture, forestry, and fisheries. They also issued their own home mortgage certificates to expand their lucrative loan operations to a wide range of customers from individuals to real estate firms. Many of these customers were introduced by parent banks bent on buying up land on speculation. This was simply because land prices were soaring during the bubble period. At lending rates of 14% to 29.22%, they were certain to make money, so long as customers were able to repay.

At the same time, their outstanding balances rose sharply. These companies were originally established by commercial banks for the purpose of financing home mortgage loans for individuals. However, the huge commissions involved in corporate land buying, where seven- to eight-digit deals were being made (in terms of the US dollar), were too much for commercial and trust banks to resist. They themselves went into financing huge development projects. Project financing was gradually surfacing in Japan.

They also supplied funds to their "Jyusen" companies. Especially in Japanese business, "Do as the Joneses do" or "Keep up with What Others Are Doing" in Japanese is a prevailing tenet. With enough financial backing, these seven Jyusen companies went after "Ji-a-ge" loans with the dedication and single-mindedness of a samurai.

"Ji-a-ge" Loans

"Ji" means land, and "a-ge" means lift. This refers to small real estate operators who negotiate with (mostly urban) land owners to buy up tracts of land making up the area, then, after buying the small tracts, resell the large area thus acquired, at a fat margin, to major real estate firms, developers, and construction companies for large shopping malls, office buildings, apartment buildings, or any other large development project. If the real buyer had come to negotiate directly, the original sellers would have jacked up the prices, so they let small, unknown realtors handle the details first. Not realizing that everyone in the neighborhood is also selling, the individual landowners fail to jack up their prices accordingly. They lose out, and the developers win; but it was all perfectly legal.

In the United States a similar technique was often used. Take Disney World, for instance. When Walt Disney first had an idea of building Disney World in Florida, he did not let his company scout for land. Half a dozen realtors did that for him, and after they got all the land they needed they handed the area over to Walt Disney. It was all legal, and cheap.

The initial buying by small, unknown realtors is called "Ji-a-ge." During the 1980s, gangs of these operators could be seen hanging around in the coffee shops of Aoyoma, one of the better residential quarters of Tokyo. It was clear they were not 9:00 to 5:00 people. They were not as tough-looking as some members of the Mob, but neither did they look normal. They projected some aura of sleaze.

How Grand Was the Lending Spree?

During the bubble, NBs and "Jyusen companies" did not have to go out making business calls. Customers came in by the drove. They wanted either to borrow money to buy land, or to sell land. In addition to those customers who came in directly, genuine banks passed along customers who didn't meet their lending criteria. The loans arranged this way were called the "roundabout loans."

Personal computers were not in much use at that time in Japan, so non-bank staff were flooded with paperwork. One deal usually called for at least a dozen forms to be completed.

In many cases, the prospective customer showed a map to the bank staff and pointed out the area where the property was located. It could be anywhere — deep in the mountains, in a river bed that was dry at this season but would soon be covered with water, a hilly place full of rocks that would require days of bulldozing, or in very damp or windy locations.

Banks, too, introduced every kind of real-estate loans to their affiliated "Jyusen" companies. Many properties involved racketeers and were deeply flawed. But the "Jyusen" staff extended loans to these questionable loan applicants, too, as they were instructed to do by their parent banks.

An Example of How "Jyusen" Company Was Used

Go Eguchi is a former branch manager of a leading commercial bank. Then, one fine day, it dawned on him that it was time he did something about his writing ambition. He decided to write about what he knew best — the banking world. Thus in March 2002 a muckraking novel, *Inhuman Bank* (Hijo Ginko), was released. Author Eguchi exposed what was going on with Japanese financial institutions and the effect on the Japanese economy[3].

In this fictional story a bank is about to merge with a bigger, commercial bank. The Managing Director is depicted as working hard to downsize the bank by decreasing the number of employees while making sure that he makes financial gains himself through questionable loans to third parties with fees that are kicked back to him in disguise. For years the bank management has had ties to an underworld chieftain (which is often the case with many banks and companies).

Eguchi's second book, Corporate Resuscitation (Kishi Kaisei)[4], describes in vivid detail small and medium-sized companies at the mercy of "loan peel-backs" (to be explained in Chapter 3) enforced by their banks, while illicit loans are still being extended to underworld figures. This fictional story presents a

3. Eguchi, Go, *Inhuman Bank* (Hijoh Ginko), Tokyo: Shinchosha, 2002.
4. Eguchi, Go, *Corporate Resuscitation* (Kishi Kaisei), Tokyo: Shinchosha, 2003.

good example of how a "Jyusen" company was exploited by its parent bank. Let's see how it is done.

The story begins when, one day in 1993, H. Usui, Kyoto Branch Manager of a Tokyo-based commercial bank has a surprise call from his superior, Yano, a director of the bank. Calling from Kyoto Station, he wants to see Usui right away. They meet. The Company Director bows deeply, which would be unthinkable under normal circumstances, and asks Usui to extend a loan of ¥1 billion ($10 million) to a certain individual with no questions asked.

The bank's managing director is due to be promoted to vice president at the coming general meeting of shareholders and he needs to keep his private affairs clean. He wants to clear up his long-standing relationship with his mistress, who has undergone two abortions. She happens to have a brother (or someone who claims to be her brother) who wants to borrow ¥1 billion ($8.5 million, ¥118/$1) to open a night club for his sister. Naturally, the brother intends to repay the loan by putting up the building and land as collateral.

The director asks Branch Manager Usui to begin loan procedures at once. The examination of the loan application and other details are to be handled by the director himself. Usui is to forward all the necessary paperwork to the Examination Department Manager. "And everything will work out fine." Usui asks what will happen should the borrower default on the loan.

The director says that after the general meeting of the shareholders, this case would be transferred to Jyuso, one of the non-bank affiliates specializing in home mortgage loans. The bank was a shareholder of Jyuso.

Usui asks if they can use Jyuso directly, and the director reveals that Jyuso had staff on duty from other participating banks, so a direct deal would be unwise and difficult. But if it came through as the bank's loan, Jyuso could easily take over.

That is certainly an interesting way for the parent bank to use its NB to pay the settlement money for its managing director. Personal connections count, especially in banking.

Loans Extended for as Much as 120% of the Security

In the case of property, collateral appraisals were carried out at usually 50% to 60% of the going rate. Suppose there is a piece of property worth $500,000. The bank would lend up to 60% of that, or $300,000. As the bubble ballooned, this collateral ratio gradually moved up. Soon, 80% became acceptable. In other words, you could borrow up to $400,000 with $500,000 collateral. The ratio edged up to 100%, then to as much as 120% in some NBs. This meant lending $600,000 for a piece of property worth $500,000.

Yet the deals were profitable so long as the economy was on the upswing. Take Tokyo land prices in 1987. In April, the National Land Agency made the land prices public and it was seen that Tokyo's land prices had soared by 76%

over the prior year. In 1989, the new 3% consumption tax took effect. In June 1989, the Life Insurance Association announced that the total life insurance assets had crossed the ¥100 trillion mark (probably close to $1 trillion). And, at the end of December of that year, the Nikkei Stock Average hit a record high of ¥38,915.

Everything looked fine. For a modest home of about 330-square foot house in a suburb of Tokyo that had sold for ¥15 million ($60,000 or so, ¥250/$1) in 1978 realtors offered as much as ¥300 million ($1.5 million, ¥200/$1).

Soryo Kisei (Total Volume Restriction)

The MOF did not sit idle. In March 1990, Finance Minister R. Hashimoto (later prime minister) decided to curtail lending by financial institutions to three trades —real estate, construction, and non-bank affiliates. Many bankers and non-bank staff have pointed out that things began to turn the other way when the MOF introduced the notorious Soryo Kisei. (Total Amount Restriction).

This is a measure designed to restrict the balance of loans to be supplied by financial institutions to real estate dealers. Specifically, it regulates the growth of real estate bank loans by holding the rate of increase of real estate loans below the rate of increase of the balance of total loans over the same prior year period. For example, if the growth rate of total loans is 10% over the prior year, then the land-related loans should be held to 10% or less, as well.

Soryo Kisei is based on the observation that the balance of loans for real estate as of the end of 1989 — on the basis of all banks — increased 14.1% over the prior year, while the balance of total loans increased 10.9% over the prior year. Since this rate of increase had been constant over the past few years, the MOF brought the measure (which was not mandatory but an “administrative guidance”) to stop any more land speculation. It was a cleverly conceived plan, although perhaps its effects on the economy were underestimated.

In January 1992, Soryo Kisei was abolished because land prices started to plummet. During these 22 months, funds had dried up and ongoing construction projects, as well as construction plans, were suspended. The economy went into a downward spiral. Many believe this should have been stopped much earlier, in 1991. Then the piles of bad loans could have been avoided.

Write-Off Free of Taxation or with Taxation

After the Total Volume Restriction came a downswing in land prices and the banks were saddled with huge amounts of bad loans as a result. The question then for the MOF was whether to let the banks write off bad loans tax-free. This was a matter of life or death to any financial institution.

Japan's notorious bureaucratic system of vertical integration means that one ministry vies against another or one agency against another within a ministry, each asserting its jurisdictional power. In this case, the MOF had the Taxation Bureau at odds with the National Taxation Agency, although both supposedly operated under the same wing.

The Taxation Bureau of the MOF took a position in favor of write-off free of taxation. After all, the bottom had fallen out of land prices primarily due to the bad loans.

On the other hand, the National Taxation Agency of the MOF, the tax collecting arm of the MOF and Japan's counterpart of the IRS, fought hard in favor of taxation. It would mean a colossal loss of tax revenue. They stood firmly for a loan write-off with taxation (although this step had not been taken by any other country in the world).

The argument went on and on, without any resolution. This called for a decision by the Finance Minister or Prime Minister, but the fact of the matter was that neither of them dared to step in. It was such a hot potato that in the end, ludicrous circumstances were created in which neither a write-off with taxation nor a write-off free of taxation was implemented.

That is a typical way to solve a dilemma in Japan. Leave it as is! So the banks had no recourse but to keep the bad loans. The result was the first wave of bad loans of ¥9 trillion in the early 1990s.

Taro Aso, chairman of the LDP's powerful Policy Research Committee, was first to say it, in his speech before the Lower House Budget Committee session of the Diet on February 6, 2003: the Soryo Kisei which was not lifted soon enough and the Write-Off Free of Taxation which did not see the light of day — these two were the chief causes of the heaps of bad loans. His explanation was right. And thus the appalling position of the National Taxation Agency was revealed for the first time. No one wants to upset that agency, and so, by some playfulness of Japan's pantheistic gods, no one had mentioned that aspect at all — until Chairman Aso.

The first time the MOF gave a specific figure for the uncollectible loans was on July 14, 1995 in the amount of ¥10 to 15 trillion ($11.5 to 17.2 billion, ¥87/$1).

This discussion notwithstanding, the MOF was aware of the potential gravity of the situation. Bad loans were certain to go on growing, and each bank was saddled with issues that could not be resolved alone.

According to K. Ohkura[5], the MOF urged bankers to liquidate bad loans. The bankers were leery, however, as the hidden profits on stocks and bonds they carried were the source of Japan's funds for liquidating bad loans. Putting up reserves, with taxation, would be too heavy a burden.

5. Ohkura, Kazutomo, *MOFU-Tan's Confession* (MOF-Tan no Kokuhaku), Tokyo: Apple Publishing, 1996.

Therefore, the MOF officials looked to the write-off without taxation. But that would mean revising the tax code, which would take far too long. The MOF sought to manage it by issuing a Ministry Notification. And the Federation of Bankers Association of Japan as well as The Group of Six Major Banks were instrumental in bringing about the write-off without taxation, and uncollectible bank loans began to be liquidated.

The MOF Notification was entitled "Basic Notification on Corporation Tax"; it specifically stipulated that when the liabilities of a financial institution considered to have probable cause are liquidated at a loss, the loss caused by the liquidation may be tax-exempt.

The question is, what and who determines "probable cause?" It is up to the MOF to determine probable cause. Any bad loans of the banks approved by the MOF in advance were to be tax-exempt. And the Notification was issued without any fanfare, quietly paving the way for bailing out the financial institutions.

A write-off without taxation comes in two kinds. The first is the well-known direct write-off. A company goes bankrupt, its liabilities are impossible to collect, and a loss is certain to be incurred by the lending bank. Then, the loss is declared as a bad debt and is written off.

The other type concerns funds that were lent out by the banks to their subsidiaries and associated companies, that is, NBs and "Jyusen" firms, which become losses if those companies become insolvent. This type of loss could be predicted for those who had invested in "Jyusen" companies. The MOF, when issuing the Notification, took this into account well in advance.

Some have said that a notification issued by the MOF carries more weight than the law.

Even so, there was a catch to the administrative guidance called Soryo Kisei. There must be other sources of funds, once the Soryo Kisei tied the slippery hands of the banks. What about agricultural funds that were not subject to MOF control? These funds provide a clue to the ensuing $75 billion "Jyusen" fiasco. Before we examine this, let's first see what happened to "Jyusen" companies and agricultural co-ops.

What Happened to the "Jyusen"?

When the prosperity bubble burst and land prices plummeted, many real estate firms and developers went bust and the seven "Jyusen" companies were left with huge amounts of bad loans. Their credit amounted to some ¥13 trillion (some $130 billion) and loans unlikely to be collected exceeded half that total, or over ¥6 trillion ($60 billion).

"Jyusen" companies had borrowed from over 100 commercial and trust banks, regional banks, and other financial institutions so that, should they go bankrupt, many of these lenders would also be adversely affected, with dire and widespread consequences for the Japanese economy.

In 1996, the government finally made a budget appropriation of a staggering (at that time) of ¥685 billion (approx. $6.8 billion) to write off the primary loss. Naturally, the idea of using taxpayers' money to save languishing private corporations came under fire from consumers. Be that as it may, because too many important parties were involved, the government rammed the bill through.

There are two sources of funds not subject to MOF control — postal savings and financial institutions subject to the control of the Ministry of Agriculture, Forestry, and Fisheries (MAFF). Note, however, that investing in the private sector is outside the scope of postal savings.

If this sounds complicated, that is because it is. When agricultural coops and related financial institutions are further involved, the story becomes a maze, but the fact of the matter is that there is a lot of available money there.

The Role Played by Agricultural Co-operatives

Postal savings are never directly used for financing the private sector. Hence, the funds available, mostly at agricultural/forestry/fisheries co-operatives and their related financial institutions — beyond the almighty control of the Ministry of Finance — attract attention.

There are over 1,000 Japan Agricultural Co-operatives (JA) in Japan, with some 13,000 offices with ATMs covering more than 3,000 villages, towns, and cities, serving the needs of over 6 million farmers (and many other people). One of the JAs' important activities is banking. Farmers save money at their agricultural co-operatives, and their savings are collected and go all the way to their central banking organization called Norin Chuo Kinko (NCK), or Central Co-operative Bank for Agriculture and Forestry. Trillions of yen (or hundreds of billions of dollars) are saved there.

In 1961, the JAs' total savings crossed the ¥1 trillion ($2.7 billion) mark, and in 1999, crossed the ¥70 trillion ($700 billion) mark. NCK's savings reached ¥33.56 trillion ($335.6 billion).

Actually, as of March 2002, NCK's total assets alone amounted to ¥57.5 trillion ($479 billion, ¥120/$1) with savings of ¥37.9 trillion ($315 billion). When all the assets related to the agricultural co-operatives are combined, you have a super bank with total assets of ¥105.7 trillion ($880 billion) and savings of ¥81 trillion ($675 billion). No wonder Moody gives it such a high rating, A1, one rank above the best of all Japanese banks, Tokyo Mitsubishi Bank. Japanese government bonds are rated A2.

Of the NCK's total assets of ¥57.5 trillion, its investments in securities amount to ¥23.9 trillion and its extended loans amount to ¥23.9 trillion. This is known as a principal institutional investor extending loans to business customers including construction firms, real estate developers and NBs. In connection with "Jyusen" companies, the role played by funds supplied by agricultural co-operatives came to light.

Over ¥6 Trillion ($75 billion) Turned Sour

As of 1995, some ¥6.45 trillion ($80.6 billion) of the loans extended by agriculture/forestry/fisheries related financial institutions to "Jyusen," became uncollectible. How did that come about? There were several factors.

"Jyusen" companies appeared from every angle to be reliable borrowers. For one thing, their top management personnel were former high-ranking MOF officials. For another, their parent organizations were major commercial, trust, and regional banks. Further, in May 1973, the MOF had designated "Jyusen" as companies under the direct control of the Finance Minister. Moreover, in 1974 "Jyusen" companies were authorized to handle mortgage securities.

When the MOF introduced the now infamous "Soryo Kisei" (Total Volume Restriction) in April 1990, some enterprising people looked for a way out. The Total Volume Restriction was enforced by the MOF. But when you shut one door, they open another. These financial institutions related to agriculture/forestry/fisheries (AFF) were subject to control not by the MOF but by the Ministry of Agriculture, Forestry and Fisheries (MAFF). This ministry is a staunch ally of farmers, forestry people, and fishermen when money is involved.

These AFF financial institutions not subject to the control of the powerful MOF, despite enormous funds over ¥60 trillion ($600 billion), are not proficient in financial engineering. They are not too familiar with funds operation and have always had difficulty finding ways to properly handle funds, for instance, buying and selling in the money market.

In his book *Kamata Senki* (*Record of the Kamata War*) mentioned above, K. Sasaki, President of the now debt-ridden Togensha, gave details of how the Total Volume Restriction was issued for the first time.

This administrative guidance was announced in two ways: one was the notification by the MOF's Banking Bureau, and the other was the notification by the MAFF's Economic Affairs Bureau. The mass media mainly covered the MOF's notification and very little was reported about the MAFF's notification. In fact, many people were unaware of it. Some suspect that the lack of information about the nature of MAFF's notification may have been deliberate.

At any rate, the MOF's notification was followed to a T by almost all financial institutions, and loans to the three fields of real estate, construction, and NBs came to a halt. Even after the notification was abolished 22 months later, the kind of lending spree seen during the bubble was gone.

Naturally, the MAFF's notification of the Total Volume Restriction was given to each agricultural co-operative and its central bank, NCK. To all appearances, it was similar to the MOF's notification, but it contained a curiously large loophole — it lacked any statement to minimize lending to the three trades of real estate, construction, and NBs.

This was the beginning of a boom and a subsequent disaster for the AFF financial institutions which had, until then, suffered a shortage of qualified borrowers and of qualified financial experts.

Commercial and trust banks which were parents to these "Jyusen" companies acted as go-betweens and the funds started pouring in from the AFF financing companies to "Jyusen" companies. After March 1990, when the Total Volume Restriction was put into effect, "Jyusen" companies fired off a barrage of loan requests to such companies.

Many prefectural federation of agricultural co-operatives saw no reason to hesitate in lending to "Jyusen" companies. They offered "Jyusen" companies loans of ¥20 billion or ¥30 billion ($250 million to $375 million) per application, with no questions asked, no matter how the loans were to be utilized and with no careful appraisal of each loan application. They commonly lent 100% of the collateral value.

Even after the bubble broke, with falling land and stock prices, their loans to "Jyusen" companies multiplied — ¥3.4 trillion ($34 billion) as of March 31, 1992, an over 20-fold increase in eight years. When this lending frenzy was questioned in 1996 in the Diet session, the MOF flatly answered that "Jyusen" companies were outside the MOF's jurisdiction because they were not banks. After all, these AFF financial institutions are closely connected to politicians, national as well as regional, and are backed by powerful farming votes.

The farmers have enormous political clout when they get together for a specific cause. Should agricultural co-ops be adversely affected, they and their politicians would be certain to put up heavy resistance against the MOF. No one wants to step on their toes.

A Secret Pact

On February 26, 1993, a reconstruction conference was held to save the No. 1 jyusen company. All the nine commercial and trust banks that had fathered the oldest "Jyusen" company met to discuss plans to reconstruct the company. The conference went on for twelve hours as the MOF's proposal included a plan for giving priority of repaying the loans to AFF financial institutions.

All the attending bankers were against this provision which was solely advantageous to the AFF side. In the final analysis, the MOF railroaded this proposal through, giving the appearance there had been unanimous consent of all the concerned parties.

The MOF had a specific reason for concluding the reconstruction agreement in favor of the AFF financial institutions. Two weeks prior to this agreement, on February 3, a secret pact was concluded between Banking Bureau Director N. Teramura of the MOF and Economic Affairs Bureau Director T.

Manabe of the MAFF to ensure preferential treatment of AFF-related financial institutions with particular regard to the disposal of bad loans.

MOF Sold Out to AFF

The memorandum thus exchanged between the Ministry of Finance and the Ministry of Agriculture, Forestry and Fisheries is a highly important document. According to *The Decade We Strayed Off Course*,[6] it gave definite assurances that the current level of bad loans incurred by AFF financial institutions would in no way increase at all. As regards repayment of loans to the "Jyusen" company, settlement priority was to be given to AFF financial institutions, and the interest rate on loans by AFF financial institutions to the "Jyusen" company would be 4.5%, while it was set at 2.5% for other banks. And the interest rate was to be fixed.

On top of that, if AFF financial institutions had a serious financial problem, both the Ministry of Finance and the Ministry of Agriculture, Forestry and Fisheries were to consult with each other and take necessary action with responsibility.

Furthermore, the BOJ was to arrange funds for NCK as necessary, as a normal BOJ loan, and was not to be made in advance as something pre-determined. Also, this provision was not to be disclosed to any outside party.

Reading this memorandum, one businessman remarked, "It's great to be a farmer. The government is always on their side. Japan's guiding principle is based on the traditional agrarian philosophy. What is good for the farmers is good for the rest of the country. Do whatever you can to save them."

When the memorandum came to light, bankers hit the ceiling: "The MOF has betrayed us." It played a significant part in the succeeding plans to dispose of "Jyusen" companies, while making it possible for the AFF financial institutions and AFF-related politicians to minimize loss by the agricultural co-ops.

Clearing Up the Bad Loans to "Jyusen" Companies

In the summer of 1995, it became imperative that something be done about the ¥6.45 trillion ($80.6 billion) in uncollectible loans extended by AFF financial institutions to "Jyusen" companies.

AFF financial institutions demanded that the entire sum of ¥5.5 trillion ($68.75 billion, ¥80/$1) be paid back. Their explanation is as follows: AFF financial institutions are officially non-profit corporations and do not have sufficient accumulation of equity capital. Furthermore, the parties to which they can lend are legally restricted so that such enormous losses had never been antici-

6. Edited and published by the Nihon Keizan Shimbunsha, *The Decade We Strayed Off Course* (Kinyu Meiso no 10 Nen), Tokyo: *Nihon Keizai Shimbun*sha, 2000.

pated. Each of these financial institutions related to agricultural, forestry, and fisheries co-operatives was limited to serving as a financial operation for agricultural purposes in the sole interest of farmers. It just happened that vast amounts of funds made available by selling land entered the co-ops, and these funds were permitted to be loaned to "Jyusen" companies.

If the same yardstick were applied to AFF financial institutions as was applied to commercial banks, the loans to "Jyusen" companies would have been disposed of proportionately, which would have caused the AFF financial institutions with the Shinren to go bankrupt, and each agricultural co-op that had provided the funds would meet the same fate.

The AFF pointed out that these "Jyusen" companies were nothing but detached organizations of the parent banks, therefore the parent banks should bear all the costs of liquidating the bad loans. On the other hand, the parent banks claimed no responsibility other than the actual amounts loaned. Because of that secret pact of February 3, 1993 between the MOF and the MAFF, the MOF had to ram through the plan in favor of the AFF financial institutions.

Someone came up with an idea how to get out of this mess by setting up a company into which they could dump all these bad loans. In 1996 such an organization was set up to take over all the assets of the seven "Jyusen" companies, and the "Jyusen" companies were all disbanded.

The main players in this fiasco were 14 top managers from heavy borrowers; they were arrested and subjected to criminal prosecution.

Disposal of the "Jyusen" bad loans began. The uncollectible ¥6.4 trillion ($80 billion) was the initial loss, the parent banks disclaiming loans of ¥3.5 trillion ($43.75 billion), and other banks which were not parent banks disclaiming ¥1.7 trillion ($21.25 billion). On the other hand, the AFF financial institutions collected the entire sum exceeding ¥5 trillion ($62.5 billion).

A "Jyusen" account was set up in the Depositary Insurance Corporation of Japan, another special-status government corporation, so that ¥680 billion ($8.5 billion) could be allocated from the General Accounts of the national budget to cover any shortfall.

The secondary loss was estimated to be ¥1.2 trillion ($15 billion), half of which was to be covered by public funds (taxpayer's money), if necessary.

In addition, with a fund of ¥212 billion ($2.65 billion, ¥80/$1), the Resolution and Collection Corporation (RCC) was set up in 1995 to specialize in collecting uncollectible loans. Assets transferred or purchased from Jyusen and other insolvent financial institutions are administered, collected and disposed of by this organization. Non-performing loans are also purchased from commercial banks.

The "Jyusen" Liquidation Law established in 1996 provided the basis for these measures. However, when it was announced in December 1995, there was an uproar from the non-government parties and the general public, with lasting political and economic consequences.

In January 1996, Prime Minister Murayama resigned and another equally or possibly more inept cabinet, headed by Prime Minister Hashimoto, succeeded his.

In October of the same year the general election was held. Japanese voters vented their anger by showing very little support for the Democratic Labor Party (another name for socialists) headed by former Prime Minister Murayama, who had implemented these "Jyusen" loan disposal measures.

These circumstances suggested what might happen if public funds were to be introduced in the future to dispose of bad loans. As a direct consequence of this, policy-makers and government officials in charge became very cautious in dealing with bad loans.

This slowed down considerably the process of resolving the bad loan problem. In other words, although at one point a massive injection of funding could have eliminated all the problems, the policy-makers released barely enough funds to remedy the financial chaos. Furthermore, in their excessive if belated caution, when they did pour in funds, it was too late.

Chapter 2. Scandals Involving MOF Officials

Media reports of salacious behavior on the part of the MOF officials abounded in the early 1990s, when their nocturnal activities came to light. Who paid the bill? Naturally, the bankers did — armed with huge entertainment expense accounts. By far the majority of MOF officials are hard-working officials; the following are some highlights of incidents involving just a few officials in key positions.

Tokyo has entertainment districts galore, Ginza, Akasaka, Shimbashi, Shinjuku, and Roppongi, to name a few. There are many bars and clubs doing business even during a depression. Most are not racketeer-related but are run by ordinary bartenders, some of whom are particularly good hosts with pleasant personalities. You can while away the evening, singing karaoke and having a chit-chat with giggling young hostesses. Some are frequented more by businessmen, some attract a different crowd.

At one club, the men all wore dark suits and had an intelligent, educated look — different from the shrewd businessmen next door. They wore their hair short. They looked like either government officials or bankers, and behaved somewhat like teachers, Buddhist priests, and the cops — the three types that lead the party when it comes to lechery or raunchiness, especially at the hot springs, where they get drunk in the company of cute young girls. On the other hand, while these gentlemen did relax and spent their time chatting with young girls, they behaved far better than they do at those other locales.

Knowledgeable people size up the scene immediately. A banker would recognize this crowd as MOF officials being entertained by the "MOF-Tan" (meaning "in charge of the Ministry of Finance") people of some commercial bank. MOF-Tan (pronounced "mo-fu-tan") people at each bank specialize in, among other things, entertaining MOF officials to get information on when the next MOF inspection will be. That's their job.

MOF-Tan

The MOF officials sometimes ask the MOF-Tan's opinion on certain matters to find out what is going on in the banking world. They are entertained at restaurants, followed by a visit to bars, so no women are assigned to the MOF-Tan. These bankers pick up the tab, apparently. Some places charge at least ¥30,000 per head ($300).

The MOF-Tan have a big budget for that. MOF officials entertained at one place belong to one Habatsu or clique, and those who belong to other cliques go to other bars. Japanese officials, it seems, and for that matter, bankers, are as cliquish as the English.

My friends in this field tell me that, "A big outfit like the MOF has many cliques. The University of Tokyo graduates are split into several cliques, and sometimes they get into inter-clique feuds just like the Liberal Democratic Party, where several cliques are always squabbling among themselves. If you are a graduate of a private university, you do not belong to any of the cliques of the University of Tokyo graduates or the University of Kyoto graduates. So you may be trusted by both camps."

The MOF-Tan banker is usually a graduate of the University of Tokyo, since his MOF counterpart in the Banking Section is a graduate of the University of Tokyo. All the banks, brokerage houses, and life insurance companies have their MOF-Tan staff.

A retired MOF official later told me that it was easy to spot these MOF-Tan walking the corridors of the MOF building, as they are always polite, bespectacled, and with short hair.

Main Job of the MOF-Tan

According to *The Lowdown on MOF Officials* (Okura Kanryo no Shotai), published in 1995, a collection of reports by investigative reporters, the name of the game is "Kura-Ken," or the MOF inspection. This is when the records of a bank are subjected to the scrutiny of the MOF, the sole authorities in charge of overseeing the activities of the financial institutions. It is normally carried out every two or three years, except when there are scandals. Then, it is suddenly conducted without prior notice.

In the early 1990s, when the bubble burst and the banks were hit with bad loans, Dai-Ichi Kangyo, Sumitomo, Tokai, Fuji, and other banks became the targets of the MOF inspections. This was before the advent of personal computers. As in any audit, these inspectors usually parked themselves in one of the conference rooms of a bank's head office for several weeks, instructing the staff to bring in specific ledgers (out of hundreds of possible books), specific notes and bills and other paperwork, even including the attendance books of the staff. This would go one on from early morning till late at night, for a period of several weeks, and all that time the top management of the bank would be on pins and needles.

It is the duty of the MOF-Tan to accompany the MOF inspectors during the inspection. One MOF-Tan tagged along with an inspector as he walked around his bank's head office and ran into one of the executives in charge of the bank business. Seeing the MOF-Tan standing by the inspector, looking just as big and giving out in-house information, he barked, "Who's that hanger-on?" Told that he was a member of the bank's own staff, the executive became furious: "Who does he think is his employer?"

Unfortunately, this executive later became president of the bank, and as soon as that individual was done with his MOF-Tan assignment he was demoted and sent to a post at some remote branch.

Inspections may also be held at a bank branches, and it is the duty of the MOF-Tan to find out in advance which branch will be the next site of inspection.

Surprise Inspection

A sharp MOF-Tan is usually able to find out in advance which branch of his bank will be hit next. But sometimes, a surprise inspection occurs. *The Lowdown on MOF Officials* cites an interesting example.

At one of the leading commercial banks, the MOF inspection went smoothly at the head office and was drawing to a close when one of its branches in the suburbs was hit by a surprise inspection without its MOF-Tan's knowledge. The inspector seldom visits a suburban branch because they are after big fish.

Another surprise was that when the inspector arrived at the branch, the first thing he said to the Branch Manager was: "Show me Mr. A's seal registration card."

This needs a little explanation. In Japan, signatures are rarely used. Instead, your seal, which has your last name (and, sometimes, first name) inscribed on a wooden stick in a cylindrical shape, is still commonly used in applications, notifications, and most forms used in financial institutions as well as government offices.

You register your seal to be used for pass books on deposits at banks, just as you register your signatures. When you make a deposit, you fill out a deposit slip (which usually does not require your seal), but when you fill out a withdrawal slip, you need to stamp it with your registered seal. Unless the seal on your withdrawal slip matches the seal registered, the bank will not release the money.

Therefore, the seal registration is a very important document. And it just happened that Mr. A's seal registration card had been missing for over a month.

But the inspector wanted to see that card. They looked for it all over the branch — without success.

The inspector was no magician. Before the inspection, he just got a tip about a missing seal registration card. Someone inside or outside the branch had a grudge against the branch, and the tip attracted the inspector's attention.

Naturally, the Branch Manager was soon kicked out and transferred to a minor post at one of the bank's subsidiaries.

MOF-Tan and Scandals Involving MOF Officials

In Chapter 1, we have seen the rise and fall of "Jyusen" companies. What was not pointed out was the part played by the MOF in regard to the "Jyusen" problem. There is no denying that the MOF, as the competent authorities supervising Japan's financial institutions, gave tacit approval to the activities of "Jyusen" companies operating indirectly behind their parent organizations. It is inconceivable that without the MOF's approval, these "Jyusen" companies could have deferred their colossal loans.

There was of course a quid pro quo arrangement between the MOF and major commercial and trust banks, other banks, brokerage houses, and life insurance companies. This is where the MOF-Tan enters the picture, fostering corruption and irresponsibility.

In July 1995, Yoshio Nakajima, former Deputy Director of MOF's Budget Bureau, resigned. According to the MOF's announcement, he had received from about ten of his acquaintances cash gifts totaling ¥50 to 60 million ($500,000 or so, depending on the exchange rate) over a period of 10 years. He also received a low-interest loan of ¥100 million (probably $1 million) from another acquaintance over a period of six to seven years.

There were suspicions as to how he had managed to get the funds to buy his new home and land, which had cost ¥123 million (roughly $1 million). He claimed that about ¥44 million ($440,000) had come from his brothers and his father-in-law. The arrangement was all carried out under the cover of a contract with a management consultant who was close to a financier, H. Takahashi, who was the former Executive Director of the now-defunct Tokyo Kyowa Credit Association.

Together with H. Taya, Director of the Tokyo Customhouse, Nakajima was the beneficiary of expensive entertainment at swanky restaurants, played at exclusive golf courses, and had all-expense-paid overseas trips in connection with a breach of trust involving two credit associations, all courtesy of H. Takahashi. Deputy Director Nakajima resigned and Director Taya was fired but neither was subjected to criminal prosecution, simply because their jobs carried no authorization regarding the credit associations in question.

It is well known in financial circles that all the major commercial and trust banks as well as brokerage houses have provided entertainment going far beyond the notion of lunch or dinner. Lavish entertainment with excessive frequency would certainly constitute graft, but the Nakajima and Taya case of 1995 escaped criminal prosecution for graft and tax evasion anyway.

MOF Inspectors

A little explanation is perhaps necessary about the dual caste system of the MOF, before we discuss whether or not the MOF inspectors (and later, of the Financial Services Agency) remained uncorrupted by the wave of temptation the MOF-Tan brought their way.

The MOF or the Ministry of Finance is the king of all ministries because it is where all the key power concerning money is concentrated. Japan is perhaps the only country in the world where one ministry of the government both collects and spends taxes.

Furthermore, the MOF controls financial institutions, financial securities, and life- and non-life insurance under one wing. On top of all that, its Financial Bureau administers all national assets, including the Imperial Palace. Consequently, it picks and hires the cream of college graduates every April, mostly from among those majoring in law or economics at the University of Tokyo, the University of Kyoto, and other national universities. They usually take the Civil Service Examination Grade I, which is a prerequisite to being a career official.

Career Officials

Yuzo Kawamura, who was the former Chief Examiner of the National Personnel Authority of the Cabinet, explained the circumstances of the caste system of career and non-career government officials[7]. According to his account, some 800 graduates who pass the Grade I are hired each year and accepted by the MOF, the Ministry of International Trade and Industry, and the Ministry of Home Affairs, and so on. More than half of them are engineers and scientists, and about 200 law majors are hired. If you add government and economics majors, about 300 career officials per year are hired. Multiply that by 30 years of service and there are about 9,000 of these career officials on top of some 500,000 officials.

Only a law major graduate of the University of Tokyo who has passed the Civil Service Examination Grade I is eligible to be the MOF Undersecretary or Bureau Director.

One might well ask whether someone with a degree in law knows enough about economics; the answer is yes and no. At the Finance Committee meeting of the Lower House held on February 6, 1998, K. Yamaguchi, Banking Bureau

7. *Heavy Decline of MOF Officials* (Okura Kanryo no Boraku), Bessatsu Takarajima M, compiled by Takarajima , Tokyo: Takarajimasha, 1998., 163 – 172

Director of the MOF, replied to a question by admitting, “I am not too familiar with economics.” One committee member was sufficiently appalled by this admission to post the exchange on the Internet.

However, an official can learn enough to get by, in just a few years as an MOF administrator. It isn’t necessary to know much about many aspects of economics if the job is principally administrative. There are a handful of MOF officials who have a thorough understanding of the workings of the ministry and whose expert knowledge of the vagaries of fiscal and financial matters can guide the economic course of Japan. But most of these officials are administrators.

After all, the Economic Planning Agency was available (now merged to the Cabinet Office) to carry out planning, although they failed miserably to identify the deflation engulfing the Japanese economy in 1998.

Let us take a brief look at the famed Civil Service Examination Grade I. A candidate can apply for only one field. The examination consists of two tests, primary and secondary, in 13 fields: public administration, law, economics, human science I and II, science and engineering I, II, III, and IV, and Agronomy I, II, III, and IV. In the secondary written test, candidates are also interviewed by examiners.

For economics, the primary multiple choice test includes economic theory, public finance, economic policy, economic history, and economic affairs, which are all required. And one selection is to be made from international economics, econometrics, management science, constitution, and civil code. The secondary written test includes economic theory, public finance, and economic policy.

For the 2002 Grade I Examination, over 3,000 men and women applied for the 15 available positions in public administration, a ratio of 20 times. For the 80 available positions in economics, the ratio was 11.9 times. In other words, close to 1,000 men and women applied.

US Undersecretary of Treasury (later Secretary of Treasury and then president of Harvard University) Lawrence Summers was appalled by what he saw as a shortage of good economists at the MOF. On the other hand, Secretary Summers, like most American economists, initially knew little about international finance himself.

Japan’s expert on international finance, Dr. Eisuke Sakakibara, is an out and out economist and bilingual at that. With a BA and MA in economics from the University of Tokyo, and a Ph. D. from the University of Michigan, he served as the Vice Finance Minister in his duties as the International Finance Bureau Director from 1997 to 1999. He is one of the few Japanese economists who have a first-hand knowledge and experience of the money market including derivatives. Currently teaching at Keio University, he was widely known as “Mr. Yen” for taking positive action to keep the yen from getting too strong while he served as the Vice Finance Minister.

Non-Career Officials

Graduates of high schools and colleges other than those universities mentioned above who have not passed the Civil Service Examination Grade I are classified as non-career officials. The career officials naturally feel superior to them, and move up the promotion ladder all the way to the MOF Undersecretary, the highest position achievable by a MOF official.

The non-career officials are generally decent, hard-working, intelligent individuals. Their education in most cases ended at the high school level, usually because they could not afford to go further. Some go to night school and obtain a college degree. But in Japan night school is never considered as good as a full-time university degree. Nonetheless, they are often as intelligent as the career officials, and they are conscientious workers.

While the career and the non-career officials work in the same offices, there is a world of difference between them, including job assignments, where they eat, where they go after hours, and where they are entertained.

There is a well-known case of a highly capable non-career official who was promoted to the post of a bureau director of the MOF. Having entered the world of career officials, he felt as if he were in a straight jacket. After a few months on the job, he found it so stultifying that he gave up and asked for re-assignment. It was granted.

Prior to 1997, fiscal and financial matters belonged to the exclusive domain of the MOF. In 1997, the two were separated, partly to ensure that the findings of the non-career inspectors could be properly reflected in the MOF's policy and administration.

Since no government agency welcomes the idea of having its power diminished even to the slightest degree, the MOF put up stiff resistance against the split. What came out was a compromise whereby the inspection and supervisory departments were separated from the MOF. In June 22, 1998, the Financial Supervisory Agency was officially created, with a staff of 165.

Suicide of an Inspector

In the early days the Financial Inspection Agency was understaffed, but it carried out intensive inspections of 19 major banks. Meanwhile, one of the inspectors checking out Fuji Bank committed suicide, which was a blow to the Agency. No one actually knows why. One rumor has it that the results of the inspection of Fuji Bank were not convincing enough, but Fuji Bank may have put up resistance to the idea of a re-inspection. They would lose face. Caught between the powerful bank and his sense of duty, the inspector committed suicide.

The Agency's name was changed to the Financial Services Agency on July 1, 2000 and on January 6, 2001, it divorced itself from the MOF and became an external organ of the Ministry of Public Management, Home Affairs, Posts and Telecommunications. In the FY2003 budget, an increase of 162 personnel was included.

Career Officials vs. Non-Career Officials

There is a sharp distinction between the world of career officials and the world of non-career officials, and they have a gentleman's agreement that a member of the one world does not cross the line to enter the other side.

However, inspectors are non-career officials, and sometimes a career official accompanies the inspectors as a career inspector to get some experience — like a West Point graduate taking command of a company under the careful guidance of a master sergeant.

N. Yanai, former executive of Japan Long-Term Credit Bank, was the manager of the sales department at the bank's head office and gave an account of his encounter with such career-official-turned-inspector. He was chosen to deal with a career inspector who knew nothing of the art and the science of financial inspection. He saw that those non-career inspectors went to almost ludicrous pains not to hurt the feelings of the career inspector.[8]

In his encounter, the inspection was conducted with one inspector and two company officials, the manager of the sales department and the chief of the section. Mr. Yanai had about 40 big corporate accounts and he prepared materials indicating that none of these clients had any bad loans. To his consternation, the career inspector did not know how to read the inspection materials commonly called the "line sheet," let alone the balance sheet and the profit and loss statement. This is akin to a professional musician who cannot read music.

The inspection came upon a client who had had a class action suit filed against it in the United States, although the case reportedly had come to settlement; the career inspector repeatedly asked a silly question: "Do you accept what the company says?" This went on and on.

Disgusted, Mr. Yanai clinched an argument by contending that the financial statement of the company in question had been accepted by the MOF, that any falsification of the financial statement would be subject to criminal prosecution, and that on the basis of years of dealing with this client, the bank was confident of the validity of the company's statement.

The career inspector, to hide this loss of face, was shrewd enough to mumble something to the effect that he had to attend a meeting at the MOF and took off, leaving the records of nearly 40 companies unexamined. At the end of the scheduled inspection period, this man showed up and cleared all the remaining cases — without examining them — as certifiably free from bad loans.

8. Yanai, Noboru, *Miscalculations of a Mega Bank* (Mega Bank no Gosan), Tokyo£º

Mr. Yanai had an interesting observation. The career inspector, even on a training mission, would never interfere with the non-career inspector's territory; he would never try to influence his inspection results. Nevertheless, it is easy to imagine a situation where the non-career inspector comes up with an honest assessment of the records and reports the presence of bad loan. That would surely embarrass the dickens out of the career official.

Consequently, the non-career inspector might show some consideration in making up the report. Such modesty results in soft inspections of the banks, often leading to a huge gap between sound and unsound financial administration. This certainly is one factor in the delaying of quick disposal of bad loans.

Mr. Yanai further observed, as Prime Minister Kiichi Miyazawa had done during the first half of the 1990s, that the key officials in charge of finance at the MOF were certainly not aware that the bad loan problem had reached crisis proportions. Mr. Yanai was appointed in June 2003 to the board of directors of the sagging Resona Bank, into which the Japanese Government decided to inject ¥1.96 trillion (nearly $16.6 billion, ¥118/$1).

Beautiful Crimson Leaves

Shukan Gendai ("shukan" means "weekly") is a muckraking newsmagazine published by the giant publishing house of Kodansha. This magazine ran a series of articles exposing MOF crimes in 1998. Its February 7, 1998, issue carried a round table talk featuring three MOF-Tan officials of major commercial banks — with their names withheld. An excerpt of their talk, in translation (permission granted), will give an intriguing insight into what was actually taking place. What their discussion reveals was also supported by other interviews.

> Mr. A: Sounds like entertaining MOF officials is our only job. But actually, we've got a lot of other hectic chores. From taking copies to drawing up a draft of a report to be written by a government official. In short, an errand boy for government bureaucrats. When you are stationed at the MOF from 10 AM till evening, you wind up being that.
>
> Mr. B: We had a MOF-Tan who was asked by an official to "run a simulation at your bank to see how the economy would respond if the interest rates were raised." He dashed home and produced the paper overnight.....
>
> Mr. C: When it comes to a highly capable MOF-Tan, he can write a draft of a paper on behalf of an official even if it has a lot to do with national politics. At the time of the "Jyusen" liquidation, the MOF-Tan of one bank complained, "We are carrying too much of the burden," and succeeded in having their share cut back. In return, he wrote a draft of the proposed measure for liquidation.
>
> Mr. C: A MOF-Tan on excellent terms with the MOF can do that. For example, Tokio Marine & Fire Insurance put up a lot of resistance to a proposed plan for Yasuda Fire Insurance to tie in with I.N.A. Himawari Life Insurance to form a subsidiary, and the proposal never went anywhere. Rumors are that this was caused by

a powerful entertainment offensive staged by the MOF-Tan of Tokio Marine & Fire Insurance against the Banking Bureau.

Mr. C: Eighty percent of the MOF-Tan's job is to get accurate information on inspections.

Mr. B: If a surprise inspection should befall one of our branches because of a delay in getting the information, it would be like a thunderbolt hitting. Our job as MOF-Tan would most likely be on the line.

Mr. A: At our bank, the unwritten code is: "If you give faulty information twice, you'll be demoted." This is why regular "maintenance" is necessary. Maintenance is our shop talk. It includes visiting officials diligently and taking good care of them all the way from helping them write a report, financial matters, to girls.

Mr. C: If you do that, bureaucrats usually will leak information on inspection.

Mr. B: It isn't necessarily so. Bureaucrats never say anything that can be taken as a commitment. It's their second nature. This is why we've got to play our cards right, psychologically.

Mr. C: One time, in front of a financial inspector, I pointed to a page in my notebook indicating late February, and asked, "It is about this time, isn't it?" He did not say anything, but nodded. It turned out that the inspection came about that time.

Mr. A: In the same way, I was just having a conversation with a financial inspector when, out of the blue, he said to me, "Nagano Prefecture must have beautiful crimson leaves in October." ...It dawned on me ,"This means an inspection will come to our Nagano Branch in October." I immediately notified our branch in Nagano, which had not had an inspection in three years. Then, in October, they had an inspection. In the nick of time, that saved my skin.

Mr. C: Nonetheless, this was the "Effect of Entertainment." If there is not enough entertainment, bureaucrats get peevish and retaliate in a sly, underhand way, in cold blood. No information giving, and worse still, inspectors can come at the end of March, the busiest time of the year, or in mid-summer when they usually stay away.

Mr. B: If you take a wrong step in handling career officials and non-career officials, they get cranky.

Mr. C: To non-career officials, talking about which school they graduated is absolutely a taboo. Some officials are graduates of first-rate schools, and some are high school graduates. One MOF-Tan who didn't have common sense once mistook a non-career official for a graduate of his alma mater, the Law Department of the University of Tokyo, and asked, "Sir, which year did you graduate?" The non-career official hit the ceiling and bellowed, "Don't you ever show your face here again!" That MOF-Tan was off to a remote post."

Mr. A: Career officials move from one bureau to another, but non-career officials transfer from one department to another within one bureau, so they are like the master of the bureau. It's no exaggeration to say that making enemies of non-career officials in the Banking Bureau or the Financial Inspection Department is like committing suicide — and jeopardizing the destiny of a bank as well.

Mr. B: You must use extreme caution when it comes to the so-called "equal status line." This is a rule of the industry that sets forth which representative of a bank is entitled to entertain which bureaucrat at which position. If you make a mistake about that, you're in very hot water.

Mr. A: In our case, if the MOF officials are the Deputy Section Manager and non-career officials, our Section Manager or Deputy Department Manager receive them; if the MOF Section Manager comes, our Planning Department Manager is in charge; if the MOF's Vice Minister is present, our Executive Managing Director or Managing Director shows up; or if the Banking Bureau Director shows up, our President takes charge of entertaining. For example, when entertaining the Vice Minister, if our Executive Managing Director or Managing Director is not present, he would be furious.

Question: On January 13, 1998, Chairman N. Saeki of the Federation of Bankers Association of Japan, said, "After the MOF made up the Ethics Code in December, 1996, we have no excessive entertainment by the MOF-Tan at all." ....

Mr. C: Aha, that's a lie. Even today, MOF officials are still doing in Mukohjima what H. Taya, former Director of Tokyo Customhouse, was doing. In a restaurant, they get drunk and sleep with a girl in the next room. I saw one section manager doing it in a closet.

Mr. A: These days, being mindful of people watching, banks often use their Company Guest House for entertainment. They bring in good looking, fashion model-like hostesses from Roppongi and Ginza night clubs and have a party there.

Mr. C: We also use our Guest House that way. Career officials really show the same reaction when they see girls. That is, they like to touch and feel them right away.

Mr. B: The MOF-Tan has a "Secret Safe" for entertaining bureaucrats. When they entertain, they always carry ¥2 million ($20,000) in cash. Bureaucrats bring receipts and bills for their own entertainment that they cannot dispose of. So I take them and give them the cash equivalent. They do that, too, at the Guest House.

Mr. A: At our bank, over ¥100 million ($1 million) per year is spent in entertaining MOF officials. The cost of a party is about ¥100,000 ($1,000) per person in the section manager class. Several of them come together, so when we calculate the cost for our side, one party costs about ¥1 million ($10,000). If it's playing golf, it will cost ¥700,000 to ¥800,000 ($7,000 to $8,000).

Mr. B: I heard a story about some bureaucrats wangling more money than that from a bank in one night. Three financial inspectors went to the US branch of a certain commercial bank for inspection, and that night, they lost ¥10 million ($100,000) in Las Vegas. Naturally, the money was paid by the MOF-Tan....

What is revealed here matches what I heard from geisha girls. One of them even said, "Their raunchiness is inversely proportional to their level of education."

"What do you mean by that?" I asked.

"Oh, the more educated they are, the raunchier they get. What some of them do after they are seated and the geisha girls show up is beyond imagination. Regardless of their position in the government, most of these government officials grab them and...!"

Is lavish entertainment still going on in the new millennium? No. Since inspections are carried out by the Financial Services Agency, there is no need for

MOF-Tan bankers to get advance information on the next site of inspection. They just take inspections when the inspectors show up. Instead, once or twice a year, the banks give dinner parties at their guest houses and not at Japanese restaurants attended by geisha girls. After the party, they may go to bars or clubs, but that is where the entertainment stops. Officials themselves avoid further entertainment.

The Background of MOF Officials

This is perhaps understandable when you consider how hard they have worked to climb the ladder of success. Typically, a successful candidate was always at the top of his class, and in high school studied all the time to prepare for the entrance examination for the University of Tokyo. The hardest examinations in Japan are the bar examination and the entrance examinations leading to the University of Tokyo Medical School. After these come the entrance examinations leading to other departments, including the Law Department, of the University of Tokyo. He had to get straight A's throughout his high school years.

The University of Tokyo entrance examination's pass ratio is not high; while it used to be 1 out of 4 or 5, it has been 1 out of 2.5 to 5 since 1996, depending on the course of study. The ratio is 1:10 or more in some other schools. But regardless of the ratio, the applicants represent the cream of Japan's high school graduates. Anyone who is not a straight-A student will be advised against attempting the University of Tokyo entrance examination.

There are a number of preparatory schools that help students hone the skills and techniques needed to pass the entrance examinations for the best schools. After failing the examination once, a student can spend a year or two in one of these preparatory schools.

Once a student manages to gain admission to the University of Tokyo, if he graduates with an overall B+ average he may qualify to enter government services — except the MOF, a seat of power reserved only for the best and the brightest. (Students with a lower grade point average can always become school teachers out in the provinces.)

Clearly, those who become MOF officials had to "cram" during their college years to maintain their good grades, and that left hardly any time for fun, particularly with girls. Once they are in the MOF, in due course, the minister's secretariat will start providing candidates in the form of a list of daughters of well-to-do businessmen. Business and industrial leaders are always seeking to have their daughters introduced to good bachelors in the MOF. And so a marriage is arranged. The happy couple can then live in government-furnished housing, which is not big but has an outrageously low rent — less than ¥10,000 ($100 to $120) per month. It is slightly higher today in 2006, in the neighborhood of ¥30,000 to 50,000 or more ($300 to $500).

For example, M. Nagaoka, MOF's Budget Bureau Director in the early 1980s, had a school classmate, Shoichiro Toyota, who was President of the Toyota Motor Company at that time (he is currently the honorary chairman of Toyota). Mr. Toyota had a daughter named Atsuko. After screening many eligible bachelors at the MOF, Director Nagaoka's choice fell on one Fujimoto, a bright young man who had joined the MOF in 1972. He was, at the time, the Assistant Manager, Investment Section III of the MOF's International Finance Bureau, and Nagaoka introduced him to President Toyota[9]. In due course, on April 22, 1983, Fujimoto married Atsuko Toyota with Mr. and Mrs. Kiichi Miyazawa as the matchmakers (Mr. Miyazawa was the Chief Cabinet Secretary at that time and was later Prime Minister).

Yukihiko Ikeda (now deceased) entered the MOF in 1961 and soon joined the top echelons of the Liberal Democratic Party (LDP). He married the daughter of the late Prime Minister H. Ikeda (who was an MOF official).

There are also several social parties held once or twice a year to present the daughters of businessmen, politicians, and government officials to eligible bachelors of the MOF. Commenting on this environment, someone wryly noted, "No wonder these government officials lack an international sense in conducting government affairs. They are isolated products of inbreeding."

Regardless of their lack of the international sense, they cannot afford to have an affair or other scandal in this setting. And anyway, they have no time.

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9. Jin, Ikko , *MOF Bureaucrats* (Ohkura Kanryo), Tokyo: Kodansha, 1982, 252.

Chapter 3. Financial Institutions: Lending Activities and Crises

As any banker can tell you, the bubble period was marked by over reliance on land as collateral, leading to the use of funds obtained from land as security for speculation. With low interest rates and an abundance of funds after the Plaza Accord, so long as there was some form of real estate involved, loans were available. "Whatever our money problems, once the land is sold, there'll be no problem recovering enough funds to repay the loan" — that's how everyone was thinking, from borrowers to bankers to government policy-makers.

Rags to Riches and Back

Masao Sen, a well-known popular singer, had a huge tract of land in the Tohoku District, which he had purchased years before at a low price. Borrowing against that land, he purchased office buildings which, in turn, served as collateral for borrowing to buy more buildings. At the peak, he owned about $2 billion worth of property. Today, his outstanding loans exceed $1 billion.

Midori Hatakeyama, another popular singer, began buying stocks on margin. Once the bubble broke, stock prices dropped. Today, her loans amount to $15 million or so.

Too Busy to Check the Collateral

Details of circumstances surrounding the banks and NBs in those days are vividly described in a special supplement to Takarajima No. 177, *Inside Stories of Real Estate Deals* (Fudosan no Ura), published in 1993.[10] Many bankers who were

10. Compiled and edited by Bessatsu Takarajima, *Inside Stories of Real Estate Deals* (Fudosan no Ura), Tokyo: Takarajimasha, 1993.

active in those days say that in most cases they had to decide on loan applications backed by collateral without actually going to the site to examine its collateral value. Even when a car is insured, the insurance salesperson sees the car and takes its picture. When it comes to a piece of property valued at several million dollars, the bank naturally sends its staff to examine its worth. However, this step was often skipped when the market was hot because everyone was too busy and there was too much cash around. If the customer felt that the bank he was negotiating with for a loan was taking too much time, he could easily switch to another bank.

Consequently, Examination Directors filled out in-house documents using the information supplied by the borrower — current price of land, stocks in possession, and other assets, without checking with the Examination Department. Ordinarily, it would take a week or more to come to a lending decision after checking every item in the application.

Furthermore, the commercial banks had to keep the ratio of equity capital to total assets at the levels required by the Bank of International Settlement. As one banker pointed out: "The prevailing atmosphere was as if one was standing with his back to the wall; that the profit ratio to total assets must be drastically boosted."

Loans Called In by Major Banks

This lending spree among commercial and other banks naturally had their excesses and many fell victim when the bubble collapsed. Let's look at a few examples of what the major commercial banks did to individual borrowers and small businesses.

Many of these victims did not borrow money from their banks because they "needed" it, but because their banks asked them to borrow, to participate in their "fail-safe" projects to make money, a technique often used by professional con men. Their banks told them that borrowing was a good way to save money to pay the inheritance tax, saying, "After all, one of the top commercial banks in Japan is recommending this. Under no circumstance will you lose money!" So ordinary people borrowed from their banks, putting up their homes as collateral, and then wound up being hounded by their banks which suddenly changed their attitude and began calling in the loans as part of a nation-wide and bank-wide drive to recover bad loans.

Bankers' ruses followed a few particular patterns, including lies, persuasion, and extortion[11], somewhat akin to what professional loan sharks do. One version is the loan peel-back, called "kashi-hagashi." More than a credit crunch, it means collecting or peeling the loan already extended to the customer

11. Oct. 24, 1998, "Exposing Legal Crimes of Giant Commercial Banks" (Daiginnko no Gohoteki Hanzai wo Abaku), *Shukan Gendai*, 49-63.

back from the hapless customer long before the due date, something that has been very rare in the United States. In December 2002, this word "kashi-hagashi" was chosen as one of the most popular words of that year.

One victim was Tescon, a company of some 300 workers headquartered near Tokyo. It had an affiliate, Tescon America, in Silicon Valley, in 1987, and its stock has been traded over the counter since 1991. One of the pioneers in manufacturing testing equipment of printed circuits, it was rated in 1998 by a noted economic journal, the Toyo Keizai (Oriental Economist) as one of the leading companies in the field with renewed record earnings and possible continuations of increased dividends.

Yet, by September 30, 1998, Tescon was about to go under because of "collection" being enforced by its bank. Their account in the bank was originally intended for settling a promissory note that was coming due, and the company found itself unable to honor it.

As Managing Director S. Mukai explained, it all came to a head at about 3:00 PM on September 29, 1998, a day before the ¥100 million ($1 million) promissory note came due. The company received a sudden call from the bank with notification that unless the loan of ¥297 million ($2.97 million) was repaid at once, Tescon's deposits in the current account would be all transferred for repayment of the loan. If all the deposits in the current account were withdrawn by the bank, it would be impossible to settle the promissory note. The bank knew very well that the company would certainly go bankrupt should such action be taken. No American would understand it. But it did happen. The bank's main concern was to get as much money as possible back from this company while there was some money in the account. Such action would certainly be unthinkable in the US bank because of possible legal action.

Mr. Mukai checked the current account deposit online at 8:30 AM the next day, September 30. The sum of ¥69 million ($690,000) supposedly received the day before, was gone with nothing left. And the sum of ¥24 million ($240,000) newly received that day had also been collected. Such collection was contrary to the repayment schedule the company and the bank had agreed on. Funds earmarked for settling the note simply vanished.

On the morning of September 30, Tescon's Director made a call to the bank. The Manager was out of the office and the Assistant Manager answered the call. "I don't understand. Did we do something wrong?" The Assistant Manager answered repeatedly that it was the bank's policy, so he could not change it.

The bank made a statement referring to Tescon's delinquent repayment. Since no specific explanation was offered in regard to the repayment schedule, they reasoned that it would be difficult for the bank to provide further assistance. This was not a simple case of foreclosing on a loan but a way of getting rid of a customer that was not doing well.

Failing to honor the note once is bad enough, but it is acceptable. However, if you fail to honor it twice within a period of six months, you have crossed the line and you are branded insolvent. Tescon apparently got over the critical situation. Thanks to its superb technology, they are thriving today even in trying times.

Is this sort of thing still happening today? No, not as long as a company is turning a profit, but if it is running in the red and if the company falls behind on the repayment schedule more than once so that the bank has an negative image of the company, then there is no guarantee that the bank will not resort to such tactics even now.

Then there were inexplicable loan deals, as a 45-year-old gentleman who we'll call Mr. Moto, found out. In 1987, Mr. Moto's father had a home built in Tokyo with a home loan of ¥25 million ($250,000) extended by a bank. He insured himself with a group life insurance plan. Mr. Moto himself lived at a different address. His father passed away in September 1998, and on September 14, Mr. Moto, thinking that the home loan must have been settled with his father's group life insurance, called the bank: "The insurance money should be coming, so you can settle with that."

The manager in charge of home loans who answered the call said that the loan was automatically transferred to Mr. Moto. "You are the party insured [under the group life insurance]. If your father dies, that has nothing to do with it [meaning there would be no insurance money forthcoming]. There are remaining obligations...."

Mr. Moto eventually found out that his father had been given a "Parent to Child Relay Loan" and there were anomalies in the group life insurance contract as well. Mr. Moto remembered that his father had asked him to lend him his seal (used with official signatures), but he was told nothing about the details of the life insurance contract in which he was to be the insured. He says, "When I looked at it, although my official seal was put on the contract, my name was written in female handwriting in the signature column. At the time the insurance contract was concluded, no "confirmation of the intention of the insured himself" was made to me who was the insured, and no explanation was given by the bank."

The stipulations of the contract were skillfully worded so that it was sufficient to offer information to either the father or Mr. Moto. Not being fully versed in the arcana of insurance policies, Mr. Moto's father was unable to properly appreciate the sort of policy he was being sold. Undoubtedly, as the lender, the bank showed gross negligence in performing its duty of explanation. Why should Mr. Moto repay the sum of ¥122,283 ($1,222.83) on the 27th of the next 269 months for a loan he did not borrow?

But if the loan should not be fully repaid, the Assistant Manager explained, once Mr. Moto fell behind by two or three months, his name would be blacklisted and he would not be able to borrow from any financial institution. Furthermore, after six months, the bank would take legal proceedings. Worse still, the property would be put up for auction. The bank doesn't lose either way.

A Seal Is a Seal Is a Seal

To make the matter worse, prior case precedents in Japan indicated that the Supreme Court took the position that once the seal was stamped on a document, regardless of the circumstances, that document was completely legal pursuant to the 80-year-old provision of Article 326 of the Japanese Code of Civil Procedure. In addition, even if you take it to court, claiming that the seal was stamped without your permission and your knowledge, you must prove it. In most cases, you lose. The law is clearly on the side of banks, which rely heavily on seals for verification.

The majority of these "bank victims" (not loan shark victims) are senior citizens.

Many bankers are hated just like many attorneys are scorned in the United States. As a matter of fact, some retirees don't even want to be known as former bankers, because all they hear is complaints about banks.

How Small Businesses Are Served

We have seen examples of small businesses at the mercy of major commercial banks. What about credit unions, credit associations, and other financial institutions catering to the financial needs of proprietors of small shops or small firms, and individuals?

"Shinyo Kinko" (literally meaning credit safebox or credit union), commonly called "Shinkin," has salespersons making rounds of their customers and collect their day's cash proceeds. Japan is still a safe country, despite an influx of thieves and bandits from China and elsewhere. Credit union salesmen can safely ride around on bicycles or motorcycles equipped with a metal box containing paperwork and cash.

In a best seller entitled *Diary of a Misfit Banker on Duty*,[12] author Hamao Yokota, a banker, describes what happened when he went to see a client of his, a very small printer specializing in silk printing. It was raining hard, so he drove over by car. While he was chatting with the printer inside the shop, he heard a small motorbike braking and coming to a halt.

Wondering who in the world would stop by despite the heavy rain, he was just looking toward the entrance when the door opened with a clatter. A fellow who looked like a delivery boy from the noodle shop — wearing a dark green rubberized raincoat from top to bottom — appeared. "Good afternoon

12. Hamao Yokota, *Diary of a Misfit Banker on Duty* (Hamidashi Ginkoman no Kinban Nikki), Tokyo: Kadokawa Shoten, 1995.

everybody. I'm from Jonan. Pardon my raincoat." And there he stood, soaking wet, dripping all over the floor, picking up today's cash from the printer. Saying, "Thank you...," he dashed back out into the rain.

This is how a credit union operates. The character in the mackintosh is a salesperson/collector for a credit union. Jonan Credit Union, Japan's No. 1 credit union, with very few bad loans, racked up a total deposit balance in excess of ¥3.2 trillion(about $27.8billion, ¥115 /$1) at the February 2006 term. Instead of having customers go to their office to make a deposit, they come to collect the day's earnings, stamp your passbook to acknowledge receipt, and take off. It is a very convenient service from the customer's standpoint. And when you and the salesperson on call have a little time for a chat, you can get loads of information from him.

Proprietors of small shops and stores have cash sales, and at the end of a day, they can keep the cash at home or deposit it at night deposit boxes of regional banks or other financial institutions. But of course, they prefer to have credit unions and credit.

The First Financial Crisis in 1994

In the first half of the 1990s, deflation was never an issue. Many MOF officials thought that business would pick up in a few years, and everything would be back to normal. Bad loans, if there were any then, were connected with the management of "Jyusen" companies.

Then, beginning in 1994, financial institutions that had been considered unlikely to fail began going bankrupt because of the many bad loans. In December, two credit associations with many small and medium-class businesses and manufacturers as customers declared bankruptcy. In July 1995, the largest credit association in Tokyo failed. The next month, another credit association in Osaka as well as the second largest regional bank went under.

This was the beginning of the first financial crisis. Twenty-three major financial institutions submerged from 1994 to 2002. Until 1997, those financial institutions going bust were small and medium-size. Then, in November 1997, one of the major commercial banks, Hokkaido Takushoku Bank, failed, followed by Yama-ichi Securities Co., one of the top four brokerage houses.

Second Financial Crisis in 1998

A sense of crisis gripped the nation in 1998. The fear was that a chain reaction of bankruptcies of banks and other financial institutions might follow. The Japanese Government decided to pour public funds, that is, taxpayers' money, into stocks of banks on the verge of bankruptcy.

In March 1998, a total of ¥1.81 trillion (some $18 billion) was poured into 21 commercial and trust banks. Less than a year later, on October 23, 1998, Japan

Long Term Credit Bank went down. On December 13, Nippon Credit Bank failed because of its dubious lending activities and poor relationships with leading politicians.

In March 1999, the Japanese Government again injected ¥7.46 trillion (some $745.9 billion) into 15 major commercial and trust banks — with the notable exception of Tokyo Mitsubishi Bank, known for its sound financial management.

Looking Up in 1997 — Until the Tax Hike

In September 1995, ¥14.2 trillion (some $177 billion, ¥80/$1) was expended under the socialist Prime Minister Murayama. This caused the Nikkei Stock Average to move up to ¥22,666 in 1996. Japan's economy was making a smooth recovery with 3.5% growth in the 1996 calendar year. But when things start looking good, it is second nature for government policy-makers to meddle. Seeing the renewed growth, they said, "Increase taxes!"

Prime Minister Ryutaro Hashimoto, buoyed by a false sense of optimism, allowed the consumption tax to be raised from 3% to 5% in April 1997. This was a mistake of epic proportions.

He said in a Diet session that this had been decided before, with the goal of making the government richer by ¥9 to 10 trillion. He failed in his duty to make proper assessment of the current situation before applying a decision that had been made earlier under different circumstances.

The opposition parties were against the move. For once, they were right. They charged that the hike would take ¥9 trillion ($12.25 billion) out of consumers' pockets. T. Suzuki, speaking for one of the opposition parties, and a former Finance Ministry official, insisted that priority be given to protecting the vitality of the private sector to swing the economy in a growth-oriented direction.

Prime Minister Hashimoto maintained that the rate increase would not affect the recovery of the economy. Concurrently with the tax increase, other taxation measures as well as social security-related expenses were also increased — in the name of correcting fiscal indiscipline. This created a total increase of ¥13 trillion ($13 billion) in consumption taxes.

The ripple effects were projected to produce a gain of some ¥20 trillion ($20 billion, ¥100/$1) for the government — or a loss of that much for the consumers, despite the fact that 1997 was probably the last chance to put the economy back on its feet. No former government economists, despite their supposedly deep knowledge of economics, criticized this policy action.

As Kazuhide Uegusa, chief economist of the Nomura Research Institute, Ltd. and the principal opponent of the tax hike, feared, the economy took a downturn in May 1997. This was too much for Japanese voters. In the Upper House election of July 1998, the ruling Liberal Democratic Party suffered a heavy loss, Hashimoto's cabinet collapsed, and so did the Japanese economy. Stock prices dropped as the Nikkei Stock Average fell all the way down to ¥12,879 in October 1998.

The LDP president, who is the president of the ruling party, automatically becomes the Prime Minister of Japan. Former Prime Minister Hashimoto had the gall to run in the 2001 LDP presidency election. Jun-ichiro Koizumi won. Hashimoto admitted his mistake and apologized, but only after four years.

Officials of the Ministry of Finance gave a strange explanation for the downturn, pointing to several factors including the Asian currency crisis that took place in the same year and the financial crises caused by the insolvency of the Hokkaido Takushoku Bank and Yama-ichi Securities. It is true that these crises were underlying factors but it was the tax hike that catapulted the Japanese economy into a quagmire.

This colossal misjudgment was aptly pointed out in 2002 by Prof. Gary S. Becker of the University of Chicago, 1992 Nobel laureate in economics,[13] who pointed out that there was no need for the Japanese economy to remain stagnant for as long as 10 years and laid the blame at the door of the government policymakers and the Bank of Japan.

Financing Small Businesses

During the bubble, some credit union borrowers switched to commercial banks. But these commercial bankers are so used to dealing with big accounts that once the downswing started, they suddenly changed their attitude toward their individual and small business accounts. They start pulling back the loans extended to small accounts.

Many individuals and small business operators took advantage of the bubble to buy stocks, land, or both. When the economy went sour, the values of stocks naturally went down and the land prices fell below the collateral values. Their businesses were in poor shape. Consequently, they could not pay the interest that also had escalated. In many cases like this, commercial banks turned their backs.

Michiyo Suzuki, age 54, a housewife living in Kanagawa Prefecture near Tokyo, wrote to the *Asahi Shimbun*, Japan's quality newspaper with a nationwide circulation of over 8 million[14] asking that loans be extended to small and medium-sized companies.

> My husband has been running a small import company and has never broken a promise with his bank which is a major commercial bank. He has earnestly listened to the instructions provided by the bank and followed their management recommendations.

13. December 27, 2002, *Nihon Keizai Shimbun*, 1.
14. July 1, 2002, Reader's Voice, *Asahi Shimbun*.

During the bubble period, his bank strongly urged him to buy some real estate. When he refused, he was intimidated by the bank. They said they would reconsider their loans to his business. So, we bought land.

Now that the world has changed completely, the bank is no longer providing necessary funds. A few years have passed. He has been honestly working day in and day out, worrying about financing to such an extent that he is talking about his own life insurance.

I'm afraid for my husband from the moment he goes out until he comes home. I never go to sleep until my husband falls asleep and I can hear him breathe. He no longer talks happily about his work like he used to, and he never smiles.

Compared to big corporations, with just a little loan he could have a good relationship with the bank, as he has plenty of business. Mr. Banker, please do not drive hard-working, honest people into suicide.

Chapter 4. Trade Credit

More recently a reader of *Asahi Shimbun* wrote in regarding payment from his clients.[15]

> I quit working for a company 22 years ago and started a small business. As my business began to grow, I have spent most of my waking hours worrying about financing. I felt the period of time from the sales and delivery of goods to the time I received payment to be unreasonable. The closing date of a bill is 20th of every month and payment for the bill is the end of the month after next. This unique custom in Japan is widely practiced so that the delay in receiving payments is as long as three months. Should any expenses occur in the meantime, you take care of them by either using payments received from other clients or by requesting a loan from the bank for operating funds. I hear that in other countries the payments are usually received 30 days after the delivery of goods. This way, receipts and payments do not converge at the end of the month. Although receipts and payments are made all the time, any profit can be used for paying expenses.
>
> Why can't it be like that in Japan?

This letter touches on the core of the Japanese economy — a shortage of cash and a credit crunch. There are some 5 to 6 million companies and manufacturers operating in Japan, and depending on the definition of small and medium-sized companies, more than 85% of them may be considered small and medium-sized firms.

Further, over 60% of these companies, big or small, issue promissory notes due in two or three months, which means that you don't get cash right now but a few months later. What are you going to do during until the notes mature? You ask your bank to discount the notes you receive and the bank is willing to do it, provided that you have a lot of money on deposit, good credit, and/or good cash flow. If you have none of those, you must have good connections.

15. July 12, 2002, Reader's Voice, *Asahi Shimbun*.

A company gets its operating funds from the owner's own funds, by borrowing from a bank, credit union, or other financial institutions, or by relying on trade credit. Trade credit is convenient; it means asking your vendor to accept a delay in payment for a fixed period of time, called the "grace period." The seller grants credit to the buyer in exchange for a promissory note or by recording accounts receivable.

Payment in Bills and Notes

Business is conducted in cash, but in Japan many business transactions allow trade credit (on promissory notes) for 60, 90, 150 days or more. During recessionary times, coupled with deflation, notes receivable in 150 days (5 months) are very common. Bills of exchange are mostly used for imports and exports.

The heavy reliance on promissory notes for domestic transactions is a unique characteristic of the Japanese economy, particularly at the level of service or product vendors to major corporations and manufacturers. After the ordered goods or services are delivered (by the closing date, which is set usually on the 25th or at the end of the month), the vendor receives a cash payment or, in the majority of cases, a note promising to pay at the end of the month after next (60 days) or later.

For example, in 2004 one manufacturer placed an order with a chemical company to produce certain quantities of a chemical. The terms and conditions of payment read, "Payment shall be made with a 3-month promissory note counting from the end of the next month following the closing date of the 20th of each month." This mumbo jumbo adds up to the following. If you deliver the ordered shipment on the 4th of June, which is before the closing date of the 20th of June. Your client then sets it up for payment at the end of July 31 and issues a 3-month promissory note to you on July 31. Add three months to July 31 and you have October 30. This is the date you can cash the 3-month promissory note for the shipment you delivered on June 4.

There are many bill discount houses in Japan, some respectable and others less so. This is an elusive world, scarcely comprehensible to many government workers, company employees, teachers, and other salaried workers who are used to getting paid in cash on a fixed date by the end of the current month, as stipulated in the Labor Standards Law.

If you don't have much cash on hand, you have several options. If your credit standing is good at your bank, you can ask the bank to cash the promissory note by discounting it; the bank will earn profit from cashing the note. The standard discount rate is 1% plus the long-term prime rate at the time (commonly called "Cho Pra,") of 1.3% or 2.3% per annum (12 months).

In case of a $10,000 receivable note payable in 90 days (or 3 months), the amount you pay for discounting is $57.50. So you actually get $9,942.50. But what if the amount of the note receivable in 90 days is $1 million? You wind up receiving $994,500 in cash if you have it discounted, paying $5,750 for the discounting.

If you have notes receivable from your customers, why not issue 90-day notes to your vendors? You can, if you have a good credit standing or an excellent relationship with your vendors. Vendors usually insist on cash payments from small- and medium-sized companies for orders of parts and other semi-finished products. They are reluctant to accept notes receivable in 90 days. Good vendors usually reduce the transaction volumes with companies whose stock prices are doing poorly.

Notes Issuable by Companies

Promissory notes can be issued by an organization if it is incorporated and properly registered. Since notes are a promise to pay, if a company fails to pay on the designated date a notice is given by the clearing house that the company has failed to honor its obligations. When this is repeated twice in a period of six months, that is the end of the company. There are bulletins reporting checks and invoices that were not honored, and the accountants of most companies are aware of the financial condition of their customers and vendors.

I said that failing to honor a payment twice in six months is the end of a company; in reality, once is usually enough because no one is willing to do business with a company after that. And only registered corporations are entitled to issue promissory notes.

Checks with Two Slant Lines

On the other hand, checks can be issued by individuals or corporations. Checks are payable to the bearer upon presentation. In Japan we also have checks marked by two slant lines. This type of check means that, although the check is good, you must collect the amount listed on the check through your bank. You turn in the check to your bank, then the bank will collect it for you and deposit the amount in your account. This is to prevent someone from illegally cashing the checks made out to you.

In September 2002, there was a news story involving a vendor who got fed up waiting to be paid some ¥1 million (about $850,000). The default must have been longer than three months, because he went to his customer and threatened him with a big knife. Naturally, that poor soul was caught and subjected to criminal prosecution. Yet, this customer continued nonpayment. He got away because he had not issued a promissory note. Of course, most vendors do not get themselves into this position.

At Least 64% of Business by All Companies Conducted in Notes

Statistics about trade credit are issued in the Statistical Annual Report on Corporations published by the MOF. Consider the FY1997 record on trade credit as reported in the balance sheets of 2.43 million corporations.

The balance of notes receivable by all corporations in FY1997 amounted to ¥55 trillion ($550 billion, ¥100/$1). When notes discounted in the amount of ¥23 trillion are added, we see ¥78 trillion or $780 billion. This is equivalent to 64% of the total monthly sales of some ¥122 trillion ($1.22 trillion). (Promissory notes payable in the same year amounted to ¥78 trillion.) In other words, in Japan, some 64% of the business transactions are carried on in promissory notes. FY1997 was a depressed year. This is why notes receivable amounted to $780 billion.

Also according to the Ministry of Finance, the total of notes receivable and accounts receivable in corporate transactions amounted to some ¥190 trillion ($1.583 trillion, ¥120/$1) as of the end of September 2002, the lowest level since 1989. This was a 25% decrease from the peak of about ¥253 trillion ($3.16 trillion, ¥80/$1) at the end of FY1995; apparently, business transactions are moving away from promissory notes toward other forms of payment, including cash.

The Bank of Japan provides data on checks and bills clearing, checks and bills that were not honored, and other items.

Table 4-1 Checks and Bills Clearing

	1998	1999	2000	2001
Number of Checks and Bills Cleared	260,061,000	239,315,000	225,868,000	208,896,000
Amounts Cleared (¥1 billion)	¥1,296,150.4 ($12.96 trillion)	¥1,138,552.1 ($11.38 trillion)	¥1,052,338.2 ($8.769 trillion)	¥877,297.3 ($7.31 trillion)
Number of Checks and Bills Not Honored	648,000	477,000	527,000	501,000
Amounts (¥1 billion)	¥1,235.3 ($12.353 billion)	¥961.9 ($9.619 billion)	¥829.2 ($6.91 billion)	¥793.7 ($6.61 billion)
Number of Cases of Bill Transactions Suspended	8,325	14,153	16,268	15,078
Amount (¥1 billion)	¥91.0 ($910 mil.)	¥71.4 ($714 mil.)	¥60.0 ($500 mil.	¥54.7 ($456 mil.)

Source: Statistical Monthly Report on Finance and Economics by the Bank of Japan

According to the BOJ, the amount of checks and bills clearing in 2001 was ¥877 trillion 297.3 billion ($7.310 trillion). About half a million checks and bills were not honored, amounting to ¥793.7 billion ($6.6 billion). This report also shows a decline in the number of checks and bills used, from 260 million bills in 1998 down to 208 million bills in 2001.

What about the number and amount of checks and bills cleared in the 2005 calendar year? The BOJ reports 146,466,000 checks and bills and ¥529,122.8 billion ($4.60 trillion). Note the decline from 2001.

Examples of Notes Used by Leading Companies in 10 Fields

All the financial data below are excerpts from those released by the respective companies for the March 2005 terms with a focus on notes.

Kajima

Major general contractors, as well as a host of minor ones, have huge liabilities bearing interest, that is, loans from banks and other financial institutions. The industry had debts of at least ¥10 trillion ($83.3 billion), some 6,000 insolvencies each year in the new millennium. Aoki Construction, for instance, had a friend in Prime Minister Takeshita but he has passed away, and despite a waiver of its debts of more than ¥200 billion ($1.67 billion), the company went belly-up.

Table 4-2 Kajima Corporation Balance Sheet (¥110/$1)

Titles of Accounts	Term ended March 31, 2005
Current Assets	¥891.742 mil ($8.11 bn)
Cash on hand and in banks	111,313 mil ($1.01 bn)
Notes receivable-trade	9,853 mil ($8,957 mil)
Accounts receivable-trade	353,443 mil ($3.2 bn)
—	—
Current Liabilities	¥964,968 mil ($8.772 bn)
Notes payable-trade	2,864 mil ($26.03 mil)
Accounts payable-trade	406,881 mil ($3.698 bn)

Construction investments dropped from a peak of some ¥84 trillion ($840 billion) in FY1992 to about ¥51.9trillion ($558.3 billion) in FY2004. While distribution, real estate and construction are the top three industries to be hit by the current recession in 2001, the construction industry is notorious for the use of notes and accounts payable.

Kajima Corporation, one of Japan's leading general contractors, had a turnover of ¥1.68 trillion ($15.27 billion) in the March 2005 term. Its use of notes is not heavy, but the accounts payable-trade exceeded notes receivable-trade by a considerable margin — by about ¥53 billion ($481 million); this can be expected in the construction industry.

Nintendo

Nintendo is well known as the maker of Game Boy, Pocket Monster, and Game Cube, to say nothing of its best selling game software, "Super Mario Brothers." It is the world's No. 1 game machine maker and game software maker with sales of ¥443 billion ($4.0 billion, ¥110/$1) in the March 2005 term with cash on hand and in banks of $6.5 billion.

It is also Japan's No. 1 company in that it is absolutely free from bad loans.

From their dealers and vendors, they accept promissory notes, and they issue notes to their vendors as well.

While Nintendo's overseas sales ratio is not as great as Sony's 79%, it is a respectable 74%.

Table 4-3 Nintendo Balance Sheet (¥110/$1)

Titles of Accounts	Term ended March 31, 2005
Current Assets	¥851,259 mil ($7,738 bn)
Cash on hand and in banks	717,758 mil ($6.525 bn)
Notes receivable-trade	1,393 mil ($12.66 mil)
Accounts receivable-trade	69,786 mil ($634.41 mil)
—	—
Current Liabilities	¥174,180 mil ($1.583 bn)
Notes payable-trade	4,063 mil ($36.936 mil)
Accounts payable—trade	102,434 mil ($931.21 mil)
Accounts payable—other	11,994 ($109.03 mil)

Toyota

Toyota Motor is Japan's No. 1 and world's No. 2 automaker with consolidated sales of ¥18.5 trillion ($69.04 billion) at the March 2005 term. The sales are expected to reach ¥19.5 trillion at the March 2006 term. An excerpt of its balance sheet is shown below.

Toyota is unique in that it accepts no promissory notes, while it issues promissory notes which are reported in combination with accounts payable. Further, Toyota is cash-rich (at least ¥2 trillion or $16.6 billion cash on hand at all times), so it usually pays invoices in cash and issues promissory notes infrequently — only when sums over ¥50 million ($416,666) or ¥100 million ($833,333) are involved.

Table 4-4 Toyota Motor Balance Sheet

Titles of Accounts	Term ended March 31,2005
Current Assets	¥3.453 trillion ($31.390 bn)
Cash on hand and in banks	60,200 mil ($547 mil)
Accounts receivable-trade	1.088,700 mil ($989.7 mil)
—	—
Current Liabilities	¥2.180 trillion ($19.818 bn)
Notes payable-trade & accounts payable-trade	910,400 mil ($8.276 bn)
Accounts payable-other & accrued expenses	844,600 mil ($7.678 bn)

Backed by superb production engineering, technological prowess as evidenced by the enormously popular "Prius," and the company-wide efficiency policy, Toyota racked up after-tax profits of over ¥1 trillion or $9.5 billion at each of two terms ending March 31, 2004 and March 31, 2005.

Yamada Denki (Electric)

This is Japan's largest discount home electronics retail chain with a 2005 turnover of over ¥1 trillion (about $9.74 billion) at 300 shops (one shop clerk says it's hard to tell because of the number of shops opening every month).

Note that Yamada Electric's use of bills is held to a minimum, never receiving notes and paying only ¥568 million ($5.16 million) in notes for sales of ¥1 trillion or nearly $10 billion. This means one thing — they pay cash and get bargain rates from wholesalers as well as manufacturers. It is no wonder that Yamada racked up an after-tax profit of ¥21,091 million ($191.7 million) at the term ended March 31, 2005 plus a profit of ¥1,854 million ($16.85 million) carried over from the previous term. And 55.5% of its shares are held by foreign investors.

Table 4-5 Yamada Electric Balance Sheet

Titles of Accounts	Term ended March 31,2005
Current Assets	¥176,338 mil ($1.603 bn)
Cash on hand and in banks	32,658 mil ($206.89 mil)
Accounts receivable-trade	26,005 mil ($236.4 mil)
Purchased goods	96,137 mil ($873.97 mil)
—	—
Current Liabilities	¥106,928 mil ($972.0 mil)
Notes payable-trade	568 mil ($5.16mil)
Accounts payable-trade	55,346 mil ($50.31 mil)

Takeda Pharmaceutical

Despite the recession, Japan's pharmaceutical industry seems to be doing fine. This industry is known for high-paying jobs — the average annual income per employee is about ¥10 million ($83,333) per year at Takeda and Eizai, and less at other manufacturers.

Takeda Pharmaceutical Co. Ltd.., commonly known as "Take-cho," is Japan's No. 1 pharmaceutical manufacturer with 2005 sales of ¥1.122 trillion ($10.2 billion). Accepting promissory notes from their dealers and distributors is an essential part of their business. When the manufacturer ships over-the-counter drugs to their dealers, it takes about six months before the manufacturer receives payment. Take-cho is a rich company with good cash flow.

Table 4-6 Takeda Pharmaceutical Balance Sheet

Titles of Accounts	Term ended March 31, 2005
Current Assets	¥983.629 bn ($8.942bn)
Cash on hand and in banks	2,329.31mil ($2.117 bn)
Notes receivable-trade	108.79 mil ($98.9 mil)
Accounts receivable-trade	1,427.67 mil ($1.297 bn)
—	—
Current Liabilities	¥259.173 mil ($2.356 bn)
Accounts payable-trade	473.31 mil ($4.302 mil)
Accounts payable-other & accrued expenses	1,056.94 mil ($960.85 mil)
—	—

Of the 2005 sales of ¥1.122 trillion or $10.2 billion by Takeda Pharmaceutical, notes receivable-trade and accounts receivable-trade make up some $1.4 billion or about 14% of sales.

Shiseido

Japan's cosmetics market is some ¥2.4 trillion (about $21.8 billion, ¥110/$1) in size. Despite stiff competition from American and European name brands, Shiseido maintains its position as No. 1 in Japan and No. 4 worldwide as a cosmetics manufacturer with 2005 consolidated sales of some ¥640 billion ($5.8 billion). But this is not the only reason to focus on this particular company.

Shiseido's far-seeing president Y. Fukuhara (current honorary chairman) gave an address sometime in the 1960s to new employees in the days when cosmetics were sold primarily for women in a male-centered society, and yet his message rings true today:

Welcome to Shiseido, Ladies and Gentlemen. We are dealing with cosmetics and if some of you think of our business as feminine, you are dead wrong. This is every bit a man's job. You must be man enough to be able to handle this job properly. Why? Well, ladies and gentlemen, should we find ourselves on the brink of bankruptcy, mind you! no banks, no government agencies, and no politicians would come around to lend a helping hand, to rescue us with funds or subsidies. Rise or fall, come rain or come shine, we are on our own. Therefore, this is every bit as man's job as any manufacturer in the machinery or steel industry.

In addition, the industry is dependent on transactions with domestic dealers, department stores, cosmetic stores, and drugstores involving promissory notes, together with accounts receivable and payable. And as someone in the industry once wistfully remarked, "You've got to extend credit to these drugstores, or they won't handle your line."

Shiseido's ratio of notes receivable-trade and accounts receivable-trade to sales of ¥640 billion ($5.81 billion) was about 15% in FY2005. This means that Shiseido was extending loans of $866 million to its dealers and distributors. It does take money, and strong nerves, to do this "man's job".

Table 4-7 Shiseido Balance Sheet (not consolidated) (¥120/$1)

Titles of Accounts	Term ended March 31, 2005
Current Assets	¥195,624 mil ($1.776 bn)
Cash on hand and in banks	20,652 million ($187.8 mil)
Notes receivable -trade	193 mil ($1.754 mil)
Accounts receivable-trade	95,109 mil ($864.6 mil)
—	—
Current Liabilities	¥100,867 mil ($916.9 mil)
Notes payable-trade	1,871 mil ($ 17.0 mil)
Accounts payable-trade	31,764 mil ($288.76 mil)

Matsumotokiyoshi

Japan's largest drugstore chain is named for its founder, Matsumoto Kiyoshi. Matsumoto is a common family name and means Source of Pine Tree. Kiyoshi is also a common first name, meaning something like Purity.

Table 4-8 Matsumotokiyoshi Balance Sheet

Titles of Accounts	Term ended March 31, 2005
Current Assets	¥80,671 mil ($733.3 mil)
Cash on hand and in banks	24,266 mil ($220.6 mil)
Accounts receivable-trade	6,798 mil ($61.8 mil)
Purchased goods	34,174 mil ($310.6 mil)
—	—
Current Liabilities	¥58,225 ($529.3 mil)
Notes payable-trade	3.15 mil ($2.86 mil)
Accounts payable-trade	42,836 mil($38.9 mil)

Its operating turnover skyrocketed to the current ¥305.3 billion ($2.775 billion) at the March 2005 term. You can easily find Matsumotokiyoshi drug-stores because nearly every store is in a good location, in a shopping center or near the train station. Its stores are usually filled with pert, stylish, young girls shopping for something that will make them even better looking. In addition, all the stores are painted yellow.

Matsumotokiyoshi sells over-the-counter drugs, cosmetics, toiletries, and sundries to consumers for cash and naturally accepts no bills, promissory notes and checks; therefore it enjoys a good cash position. It issues a surprisingly low amount of promissory notes payable. Since they can afford to pay cash for their products they get a discount from dealers, and other drugstores.

MacDonalds Japan

McDonalds opened its first shop in Japan in 1971, and today it has nearly 4,000 shops all over Japan. As Japan's No. 1 fast food chain, McDonalds Japan's operating revenue was over ¥361.672 million ($3.139 billion) with a current profit of ¥18.933 million ($157.775 mil) in 2001, then something happened. Even McDonald's uses promissory notes for payment reflecting the original conservative payment policy of the late founder Den Fujita, even though they get nothing but cash from customers.

Table 4-9 McDonalds Japan Balance Sheet

Titles of Accounts	Term ended March 31, 2005
Current Assets	¥25,186 mil ($229.96 mil)
Cash on hand and in banks	7,274 mil ($66.12 mil)
Accounts receivable-trade	7,697 mil ($69.97 mil)
Current Liabilities	¥57,657 mil ($524.15 mil)
Notes payable-trade	6,606 mil ($60.05 mil)
Accounts payable-trade	9,419 mil ($85.62 mil)
Accounts payable-other	16,053 mil ($145.93 mil)

In February 2002, McDonalds raised its hamburger price from ¥65 (54 cents) to ¥80 (67 cents). Fewer and fewer people came to their shops, down by over 16% from the same month prior year. Consumers plainly said "No" to the ¥80 hamburger. Five months later, McDonalds dropped its hamburger price to ¥59 (50 cents), but its sales have never returned to the previous level. Even that marketing genius Den Fuijta made a wrong decision.

McDonalds' operating revenue dropped by over 51% to ¥186.900 million ($1.557 billion) and its current profit registered a first-time loss of ¥1,375 million (about $11.45 million) at the end of 2002. McDonalds closed 176 stores, Chairman Den Fujita soon passed away, and his son resigned. But it still holds the No. 1 position as Japan's leading fast food chain.

In FY2004, MacDonalds reported a gain in sales — ¥308 billion ($2.933, ¥105/$1) with a current profit of ¥7.2 billion ($68.6 million) and the FY2005 remained about the same level with sales of ¥307,552 million ($2.8 billion) — due chiefly to new marketing techniques introduced by a new president scouted from Apple Computer Japan.

Starbucks

Starbucks Coffee Japan opened its first shop in Tokyo's famed Ginza in August 1996, just as McDonalds Japan did in 1971. Today, it boasts 390 shops all over Japan with an operating revenue of ¥615.91 million ($559.91 million) in FY2005. Obviously, it does not issue bills and promissory notes because of daily cash income. Its accounts receivable-trade is a mere $17,000.

Starbucks Coffee Japan pays cash for imported coffee, other supplies and goods, and services rendered by vendors; invoices received by a certain date of a given month are paid in cash at a designated date the following month or later.

Prior to being listed on the Tokyo Stock Exchange, Starbucks Coffee Japan had an excellent Japanese partner, Sazaby Inc., which successfully operates a number of restaurants, shops, and variety stores. After it was listed, Sazaby with its successful marketing prowess remained one of the major shareholders in the company.

Table 4-10 Star Bucks Coffee Japan Balance Sheet

Titles of Accounts	Term ended March 31, 2005
Current Assets	¥11,443 mil ($104.0 mil)
Cash on hand and in banks	5,123 mil ($47.4 mil)
Accounts receivable-trade	1,885 million ($17.1 mil)
Current Liabilities	¥8,721 mil ($79.2 mil)
Accounts payable -trade	1,287 mil ($11.7 mil)
Amounts payable-other	1,702 mil ($15.4 mil)

Dentsu

Dentsu is Japan's No. 1 and the world's No. 4 advertising agency, with ¥1.531 trillion ($ 13.9 billion) in operating revenue, as of March 31, 2005. For an advertising agency, Dentsu has been known as a financially well-managed company. Its operating profit was ¥41,717 billion ($379.2 mil). In addition, there is a profit of ¥2.8 billion ($25 mil) carried over from the previous term.

For a company with over ¥1 trillion in billings, it carries a surprisingly good balance of notes receivable as well as notes payable. This is critical in protecting the agency against the possibility that any of its clients goes bust. Today, corporations and manufacturers are spending tens of millions of dollars, even hundreds of millions of dollars, on mass media advertising in Japan. If any one of them should go bankrupt in this age of depression, that could easily knock out any agency.

Unlike other agencies, Dentsu keeps a tight control over entertainment expenses. Account executives have no expense accounts except for special occasions. While I was working there, I learned how the section manager had to apply for approval of such an occasion. He wrote a "ringi-sho" explaining the reasons for entertaining the client, and had the ringi-sho duly stamped with his superiors' seals. The vice president gave a final seal of approval, and they took the client to a swank "Ryotei" restaurant, where they dined and drank sake. And that was all. The restaurant was the one specified by Dentsu for such occasions, and they billed Dentsu directly. This use of specified restaurants makes it impossible to tamper with the bill, as abound in many other companies.

It is not easy for a new client to be accepted by Dentsu because there is a review board that carefully examines the prospective account's financial status and assesses its ability to pay. The board rejects prospective accounts if they do not meet Dentsu's accounting criteria. News of such a rejection would raise a red flag and could very well provoke a disaster for the company; banks and other financial institutions would start to wonder what caused such a respectable agency to reject a potentially lucrative account.

Table 4-11 Dentsu (Advertising) Balance Sheet

Titles of Accounts	Term ended March 31,2005
Current Assets	¥548,320 mil ($4.98 bn)
Cash on hand and in banks	50,167 mil ($456.0mil)
Notes receivable -trade	24,560 mil ($223.2 mil)
Accounts receivable-trade	383,637 mil ($3.48 bn)
—	—
Current Liabilities	¥495,818 mil ($4.507 bn)
Notes payable-trade	44,220 mil ($402 mil)
Accounts payable-trade	338,813 mil ($3.08 bn)
—	—

A Client May Be Rejected

One client of Dentsu's, in Nagoya, was notorious for haggling over advertising expenses. They tried to encroach upon the agency's sanctuary — media advertising commissions, which were 15% of the gross or 17.65% of the net. This company wanted to cut it down by 5%. (By the way, Nagoya, like Kyoto, is notorious for being tight with money. If you are a vendor for a Nagoya-based firm, you can expect to charge at least 20% less than in Tokyo.)

Exasperated over this demand, Dentsu Nagoya quietly served notice that Dentsu would no longer be interested in handling this company's account. This unprecedented move shook the company management and their demand was quickly withdrawn, for fear that its reputation would suffer.

Risks Involved in Promissory Notes

There is always a risk when transactions are based on promissory notes; a medium-sized company, after issuing a number of notes payable, can always go bust. Then all the vendors that are left holding the company's notes are left in the lurch, no cash comes in, and the vendors can go bust as well. This can set off a chain reaction.

Another pitfall is that the company that issued a promissory note could misplace the note, or the note could be stolen. This happens more often than one would think, just as it does with credit card information. What happens then? You can take the proper procedures to declare the note in question null and void, but usually it is too late. You wind up paying for, say, a promissory note in the amount of two million dollars. This is where mobsters come in, as explained in Chapter 8.

Chapter 5. Self-Induced Recession

From 1992 until 1998, Japan was in recession. Since 1998, this recession has been compounded with deflation. In spite of, or because of, a flurry of new policies hastily applied, business was sluggish in the early part of the decade. No doubt policy-makers bungled in more ways than one, on a continuing basis. (As an elderly farmer told me a few years ago, "We trusted these guys in high places just like we trusted them before the last war.") Finally, they have poured billions of yen in taxpayers' money, euphemistically called "public funds," into the banks, and the situation has gradually improved. On the other hand, bankruptcies are on the increase.

Onset of Deflation in 1998

Although none of Japan's policy-makers acknowledged deflation, 1998 saw deflation as such set in, simply because people only buy cheaper goods. Many manufacturers of consumer goods, big and small, moved their plants to China, with its inexhaustible supply of cheap labor, to make inexpensive products that are then shipped back to Japan. What happened in the United States in the 1950s and 1960s because of low-cost Japanese goods is happening now to Japan. Naturally, this trend of setting up plants in China is also hurting small- and medium-sized domestic manufacturers which serve as vendors supplying parts and components to major manufacturers. Worse still, China is exporting shiploads of organized thieves and robbers to Japan, upsetting the peace in this nation that once was, literally, an island unto itself.

Since Japanese manufacturers took their know-how and technology to China, most of these low-cost made-in-China imports are of good quality. A few years ago you could buy a cheap watch a discount drugstore chain for ¥2,900 or about $14. Now, you can go back to the same drugstore and get a better-looking one, for ¥980 or about $8.

During all these years of recession, the Japanese government carried out a high-spending fiscal policy, a total of ¥130 trillion ($1.08 trillion, ¥120/$1), to create effective demand — with limited success. Setting a 0% discount rate does not seem to keep money flowing. The economic growth rate has been negligible and prices seldom went up. This is because, as a result of the bubble collapse, those values of stock and real estate worth over ¥1000 trillion ($8.33 trillion) were wiped out. Whatever money was poured in to create demand was sopped up by the atrocious debts of corporations and manufacturers and by disposing of bad loans on the part of over 800 financial institutions, plus non-banking financial institutions that once numbered more than 20,000.

Worsening deflation makes the actual burden of corporate debts heavier, pulling down any hope investors had of growth of the Japanese economy. Manufacturers and retailers are hurt because reduced prices affect their total sales volume. Price "busting" is the order of the day and huge discount centers are flourishing all over the country, while department store sales are sagging.

During the bubble of the 1980s, many business and economic critics as well as news commentators who should have spoken out against the policy of the Japanese government failed to do so. Actually, they supported it, since most of them were former government officials in charge of economic planning or research. Their utter silence has been noticeable. Which party is responsible for all the mess? At this point, everyone from policy-makers including politicians and high officials of the Ministry of Finance to business and industry leaders as well as those engaged in lending and borrowing.

The factors contributing to the Japanese crisis can be divided into international and domestic causes. The decisions of the G-5 countries and the United States were the primary international impetus, and that historical factor will be explained first since it relates to the present extended domestic crisis (which is on the road to recovery since 2004).

Plaza Accord for Redressing the Balance

The current downturn of the Japanese economy actually stems from the Plaza Accord of September 22, 1985. The finance ministers of the G-5 nations met at the Plaza Hotel in New York (James Baker was the US Secretary of the Treasury at that time), and it took all of about 20 minutes for them to reach an agreement to cooperate with the US request for a cheaper dollar to redress Washington's balance of international payments. The purpose of the Plaza Accord was to induce the exchange market towards the cheaper dollar, so that the US trade deficit could be cut back to decrease Japanese and European surpluses.

This was supposed to be a secret meeting, as Finance Minister Takeshita pretended that he was going to play golf somewhere in Japan.

Under the "strong dollar" policy of the Reagan administration, the US trade deficit doubled from $67 billion in 1983 to $112 billion in 1984, one-third of which represented trade with Japan. "Redressing the balance and expanding domestic demand" was foremost in the minds of Japanese policy-makers in the first half of the 1980s. That meant a strong yen. At the same time, Japan's official discount rates were dropped from the peak of 9% in the mid-1980s through five succeeding decreases to 2.5% in 1989.

In 1983, Japan's real economic growth was 2.5%, and in 1984, this came to 4.1%. In 1985 a still buoyant Japan became the world's largest creditor nation, while the United States became a debtor nation.

Takeshita Called for Stronger Yen in Response to US Deficits

The Decade We Strayed Off Course[16] gives a detailed account of Finance Minister Takeshita's views in regard to increasing the yen rates. A continuing weak yen would prevent him from moving up to the premiership from his post of the Minister of Finance, and apparently he even said as much at the Plaza. Japan's policy of cheap yen rates was under fire from all sides.

On the flight back to Tokyo after the Plaza Conference, Takeshita spoke to BOJ Governor Satoru Sumita and said, "We cannot very well retreat. Let's go all the way!" And they did. Both the Minister of Finance Takeshita (later Prime Minister) and the Bank of Japan Governor Sumita felt that Japan had to do something to shore up the US economy, caught as it was in huge trade and fiscal deficits.

Paul Volcker's Request for Official Rate Reduction

On January 24, 1986, the exchange rate passed ¥200/$1, and in the second half of February, the rate reached ¥180/$1. According to Paul Volcker's Autobiographical Note that was serialized in the *Nihon Keizai Shimbun* during the entire month of October, 2004, US Fed Chairman Paul A. Volcker made a call to BOJ Director S. Ogata on February 25, 1986. Ogata was proficient in English. Volcker asked him to convey a message to BOJ Governor Sumita: "We are reviewing the implementation of financial relaxation. What would Japan do?"

In other words, he was requesting Japan reduce the official discount rate together with the United States. This sounded odd to many in international finance, since Volcker had always been cautious in regard to discount rate reduction. He feared that such step might give rise to drastic exchange rate fluctuations (which proved to be true for Japan).

16. Compiled and edited by the *Nihon Keizai Shimbun*, *The Decade We Strayed Off Course* (Kinyu Meiso no 10 Nen), Tokyo: Nihon Keizan Shimbunsha, 2000.

On the other hand, the US government was aiming to boost the US economy by any means available. According to Strayed Off Course, Volker in an about-face decided to go along with the US government policy. He began pushing the discount rate reduction, thus furthering financial relaxation on the part of Japan.

This change of approach notwithstanding, according to his Autobiographical Note, Volcker did not change his mind. He was obliged to make the change, against his better judgment, as the four executive members of the Federal Reserve Board put up a motion at the board meeting for reduction of the official discount rate. The motion was carried with 4 in favor and 3 against. This historic coup d'etat took place on February 24, 1986.

The fourth official rate reduction of Japan took place in November, 1986. There followed the Louvre Accord of February, 1987, in which the finance ministers of G10 nations met. This accelerated a trend for the strong yen rates and the low dollar rates. During the period of 27 months from March 1987 to May 1989, the official discount rates of Japan plummeted to 2.5%, the lowest in history at that time. And yet, this was accepted as a matter of fact in those days.

Hardly anyone made any comment about it. The media welcomed it and the general public liked it, because these measures were aimed at those individuals and companies who were profiting from speculative gains through land deals.

Former Prime Minister Miyazawa Speaks up

No politician is more intimately connected with every phase of the bubble than Kiichi Miyazawa. As the Finance Minister in the second half of the 1980s, he struggled with the strong yen and had a lot to do with the extended period of easy money that gave rise to the "bubble." When he became the Prime Minister of Japan in 1992, he was one of the first to sense the gravity of the situation, as bad loans were piling up in every corner of Japanese business and industry.

Despite his good breeding and years of experience as a member of the conservative government bureaucracy (which would make anyone slow in taking effective measures), there was a time when he suggested taking "decisive action" by pouring in public funds to correct the root cause of the bad loan situation.

Unfortunately, no other policy-makers listened to his proposal since at that time, in the early 1990s, practically everybody in the government as well as business and industry thought that things would return to normal in a few years. Japan needed someone who was not afraid to do the heavy lifting. For that, we had to wait until 2001, when Jun-ichiro Koizumi, a tough-minded yet clean politician, entered the political scene.

When Miyazawa again served as the Finance Minister during the Obuchi administration in 1998 and the succeeding Mori administration in 2000, he faced the tremendous turmoil of Japan's financial system. (One critic said jokingly, "He's facing the outcome of what he did as the Prime Minister"). He developed an aggressive fiscal policy while pouring in government funds, and worked hard to remedy the situation.

Kiichi Miyazawa should perhaps be given more credit. He faced unprecedented circumstances, something no one in Japan had any experience with, as the fluctuation of exchange rates affected every aspect of the economy.

His tragic flaw was that, having been a government official for a very long time, he knew the limitations of a cabinet minister, namely that unless every high ranking official of the MOF was solidly behind him, no economic measure could successfully be implemented. He could not force through any action aimed at bringing about sweeping changes to the status quo.

His role and responsibility are disclosed in *Mistakes Without Criminal Intent* (Han-i-naki Ayamachi),[17] which opened with a chapter on "Fifteen Years of Kiichi Miyazawa." What is interesting is the candor — a rare quality among politicians — with which he explained the course of events leading to the financial chaos from an insider's point of view.

The 15-year financial reign of Kiichi Miyazawa can be likened to the service of a highly capable internal medicine doctor brought to the bed of a sick ship captain who is running a high fever, while the ship is rocking up and down, round and round, in the middle of a typhoon. Unless the fever and the typhoon go away, there is very little the doctor can do. Perhaps he wants to perform an operation but the first mate says, "No, Doctor, you are not a licensed surgeon." The doctor tries to steer the ship away from the typhoon, but someone butts in, "You're going the wrong way. Go thataway." Still another individual comes in and says knowingly, as if there were no typhoon outside, "Get a helicopter to take the captain to the nearest medical facility." When the Americans say: "All chiefs and no Indians," the Japanese version is: "Too many captains and no one at the rudder."

Miyazawa thought at that time the Bank of Japan was thinking seriously about the currency. And yet not a rumble was heard regarding the crisis, hence there is no sign that anyone noticed what was happening.

Miyazawa observed that many officials clung to the thought that as long as there was even half a chance that "real estate and stock prices might make a comeback," that would take care of everything. Asked whether any of his peers had shared his sense of impending crisis, his reply was: None.

Here is an excerpt from the 1999 interview with Kiichi Miyazawa.

No Definite Target Range

> "Japan announced its policy of cooperating with the revision of the strong dollar in the Plaza Conference to correct [the US] imbalance of international payments. Sub-

17. Compiled and edited by the *Nihon Keizai Shimbun*, *Mistakes Without Criminal Intent* (Han-i-naki Ayamachi), Tokyo: Nihon Keizai Shimbunsha, 2000.

sequently, the strong yen rapidly made its way. Did you have any projection on the exchange market at the time?"

KM: I keep this record [leafing through his notebook of the daily exchange rates]. Let me take a look at it. On September 24, 1985 (immediately after the Plaza Accord), it was ¥228 /US$1. On September 20, it was ¥241. And the end of that year, ¥200.50. It sure was awful. I myself asked Mr. Takeshita [Noboru, former prime minister] and other gentlemen from abroad how far the rate would go up. No one gave any clear answer. Now, after many years since then, I had a chance to meet one of the parties concerned, Paul Volcker [former Fed Chairman] and asked him about it, and he said, "I had no idea."

"We heard that you were going to raise the yen rate by ¥20."

KM: I didn't say that. In three months, from ¥240 to ¥200... there was no sign of any one talking about how far.... It seems that it just turned out that way before we knew what was happening.

"How did you take the strong yen rates after the Plaza Accord?"

KM: When I took office as Finance Minister in July, 1986, all that the Minister could do was think about how to explain the endlessly strong yen rates and what the government could do about it. In those days, as I was thinking that some step must be taken, the rate went up by ¥2 just while I was eating lunch one day. It was like that day after day. What I was thinking then was, what to do about fiscal spending, interest rates, and intervention as well. Speaking of intervention, I came to the office in the morning, and my men showed up, asking "Can we go all the way?" And we spent about $2 billion for intervention. That was about ¥300 billion worth of money in those days, and yet, when the reports came in, in the evening, we heard nothing but "The market didn't budge," "Money poured in but no reaction," or "It was sucked up in one shot — like a black hole."

After that revelation, I had to go to a party and business leaders there came up to me and said, "Mr. Finance Minister, can't you do something about it?" I couldn't very well tell them, "We just did it [intervention] today" [laughter]. In a couple of days, the value of the entire $2 billion was gone. You buy the dollar knowing that it will decrease in value. So buying the dollar is foolish, doing nothing is foolish, and doing something is foolish anyway. There is nothing you can do. So I said, "We've got to work out a supplementary (budget compilation)," but the MOF would not nod. Even when I suggested, "Let's issue some bonds," they said, "We shouldn't spend money under these economic circumstances." At last, at the end of the year, Yoshino-kun (Yoshihiko, former Undersecretary of Finance) said, "Well, shall we try one?" And we did — after the next fiscal year budget was compiled.

Visit to the United States to Plead for Intervention

KM: I was just thinking I had to meet Baker [former US Treasury Secretary], when he happened to call and said he wanted to see the Finance Minister. So I went incognito to, I believe, San Francisco in September, 1986. I said to Mr. Baker, "If the exchange rate increases ¥2 in a single day, no one is going to invest in Japan. If he has to, he'll invest overseas. So unless you agree to stabilize the exchange rate, I am in trouble." We had to stimulate domestic demand. He said, "I understand. In return, please, lower the interest rate." I answered, "The interest rate is not my territory, but I hear you. I will forward your request to the Governor of the Bank of Japan." As a result, the Baker's and my statements came out on October 31. That was a statement for stabilization and at long last, the yen dropped a little to the ¥160 level. It was a very slight change, though. The end of that year closed with ¥160, so it had a little effect. It was against this backdrop that the interest rate was lowered."

"Did Baker not say something about public finance?"

KM: As a matter of fact, he did. Stimulate the Japanese economy with fiscal measures, that's what he asked. I had just taken office (as Finance Minister), so my reply was, "I'm thinking of implementing a supplementary budget, but the MOF has not taken that policy, so nothing can be done by the end of this year." Then I added, "Not this year, but fiscal measures will certainly be implemented, because that is what I can do."

"You again met with Baker in January, 1987."

KM: January came and I went to see Mr. Baker. It snowed so heavily that I was unable to return to Japan from Washington, DC. By way of Chicago, I got out by military plane. The exchange rate again hit ¥150. It was like I was going to plead with him to intervene because the yen was too strong. If my memory serves me right, I believe that there had been a prior promise made with Mr. Yoshino that we might as well get going (with reviewing a supplementary budget). Therefore, when we met, naturally, I mentioned that the supplementary budget would be quickly arranged. As for lowering the interest rate, the BOJ consented. As a result, on January 29, the United States intervened and the rate of ¥150/$1 lasted for a while.

Decided to Close the Stock Market

"Stock prices plunged in August, 1992, and you were confronted with the first critical situation since the Bubble burst."

KM: August 1992 is the time when I was the prime minister. Stock prices had been falling and falling. The bottom was hit on August 18 at ¥14,309 [on the Nikkei Stock Average]. This was terribly dangerous. If the ¥14,000 mark was passed [to a lower position], we would be in a tight corner. I thought of going from Karuizawa to Tokyo and suspending the stock market for one day. But I could not mention this to anybody. I called Mr. Mieno [Yasushi, then BOJ Governor] and said, "It's getting a little risky." He, good banker that he was, was kind enough to remark, 'Mr. Prime Minister, I'll work something out; keep in touch with me." I said to Mr. Hidaka [Sohei], general affairs councilor of the MOF, "We've got to do something about it, things are getting out of hand." He drew up an intriguing paper entitled, "On the Current Operation of Financial Administration."

Government officials live in a world of sectionalism. They look at only the field they are in charge of, and they don't see the bigger picture. The way officials think has been that since those circumstances surrounding real estate and stocks were just temporary, recovery was a cinch. Therefore, once the situation returned to normal, the problems would be over. They must have thought so. I am sure that they must have wondered what the heck this Prime Minister was talking about. Moreover, there was no cause for the Prime Minister to expose whatever difficulties and problems they were having among ministries. Once the prices of real estate and stocks came back, it would be over and done with. Finished. They must have believed so from the bottom of their hearts, I think. When the "Jyusen" problem [see Chapter 1] occurred, there were many goings on with the Ministry of Agriculture, Forestry, and Fisheries. I think they believed things would quiet down if we could get ¥685 billion from the General Account of the National Budget. The world of government officials being like that, naturally they never admit anything. I wondered whom I should give instructions to. The Minister of Finance then was Hada-san, but negotiations were conducted so what went on in August [the secret pact by which the BOJ would provide necessary funds to the Norinchukin Bank or the Central Bank for Agriculture and Forestry] was kept confidential. Consequently, it was not possible to treat it as a political problem. That's how it was, and so what I said remained [just words].

Government Officials Unable to Detect

"Was there an underlying sense of crisis so grave as to cause you to mention public assistance?"

KM: When a crisis sneaks up on you without your knowing what happened, it is generally something beyond the capacity of any bureaucracy. The Prime Minister wakes up and says, Whoa! We're in trouble! There is no one in charge when that kind of thing happens. Will the BOJ Governor take care of it? Well, Mr. Mieno was knowledgeable, like the great banker he was. I thought then that the party really thinking seriously about currency was the Bank of Japan. If the Prime Minister made a special trip to Tokyo, the stock market would close. I was thinking that we might as well start from there. But before we got to that, a paper was circulated ("On the Current Operation of Financial Administration') which helped put the matter to rest before we had to resort to all that. Perhaps, it might have turned out better if we had made a whole lot of noise. But not a rumble was heard, hence it could be that no one noticed anything as long as things were still going along without a hitch.

"Do you mean that in the event stock prices dropped below the ¥14,000 mark [of the Nikkei Stock Average], you were thinking of a plan to close the market and provide compensation by extending a Special Loan from the BOJ?"

Considering the nature of the problem, if I made a special trip to Tokyo, everyone would be surprised, and the market would be closed; what I would do after that is the kind of thing that cannot be planned in advance. So as long as I had the details ironed out with Mr. Mieno, then, "Is it okay?" "Yes, Mr. Prime Minister, I get you, sir" settled everything. After that, there was no alternative left but to take emergency action. That's what I thought. All of a sudden, I made a call and said, "Mr. Mieno, it's going to be this way, is it not?" And he responded, "I get you."

I didn't say anything, but Mr. Mieno understood.

The Market Knew

"Generally speaking, at what point in time was it appropriate to communicate some sense of the damage incurred by the financial system?"

KM: There's the rub. If the market truly could make a recovery, there is no need to do that. As Prime Minister, or even after you've left government service, you can say that sort of thing. Nevertheless, I'm not sure if I can say that. As many officials thought, so long as there is even half a chance that real estate and stock prices may make a comeback, explaining what was the truth of the matter would serve no purpose at all. In other words, I could not make it public. Let me add, though, that unless the financial system was greatly damaged, stock prices could not have plunged to that extent.

> This is a very strange way of saying, but I think that the market knew.
>
> "Did any of your peers share that sense of crisis?"
>
> KM: Not one. Circumstances that would call for closing the stock exchanges are never the kind of information you share with. It would not exactly help if we sat around scratching our heads and wondering aloud, "What should we do?" It's a kind of crisis management, after all.
>
> "Did you get anyone's advice?"
>
> KM: It has been my firm belief that I should in no way refer specifically to tax and budget expenditures. There was no advice, for I was in Karuizawa, actually all by myself.

The most intriguing information in this interview with former Prime Minister Miyazawa was that, while he was Prime Minister during the tumultuous period from 1992, MOF officials were optimistic. They kept saying, "Yes, Mr. Prime Minister, once the situation returns to normal in a few years, Japan's problems will be over." The situation didn't return to normal, and therein lies the root of all this problem.

Japan's Bubble Was a Big Boon to the US

Let us examine briefly whether Japan's Bubble was in any way beneficial to the US economy. The very low discount rate of 2.5% was kept on in Japan for a period of two years and three months, until May of 1989. This caused stock and land prices to skyrocket, creating hidden profits due to differences between the book value of land and stocks in the corporate balance sheet and the ongoing market rates.

This was a saving grace of the bubble economy, as it enabled many institutional investors to offset losses due to changes in exchange rates. One estimate is that the financial institutions in Japan had gains of approximately $1.5 trillion during the bubble period — something close to the US fiscal deficits for about 10 years. Japan's land prices soared so high that the asset value of the country of Japan was estimated to be ¥2,400 trillion ($24 trillion) at the end of 1990, about four times as much as the asset value of the entire United States.

In the three years from 1987 to 1989, financial institutions racked up appraisal profits, mostly from stocks, amounting to ¥205 trillion or something in the neighborhood of $1.5 trillion. This caused the private sector, including banks and insurance companies, to buy US treasury bonds, thereby shoring up the sagging US economy. It was common knowledge among international bankers and investors in those days that the Japanese purchase of US treasury bonds amounted to 30–40% of the bonds issued every year.

Every Japanese Paid a Share of the $9 Billion

Even during the Gulf War, this US bond buying continued, in addition to the $9 billion Japan had pledged and provided specifically in support of the war effort. This means that 30–40% of the Gulf War expenses were footed by Japanese contributions through US bond buying. Some American politicians publicly complained that Japan's cash contribution to the Gulf War was insufficient. Premier Kaifu, on a visit to the United States, mildly reminded President Bush that Japan was contributing $9 billion. He should have mentioned this bond-buying on the part of the Japanese government as well as business and industry. Unfortunately, many Japanese politicians and government officials lack the assertiveness that marks Americans. No one from government pointed to this bond buying as Japan's additional contribution to the financing of the Gulf War.

By the way, this $9 billion contribution was allocated equally among every Japanese citizen; the government collected it as special tax. They are always long on tax collection!

During the Reagan Administration, George Baker was the Secretary of the Treasury. One of his many chores was to politely exhort top Japanese government officials to reduce Japan's discount rate and keep it low. Whenever he had a chance to talk with Japan's premiers and finance minister, he insisted that Japan's discount rate be kept down.

As a friend of the United States, we obliged. The result was a difference in the US bond interest of 5–6%, while Japan's discount rate was on the 2–3% level. Any businessman worth his salt would find it more profitable to invest in the US money market. This consideration is partly responsible for the flood of Japan's money into the United States.

No Increase in Iraqi Oil Imports

Americans also complained that Japan imported large volumes of oil from Iraq. This was a misperception that requires correction. True, Japan hardly produced any oil, so it does import oil from the OPEC countries, which include Iraq. To avoid over-dependence on a few exporting countries, Japan buys oil from many countries, and Iraq accounted for less than 10% of Japan's total oil imports at the time of the Gulf War.

What Americans do not know is that after the Iran fiasco, during the Carter administration, the United States Government encouraged Japan to trade with Iraq instead of doing business with Iran. Prior to the Gulf War, Japanese companies and manufacturers did a lot of business with Iraq. When the Gulf War started, Mitsubishi Corporation and other Japanese companies lost ¥2 trillion or so (probably $20 billion). This should be remembered. Japan has paid quite a price for its cooperation with the United States.

American Officials' Contributions to Decrease Trade Deficit

In late December 2003, James Baker visited Japan as a special envoy from the United States in regard to writing off loans to Iraq. Iraq owes Japan $4.1 billion, and Prime Minister Koizumi promised to cooperate by writing off as much as possible. It's surprising that Baker even condescended to come to Japan: he visited only once while he was Secretary of State and even then he stayed for an incomprehensibly short time.

Nonetheless, Japanese officials, especially K. Miyazawa, liked Baker because Baker was an intellectual on a par with him, despite his understandably persistent talk regarding "Japan doing its share" about the trade deficit. In this respect, the United States sent two outstanding and intelligent officials to bridge the gap in their own ways — Lawrence H. Summers and Michael H. Armacost.

Lawrence Summers

Lawrence Summers was the US Treasury Secretary in the second Clinton Administration. His achievements, if any, were based on the guidelines and policy set by his pre-eminent predecessor, James E. Rubin, for he could not go wrong following Rubin's footsteps. Be that as it may, his derogatory attitude towards Japanese officials was so notorious that the *Nihon Keizai Shimbun*, Japan's counterpart of the Wall Street Journal, was obliged to describe him as a man "contemptuous of Japan" ("bu-nichi," bu — as in bubetsu — meaning contempt, scorn, disdain, and nichi meaning Japan). This is perhaps the first time such a statement ever appeared in the Japanese press.

It was reported that Secretary of Treasury Lawrence Summers often bellowed at Japanese officials on the other end of the phone. He was known for his contentious way of talking. An unfortunately large percentage of Americans, even high-powered executives and attorneys, are like that; it sets them apart from Europeans and Asians alike.

Tokyo's Governor Shintaro Ishihara is known for his straightforwardness. He wrote in the *Chuo Koron* (meaning Central Public Opinion), one of the leading opinion journals with large readership,[18] about what went on between Kiichi Miyazawa, then Japanese Minister of Finance, and Lawrence Summers, US Secretary of Treasury, in the G-7 Summit of 2000.

At that time, Summers' main concern was to retain a big difference between the Japanese discount rate of 0% and the US discount rate to continue to encourage (or oblige) Japanese government and businesses to invest in the

18. Ishihara, Shintaro, "Politicians Without Historical Outlook Should Quit," March, 2002, issue, the *Chuo Koron*.

United States. This has been the position of the US Treasury Department for many years, leading the Japanese to joke that "Japan is the US cash register!"

Finance Minister Miyazawa was about to propose a discount rate hike by the Bank of Japan from 0% to 4%. Since the United States could not accept such a hike, Secretary Summers like a feudal king called Miyazawa into his presence, demanding that the proposal be retracted. Miyazawa quickly gave in. This was a predictable response from the US Treasury Secretary, because the 4% discount rate would result in less outflow of Japanese investments to the United States.

According to the Governor Ishihara, he heard later from an American reporter that after Miyazawa submitted to Summers' demand, Secretary Lawrence Summers sat back in a sofa surrounded by his coterie and boasted that he could get the Japanese to do whatever he told them to.

Another popular weekly[19] ran an article headed "Summers Berating Japanese Government" while he was still the Undersecretary of Treasury. This little anecdote reflects the intelligence of some of Japanese politicians. The same story was also related by other sources. In May 1998, Secretary-General K. Kato of the Liberal Democratic Party paid a visit to the United States to tell Summers that Japanese government had decided to spend ¥16 trillion (some $16 billion) to shore up the Japanese economy. Summers did not raise his voice, although perhaps this time he should have.

Summers quietly told Kato that eliminating bad debts should be given top priority. He thought that Kato was sharp enough to get the underlying message: what the Japanese economy needed was not additional government spending but tough measures aimed at getting rid of those banks holding large volumes of bad loans. But Kato misunderstood, or wanted to believe, that Summers was happy with the proposed spending of ¥16 trillion.

As Secretary General of the ruling Liberal Democratic Party his major concern was how to win in party politics. He later resigned because of a scandal involving his diversion of political contributions to his private use[20], but recently came back into politics (reputedly aiming at the premiership).

Lawrence Summers, irate over the fact that Japan had done nothing while major banks were facing a crisis, paid a special trip to Japan on June 19, 1998 to do some tongue lashing.

Two things Summers said to the former Prime Minister, Kiichi Miyazawa, were particularly memorable: "Stop protecting these commercial banks like a convoy"; and "What the US wants for boosting the economy is a permanent reduction of corporation tax and income tax."

If this was true, Summers was clearly out of place, as such demands constitute an act of intervention in Japan's domestic affairs. He also met with Finance Minister A. Matsunaga (ex-D.A.) and Governor Y. Hayami of the Bank

19. "Summers Berating Japanese Government," July 2, 1998, *Shukan Bunshun*.
20. April 11, 2002, *Shukan Bunshun*.

of Japan and made the same demands, only to be disappointed at their superficial knowledge of economics as well as their lack of leverage over the financial system.

The fact of the matter is that tax reductions are determined not by the MOF but by two councils — the Government Taxation Research Council chaired by Prof. Y. Ishi of Hitotsubashi University and the LDP Taxation Research Council chaired at that time by K. Yosano, a veteran politician versed in taxation. The former examines and recommends new tax measures, usually from a theoretical standpoint; the latter also examines them and gives specific and final recommendations on any taxation measure. Tax reduction, then, is beyond the power of Prime Minister Koizumi. He wields power to close out bad loans, but he cannot reduce taxes to help stimulate the economy because of this separation of powers.

Michael H. Armacost

There are many sharp American officials who manage to be polite at the same time. For example, Michael H. Armacost, the US Ambassador to Japan from 1989 to 1993, performed unobtrusively. He was never contemptuous of Japan. In fact, he liked Japan. But since his mission was not to serve as a wet nurse, he was never soft, constantly exhorting Japan to import more from the United States. This earned him a nickname, "Mr. Gai-atsu" ("External pressure").

Armacost quietly and logically persuaded influential Japanese government officials as well as key politicians to make monetary contributions to the US war efforts in the first Gulf War. The far-reaching effect of this led to the Japanese decision to send troops to provide humanitarian aid in the current Iraqi war. Furthermore, a Japanese refueling ship has been made available in the Indian Ocean to provide fuel for the ships of the coalition forces, serving like a convenient filling station in the desert. Some 534 refueling to the tune of 406,000 kiloliters or 107,266 gallons (worth about ¥15.5 billion or $155 million) took place from December 12, 2001 to July 18, 2005. [21] This assistance continued in 2006.

These events are definitely helping shift Japanese public opinion away from the anti-war position. Take the revised Self-Defense Forces Act that passed the Japanese Diet in July, 2005. This now enables the Japanese Self Defense Forces to determine when to shoot down missiles from hostile forces without prior approval of the Diet. Article 9 of the Japanese constitution "renounces war and the threat or use of force as means of settling international disputes" (this was drafted by an attorney/legal officer under Gen. Douglas Macarthur during the occupation following World War II). The shift is towards recognizing Japan's rights to defend itself collectively, with its allies.

21. July 20, 2005, the *Yomiuri Shimbun*, 2.

Now North Korea, only two hours away from Japan by boat, is developing nuclear arms and missiles, not to mention China's long-range missile capability. When you consider the importance of Armacost's work, many years later, from this contemporary perspective, you realize the value of a first-rate diplomat.

Expansion of Japan's Domestic Demand Sought

Secretary Baker was persistently seeking expansion of Japan's domestic demand, and so when Miyazawa became the Minister of Finance in 1988, he incorporated in the FY1988 Supplementary Budget plans to expand public works projects. This was on top of the already easy money situation, and aided in triggering the bubble economy. Then, by some irony of fate, the bubble crusher BOJ Governor Yasushi Mieno took over.

A plethora of cash made available by the bubbling economy brought a chaos into the Japanese economy. The BOJ naturally decided to take the tight-money policy, since unbridled creation of credit would lead to the flash point. This reasoning was responsible for the decision made by Y. Mieno, who took over Satoru Sumita as the BOJ Governor, to raise the discount rate to 3.25% in May 1989. During the next 15 months, the discount rate was hiked five times and 6.0% was reached in August 1990.

At the same time, the BOJ put the screws on the high-powered money in Milton Friedman's term. Until April 1990, the total liabilities of the BOJ increased by two digits from the same time, previous year. The Discount Rate was squeezed down to 2.7% in February 1991 and raised to 6% in a 12-month period from November 1992 to October 1992. In other words, monetary restraint was being used to keep the money supply at a negative level compared to the same month in the previous year. This was the beginning of the Lost Decade.

In 1993, Governor Yashushi Mieno recalled the policy of those days in a financial journal Finance and Public Finance Affairs (Kinyu Zaisei Jijyo). He suggested that the BOJ entertained a regret, even to this day, that they had not taken that measure a little sooner, when the changes might have been easier. He also pointed to the great moral of the situation — financial policy should reflect the asset values as well as the consumer price index, the wholesale price index, and other indicators.

Meanwhile, what were other government officials saying? Take Yoshimasa Nishimura, currently teaching finance at Waseda University, was the Banking Bureau Director of the MOF from 1994 to 1996.

Prof. Nishimura reflected on his experiences in his book[22], *Causes of the Failure of the Financial Administration* (Kinyu Gyosei no Haiin), and ponders why they were unable to handle the problems in advance but were able to defer them

22. Nishimura, Yoshimasa, *Causes of the Failure of the Financial Administration* (Kinyu Gyosei no Haiin), Tokyo: Bungei Shunjyu, 1999.

later. It could be that mistaken assessments of the problem led them to take inappropriate countermeasures. Nishimura's answer is a typical answer of one of the policy makers made after the fact.

What everyone wonders now is why the BOJ kept the low 2.5% for as long as two years and three months. What factors were responsible for not raising it sooner?

S. Sumita was the former BOJ Governor (during the bubble). His explanation was that the majority of opinion in those days was dead set against higher discount rates. A shift to the tightening policy would move the strong yen rates to go higher. For example, "the exchange rate of ¥150/$1 must be defended at all cost," said Finance Minister K. Miyazawa at that time.

By the same token, politicians as well as business and industry all opposed to stopping the strong yen rates. And Sumita ruefully recalls that raising the discount rate was a task of immense difficulty then. It seems that this was the cause of the extended period of low discount rates.

Not that I am for Sumita, but I certainly understand his position at that time. As everyone familiar with the state of the economy in the first half of the 1980s can recall, it was after the second oil crisis and business was extremely slow. No doubt, we were in recession in those days. His action to drop the interest rate to 2.5% was a right action. The question was: should the low 2.5% rate be kept that long?

Chapter 6. Financial Institutions in the Millennium

Japan's financial world found itself in hot water in many ways in 2002 due to the cumulative impact of the decade-old recession. Meanwhile, Prime Minister Koizumi was gearing up, taking steps to boost the economy in that year.

In the fall of 2002, the main interest of Japanese commercial banks was to raise their ratio of net worth to total capital or equity capital to total assets — any way they knew how. Safety of bank management is measured by the BIS (Bank for International Settlements) equity capital adequacy requirement ratio in terms of the ratio of equity capital to total assets. This ratio must exceed 8% for a bank engaged in international banking. A bank handling only domestic business is required to maintain the ratio over 4%.

If a bank fails to meet this BIS ratio requirement, the Financial Services Agency will promptly issue an order to the bank to implement a sound banking management program, which would be a disgrace and hurt the bank's reputation.

As of the fiscal year ended March 31, 2002, major banking groups reported over 10% for the BIS ratio. But can you trust what the banks say about their BIS ratio? They must do all they could to give the impression that the scope of bad loans was manageable and they had various means by which to hide the loss. Many analysts suspected that claims of a BIS ratio over 10% were inflated, and this added to the smoldering air of impending financial crisis in 2002.

Cross-Holding of Shares

The major commercial banks own the stocks of major corporations and manufacturers, and vice versa. This is called "cross-holding" of shares and it amounted to some ¥25 trillion ($208 billion) in 2002. Accordingly, when US stock prices went down as a result of situations such as the Enron collapse or the World Com fiasco, which also adversely affected Japanese stock prices, any commercial bank management in Japan trembled at the thought of its dwindling BIS ratio.

When the Nikkei Stock Average fell below the ¥10,000 mark in July 2002, some major commercial banks saw their BIS ratio dropping below the 10% level. Should the Nikkei Stock Average fall below the ¥9,600 mark, virtually all major commercial banks would find it difficult to maintain the 10% level, thereby losing their credibility. This was one of the mini-crises that abounded in 2002. According to trial calculations by a major stockbroker-affiliated think tank using the closing prices of the Nikkei Stock Average on July 24, 2002, as quoted by the *Nihon Keizai Shimbun*, the hidden loss in stocks held by eight major commercial bank groups reached ¥2 trillion 500 billion ($20.8 billion).

Bad Loans in 2002

In 2002 some analysts (not the critics of former MOF officials, who are not trusted at all, but mostly from the brokerage houses), estimated the bad loans of Japanese banks to be anywhere from ¥100 trillion to ¥150 trillion ($777 billion to $1.15 trillion, ¥130/$1). Despite injections of billions of dollars, due to deflation bad loans still did not seem to be on the way down.

Some commercial banks merged, to strengthen their financial positions. Fuji Bank, Dai-Ichi Kangyo Bank, and Japan Industrial Bank merged to form Mizuho Bank. In April 1996, Mitsubishi Bank absorbed the debt-ridden Bank of Tokyo to form the Bank of Tokyo-Mitsubishi (BTM). Mitsui Bank merged with Sumitomo Bank. Sanwa Bank merged with Tokai Bank and Toyo Trust Bank to form UFJ (United Financial of Japan).

The year 2002 saw four major financial groups — Mizuho, Tokyo-Mitsubishi, Sumitomo-Mitsui, and UFJ. We also have the Resona Group of Daiwa Bank (currently Resona Bank), Kinki Osaka Bank, Nara Bank, and Asahi Bank (currently Saitama Resona Bank), its role being a super-regional bank in Osaka, the No. 2 city in Japan. Daiwa Bank is the fiscal bank of Osaka Prefecture. Could these banks financially withstand the impact of the remaining bad loans which were reported to be ¥120 trillion or over $1 trillion?

Since 1993, the government has been making the bad loans of banks public information. In 1997, the MOF announced ¥21 trillion ($210 billion) as the total amount of bad loans of all the banks in Japan. Banks are now required to disclose their bad loans. In March 2000, the figure came to ¥81 trillion ($675 billion), of which ¥18.5 trillion ($154.2 billion) belonged to the 16 major banks. These figures were the results of the banks' own self-assessment. Some loans claimed as normal by the banks might be questionable. For example, suppose a manufacturer has a bad debt of ¥200 million ($1.67 million), and its bank waived half of this claim and wrote off ¥100 million ($833,333). As far as the lending bank was concerned, the remaining ¥100 million became a normal, bona fide loan and yet the fact remains that the borrowing manufacturer was hardly capable of repaying the loan at all.

The *Weekly Shincho*, known for clever scoops, made a shocking revelation of estimated bad loans held by 16 major banks. Of the total credits of ¥341 trillion 300 billion ($2,844 trillion, ¥120/$1), ¥63 trillion 500 billion or 18.6% were bad.[23] This is roughly 3.5 times the total bad loans of ¥18 trillion ($150 billion) as announced at the term ended March 31, 2001.

Since 1993, all major commercial banks, their banking business divisions in particular, have been in the red. Except for Tokyo-Mitsubishi Bank, their equity capital was down the drain. Thus, they were financially incapable of clearing bad loans which reputedly rose to the ¥120 trillion (over $1 trillion) level. Nearly 80% of the core of the equity capital was "padded" through injection of public funds and deferred tax assets. In other words, they became semi-government owned banks.

This continuing financial chaos came about as efforts to come to terms with bad loans were postponed. Beginning with the fall of 2001, the borrowers of the 149 banks underwent special inspections by the Financial Services Agency in an attempt to determine the status of their loans.

Since Biblical times, inspectors and tax collectors have been abhorred and these inspectors are no exception. Inspections were carried out by strictly applying the Financial Inspection Manual. Some questionable debtors who were listed in the second category — accounts "requiring caution," were demoted to the third category of accounts, representing those headed toward bankruptcy.

It was reported[24] that when the Financial Supervisory Agency team of inspectors went to Sumitomo Bank, around the turn of the last decade, and politely questioned the financial status of a general contractor that was straining under an outstanding balance of ¥260 billion ($2.17 billion) and suggested that this account be put in the third category, the Sumitomo Bank officer retorted, "Never mind! We'll take care of that account."

Sure enough, in February 2001, it waived its claim by writing off the bad loan and Kumagai gumi, whose stock price was below par (¥12 or ¥13, or about 10 cents per share, like WorldCom) was soon put back in the second category. It's a technique often used in banking. (Kumagai-gumi merged with another construction company in 2005.)

Officers of this bank were not always polite to the Financial Services Agency non-career inspectors. This is difficult to understand, because "you should never make inspectors mad." One banker observed to me that "Something incomprehensible to the outsider may possibly be going on, otherwise the banker would not act in such rude manner. But you cannot look down on these bankers simply because the inspectors represent the government. Japanese

23. July 19, 2001, *Shukan Shincho*.

24. July 29, 2002, *Shukan Shincho*.

banks buy over 35.6% of the government bonds issued. Bonds issued by local prefectures are mostly bought by Japanese commercial and regional banks. So what would happen if the banks stopped buying bonds? You cannot fool around with banks." This was in 2002.

Contractors have many connections with politicians who can apply pressure to the banks. Sure enough, one stockholder of Kumagai-gumi filed a suit against Kumagai-gumi, seeking an indemnity of ¥87 million ($725,000), which had been donated to the Liberal Democratic Party despite the continuing deficits of the company and which constituted a violation of the Regulation of Money for Political Activities Law.

On February 12, 2003, Y. Matsumoto, former president of Kumagai-gumi, stood trial and the presiding judge ordered him to pay an indemnity of ¥28 million ($233,333).

Outstanding Balance to Be Reduced

In 2002, the situation became much tighter. The Financial Services Agency was taking a tough stand, insisting the banks take action on those accounts feared to be going bankrupt. One retired banker ruefully recalled his working days in the mid 1990s at an urban branch of his bank when a new, high-powered manager took over. The first thing the manager did was give the usual pep talk: "Ladies and Gentlemen! The target for this month is to have ¥1 billion ($9.2 million, 120/$1) in lending — that's what I'd like to say, but actually it's double that. The target is to extend new loans of ¥2 billion [or about $18 million]. I don't care how you do it. Just do it. When it comes to new accounts, each of you ought to get at least five."

This approach, of course, took people off the important business of shoring up loans that were already outstanding, working out reconstruction plans to get clients financially back on their feet, requiring cuts where a company had overspent on advertising, and so on. It also meant working quickly, and skipping the all-important due diligence to ensure the new loans would be good.

Twelve years later in 2002, the company had a complete reversal of policy. Instead of lending, the headquarters' specific instructions were to trim the outstanding balance. The monthly target was to collect outstanding loans of ¥1 billion per month. If there was a company in the third category, collection of the entire loan must be carried out as soon as possible. Loans were to be pulled out of other accounts if they were showing poor performance.

Setup for Accommodating Bad Loans

Commercial banks maintained subsidiaries to conduct the kind of business from which they are legally excluded, such as real estate. Now that these subsidiaries freed themselves from the ties of their commercial banks by restructuring themselves as independent companies, their transactions with the former parent banks were legitimate form, so that their qualifications as independent corporations were proper.

Their balance sheets were not part of the consolidated financial statements of the commercial banks and the government was left none the wiser. This is where bad loans were transferred and hidden off the books.

It follows naturally that the independent qualified company held huge amounts of bad loans with substantially heavy debtor balances and with profits barely sufficient to survive. Bad loans were showing no sign of decreasing despite write-offs spreading in small batches and being incorporated by these independent qualified companies.

Furthermore, in some cases, subsidiaries of these independent qualified companies were set up in large numbers, all having assets under a ceiling of ¥20 billion ($166 million, ¥120/$1) to make them exempt from auditing according to the Japanese Commercial Code. This way, bad loans were doubly hidden.

More Mergers?

Of the four, Tokyo Mitsubishi Bank was the indisputable winner. It gained over ¥4 trillion in a single year in personal deposits, as of September 30, 2002. It was Japan's No. 1 bank in terms of the personal deposit balance in the amount of ¥30 trillion 888.4 billion ($257.403 billion, ¥120/$1). No. 2 was Sumitomo-Mitsui Bank with a balance of ¥30 trillion .412.6 billion ($253.438 billion). Mizuho Bank was No. 3 with a balance of ¥28 trillion 668.1 billion ($238.9 billion), and UFJ Bank was No. 4 with a balance of ¥20 trillion 673.1 billion ($172.276 billion). This status will change again in 2005 with another merger..

Tokyo Mitsubishi Bank's prowess comes from its farsightedness. Some 40 to 50 years ago, they acquired the stocks of then-burgeoning manufacturers and corporations when the par value was only ¥50 per share (about 14 cents). It is well known that it has been a loyal shareholder of Honda Motor (along with Mitsubishi Trust Bank and Tokyo Marine & Fire Insurance which are part of the Mitsubishi Group), Sony, and Ricoh as well as a host of Mitsubishi Group companies.

Root Cause of Japan's Bad Loans

Let me recapitulate that the root cause of the decade-old recession is bad loans used by corporations, manufacturers, organizations, and individuals for new plants, equipment and, mostly, for purchasing land on speculation, in the belief that land prices would eventually rise. This is simply because, except for a brief period during the oil crisis, Japan's land prices had never dropped since the end of the last war.

In the late 1980s, when Tokyo land prices peaked, values were said to exceed the total land prices of the United States. Underlying this phenomenal increase in land values was a forecast that the demand for office space in Japan would eventually surpass supply. In other words, efforts to expand the supply of office buildings to meet the forecasted increased demand led to the speculative land buying and construction boom.

This was directly tied to huge loans banks provided to real estate firms and developers, construction companies, developer-contractor consortiums, and the distribution sector including supermarkets and other businesses during the bubble economy in the second half of the 1980s. Loans for real estate usually involve huge advance investments into each project, and it is easy (supposedly) to secure collateral.

As the economic downturn began in the early 1990s, land prices plummeted, causing many real estate firms and developers, as well as other companies, banking on profits from the sales of land, to go bankrupt. And the loans are impossible to recover.

One Calculation of Bad Loans

Under certain conditions, the loss suffered by financial institutions came to about ¥63 trillion (approx. $525 billion, ¥120/$1), with the possibility of further increases. If operating profits were to be used to write off these bad loans, it would take eight years. This is an estimate made by David Atkinson of Goldman Sachs Japan, as disclosed in the *Nihon Keizai Shimbun* early in 2002. The report was based on a macroeconomic approach and it gave a theoretical time frame for eliminating the bad debt as well as a theoretical amount of the bad loans themselves.

The total amount of loans extended by financial institutions handling deposits in Japan amounted to ¥673 trillion 300 billion (approx. $5 trillion 610.8 billion, 120/$1) on March 31, 2000. Financial sources gave rough estimates of the total bad loans anywhere from ¥100 trillion ($833.3 billion) to ¥150 trillion ($1.25 trillion)

Clearing Bad Loans

Many promises have been made as to clearing the bad loans. The Director General of the Economic Planning Agency confidently declared to a TV interviewer in 1997 that the economy would be moving up again within a month. In 1998, one magazine noted that despite spending ¥16 trillion ($160 billion) to boost the economy, a private research organization had predicted negative growth for FY 1998. Director General Omi's answer was that the government was sure of a 2% increase and that in four to five years, the Japanese economy would probably reach the top level in the world.[25] Was it Hitler or Mussolini who remarked, "When you tell a lie, tell a colossal lie. People will believe you!"

The economy worsened with the government action aimed at increasing revenue by some ¥9 trillion ($90 billion) by hiking national health insurance rates, and the consumption tax (from 3% to 5%), and so forth.

These promises were like General Westmoreland's statement during the Vietnam War, that the war would be over in six months. It wasn't; but he gracefully retired from the national scene.

How Big Were Bad Loans?

The commercial banks and other financial institutions naturally have their list of bad credit, called the Risk Control Debt. This includes four types of debt: debt of the insolvent parties; debt in arrears with uncollected interest; debt in arrears by more than three months (interest and principal); and debt whose loan requirements have been relaxed.

The first category, insolvency, is uncollectible. The second category often has to do with a borrower who fails to pay interest, one installment, and then another and often spilling into the third month, when it joins the third category. There were many, many borrowers of this type.

In the best case, suppose a medium-sized contractor runs short of cash and asks his bank for a six-month deferment of the interest and principal on an outstanding loan. If his past record of repayment is good and his prospect of landing new contracts, too, then his deferment request will be granted. This falls in the third category. Five months later, he may succeed in selling some assets and so paid off all his outstanding debts.

Suppose the debt is for a large amount. If the times were good, and if the chances of selling the collateral, mostly land, to recover the debt were good, the bank might grant his deferment request and confiscate the collateral. But in bad times, the bank would have no recourse but to keep the collateral. Then the banker may go to clients who still have cash on deposit and ask them to buy some of the land that the bank is stuck with, at a discounted price. If he can sell the land, confiscated because of the bankruptcy of its previous owners, a developer might yet do very well with it. And the homes or offices thus created might be purchased with loans from the same bank that sold the land. (I personally know of several cases of this type.) The fourth category is the bad loan whose repayment requirements are relaxed to enable the borrower to repay.

25. July 23, 1998, *Shukan Shincho.*

New Classification of Bad Loans

There is another classification of "Furyo Saiken" set up by the Financial Services Agency (Kinyuh-cho) which was established in July 2000 to take charge of financial administration. Part of its business is to bring order into the current chaos involving bad loans. The Financial Inspection Manual of this Agency classifies bad debt according to the borrower's status in terms of ability to repay and loan collateral:

- 1st category — normal accounts
- 2nd category — accounts requiring caution
- 3rd category — accounts feared to be approaching bankruptcy
- 4th category — virtually bankrupt accounts

Loans that fall into the 2nd–4th category are considered bad loans.

Since April 1998 all 870 banks and other financial institutions have been required to make a self-assessment of their assets and to disclose the results. The aggregate total at the term ended March 31, 2000 indicated the 1st category of normal loans in the amount of ¥591 trillion ($492.5 trillion, $1=¥120) against the bad loans of ¥81 trillion ($666.6 billion). In other words, the bad loans constituted 13.7% (assuming that these self-assessments by the banks were honestly made).

Hidden Profit

Fujitsu, a telecommunications/computer giant, is the leading stockholder of its subsidiary, FANUC, the world's leading manufacturer of factory automation. It reported that in the period ending March 31, 2003, it was planning to sell part of its stake in FANUC, for a maximum of ¥100 billion ($800 million). Fujitsu's holding of FANUC was 93.2 million shares (some 8.5% of this, 8 million shares, contributed to the retirement benefit trust) or 39% of the total shares issued. The stock's book value was estimated to be about ¥2,700 ($2,160, ¥125/$1). On June 14, 2002, its closing price was ¥6,140 or $4,912 per share. According to the *Nihon Keizai Shimbun*[26] preliminary calculations of the hidden profit, excluding the 8 million shares for the trust, amounted to about ¥290 billion ($2.32 billion).

This is a good example of the hidden profit regarding stocks. When it comes to property, there is a huge gap between the actual purchase prices of real estate listed in the asset section of any corporate balance sheet and the actual going rates for such property. Naturally, bankers were well aware of that.

Bank after bank extended loans whenever land was offered as collateral. Usually, the amount of the loan granted was 30% of the going rate for the land.

26. June 17, 2002, *Nihon Keizai Shimbun*.

During the bubble, this gradually increased from 30% to 80% and, in some cases, to 120%, because of competition. If one bank offered ¥200,000,000 for collateral of a piece of property worth ¥3,500,000 and if the owner wanted more money, another bank would come in with an offer of ¥30,000,000.

Let's say a man wished to take out a loan, and put up a small apartment in Tokyo's Aoyama section, an A-1 location, as collateral. He may have bought property in the 1960s for ¥5 million (about $14,000, ¥360/$1). In 1989, he could get a loan of ¥20 million ($133,000, 150/$1) or 67% of the value of the property from the major commercial banks;

But one of the NBs, a subsidiary of a major commercial bank, might offer a whopping ¥45 million ($300,000), well above what the property was worth at the time. And, indeed, given its choice location and the pace at which prices were escalating, a few months later the NB could sell it at a profit.

Takenaka Takes Over

In early September 2002, Prime Minister Koizumi made a trip to the United States. He stopped by Harvard University to have a talk with President Lawrence Summers, former US Secretary of Treasury during the second Clinton Administration, whose tough stance had scared many Japanese officials. Be that as it may, Summers, whenever he had a chance, had given very sound advice to Japanese officials in his characteristic haughty manner, but they ignored it for one reason or another.

His overriding message had been — Rid yourself of bad loans. And that must surely have been the message he gave to Prime Minister Koizumi. Convinced of the dire necessity to dispose of bad loans, Koizumi, upon his return to Japan, reshuffled his cabinet to pave the way for taking decisive action.

One bottleneck in getting rid of bad loans, particularly of the major commercial and trust banks was, oddly enough, Hakuo Yanagisawa, State Minister of Financial Services.

In December 2000, at the second Mori cabinet, Yanagisawa was asked to join in as Chairman of the Financial Reconstruction Commission, a post he held in the previous cabinet. That's usually the procedure when no one else wants to risk his neck in something so tangled up. This was also during the administration of a less competent prime minister.

During that time, Yanagisawa was instrumental in paving the way to financial reconstruction. His goal was to "make these financial institutions of Japan truly sound somehow or other by the end of March 2001...."

Yanagisawa's position in 2002 was well known: "No sense injecting any more public funds into banks, because they have ample funds to dispose of bad loans. Also, any more public funds at this point would be detrimental to the banks' own efforts to get on their own feet." This was obviously wrong. Anyone could see that. What was he thinking?

One dominant view in financial circles — not disclosed in the mainstream media — was that Minister Yanagisawa did not want to change his long-held opinion because he would lose face. But this was no time to be concerned about maintaining face.

On the other hand, Heizo Takenaka, State Minister of Economics, was all for the further injection of public funds and taking measures to enforce management discipline in banks.

Prime Minister Koizumi asked Minister Yanagisawa about his plan for coping with the bad loan situation; he soon decided to have Takenaka replace him, and to focus on disposing bad loans. It was September 30, 2002. This was the beginning of the Koizumi revolution.

The Current Bad Loan Status

A noted female economic journalist, H. Hagiwara, compared the situation to Pandora's box. Once the box is open, it was certain that the recession, if coupled with deflation, would worsen, with adverse effects on every sector of the economy. Hence, one administration after another tried to open it a little but quickly closed it. Instead, they resorted to issuing more government bonds and increasing spending for public construction projects.

Prime Minister Obuchi, from 1999 to 2000, and Prime Minister Mori, from 2000 to 2001, prior to the current Prime Minister Koizumi, increased spending but did little to dispose of bad loans. In fact, during the Obuchi Administration, bad loans increased by ¥16 trillion or $133 billion.

When Prime Minister Koizumi took over, it was anticipated that he would take proper action to reduce the bad loans held by financial institutions. State Minister of Financial Services Hakuo Yanagisawa was supposed to do it, but he did not go all the way. New State Minister Takenaka shouldered the responsibility for taking the lid right off Pandora's box.

And what was in Pandora's box as of November 2002? In terms of national debts, about ¥414 trillion ($3.45 trillion, ¥120/$1). This is equivalent to ¥3.26 million ($27,167) per head. For a family of four, this would be comparable to a loan of some ¥13 million or $108,333.

What about bad loans still held by financial institutions? In December 2001, after writing off bad loans of some ¥90 trillion (some $900 billion) over the previous 10 years or so, the major commercial and trust banks asserted that the disposing of bad loans had passed its peak. At that time, about ¥18 trillion was classified as accounts at risk for bankruptcy and virtually bankrupt. Since steps were taken to dispose of these accounts in the coming three years, with appropriate reserves, there was nothing to be concerned about. But those outside the financial world did not think so. There are mountains of bad loans yet to be disposed of.

Other loans, classified as requiring caution, amounted to some ¥110 trillion (over $1 trillion). Some believe that ¥110 million is a conservative estimate and that the actual figure is in the neighborhood of ¥130 or 140 trillion. Of these loans, over ¥40 trillion (over $300 billion) are problem loans which are held by major commercial banks and whose interest payments are either unpaid or delinquent for over three months. To make the matter worse, bad credit increases by ¥6 trillion (some $50 billion) per year.

In the single year of 2002 alone, major commercial banks incurred additional bad loans of ¥15.4 trillion ($128 billion, ¥120/$1) due to deflation, for which Prime Minister Koizumi was held liable. It is a very crude argument to attribute all the additional bad loans to deflation, yet such nonsensical accusations abound in the media.

It was K. Uegusa, senior economist of the Nomura Research Institute, Ltd. who first pointed out in February 1997 that the scale of the bad loans should be considered to be on the order of ¥100 trillion in contrast to the MOF estimate at the time of ¥28 trillion. And all this time Finance Minister Mitsuzuka was saying, "Japan's bad loan problem is over the hill." Coming from someone like Mitsuzuka, who knew next to nothing about finance, this was no surprise.

Take, for instance, the Japan Long-Term Credit Bank. Before it went belly up in 1998, its ratio of equity capital was reported to be a respectable 10.32%. However, post-bankruptcy examination turned up a debt of ¥4 trillion (probably in the neighborhood of $40 billion). In addition, a contract on warranty against vices in force until March, 2003 had to be concluded with an American company, stipulating that the American buyer had the right to ask the Deposit Insurance Organization to buy back any debt if its value showed a significant decrease.

Another question is ethical: the supposedly-retired top management tier of major commercial banks who were responsible for this massive mess, then in their 70s, 80s and 90s, never resigned and some still retained executive perks such as an office, secretary, and a company car. They hold semi-retired positions as an adviser or counselor to their banks, and draw a salary. Japanese banks are more bureaucratic than Japanese government service, and quite feudal as well, so the current top management never dreams of firing these non-productive, once-powerful, but irresponsible top management personnel.

Be that as it may, there has to be some way of estimating the amount of bad loans. One report stated that as of the end of January 2003 some ¥90 trillion ($750 billion) of bad loans had been liquidated by Japanese banks with ¥60 trillion ($500 billion) of bad loans generated due to deflation. It is up to the MOF, the BOJ, and the banks to work out an effective solution.

Equity Capital of Major Commercial and Trust Banks

Now, we should look into the equity capital of major commercial banks. As of October 2002, the total amount of the equity capital of the major commercial and trust banks was reported to be ¥33.1 trillion (about $275.83 billion, ¥120/$1). However, this amount is padded because it includes public funds injected by the government over the years as well as tax assets deferred through tax effect accounting.

Of this total, ¥8.3 trillion or 25% consists of public funds injected by the government and ¥7.9 trillion is made up of tax effect accounting. The sum of these two is ¥16.2 trillion. Subtract it from the total equity capital of ¥33.1 trillion and you obtain ¥17.1 trillion ($142.5 billion), which represents the unadulterated figure for the total equity capital of major commercial and trust banks. Some assert that major commercial and trust banks are already as good as state-owned because 25% of their equity capital consists of public funds and 24% is finessed by juggling accounting rules.

CHAPTER 7. THE TAKENAKA SCHEME

When the news of The Takenaka Scheme leaked out, the senior bank executives of seven major commercial and trust banks set up a breakfast meeting with LDP leaders and pleaded with them to kill it, particularly regarding the provision about the responsibility of top management. Well, these bankers are still powerful people despite their seemingly waning influence; therefore, the eight LDP leaders hastily summoned Minister Takenaka on the evening of October 22, 2002, the day scheduled for the Scheme to be made public.

Interim Election Day

At this meeting, Minister Takenaka spent sometime explaining the gist of the rules changes regarding deferred tax assets and added that the Interim Report of the Scheme was in the process of being adjusted. Partly, they were upset because they felt they had been shut out of the decision making in financial matters. The meeting turned out to be a kangaroo court for Minister Takenaka, with LDP political leaders taking him to task with questions like, "Why announce the Scheme today?" "Just before the interim election, if you disclose the financial policy, do you know what will happen to stock prices? Down, and down. Can't have that." The major issue for them was the interim election. (By the way, the October 27 interim election was a huge victory for the LDP.

As a result, the Interim Report on The Takenaka Scheme was postponed. Some considered this a loss for Takenaka and Prime Minister Koizumi. But the banks realized that Takenaka meant business. They quibbled about 10%, but it was clear that Takenaka would go after their deferred tax assets, maybe not 10%, but close to that percentage.

Furthermore, Prime Minister Koizumi is a shrewd, highly experienced, and straightforward politician who gets his way. Former Prime Minister Nakasone, one of the elder statesmen of the LDP, once described Koizumi as a

70% man: "Even if you don't agree with his position, once you have a talk with him, you wind up agreeing with him 70%. So he gets 70% of what he wants. He doesn't look for a 100% win." Postponing the announcement of The Takenaka Scheme gave him one step back and two steps forward in the coming months.

Takenaka Meets with Bankers

The next day, on October 23, Takenaka called the top management personnel of 12 major commercial and trust banks to a meeting. Should the rules of the deferred tax assets be changed as recommended in The Takenaka Scheme, these banks would find themselves in circumstances where their ratio of equity capital would certainly fall below the 8% BIS rule. Then the responsibility of the current top management personnel would be seriously questioned, while some shareholders would naturally file charges for causing material damage to their equity. In other words, the Scheme would put their careers on the line.

These bankers made no secret of their views on possible applications of the stricter rules of calculating the deferred tax assets. "Stamping on the property rights of the shareholders of a bank," "sure to cause a big credit crunch," "aggravating deflation," and so on. Mizuho Holding's President Maeda commented to the effect that the Mizuho Group's assets would need to be compressed by ¥30 trillion ($250 billion); in other words, they would peel back the loans to their debtors to collect the money.

Right after this meeting, Minister Takenaka attended a cabinet meeting where he casually mentioned that the bankers generally understood what he had to say. Upon hearing this from their LDP friends on October 25, these bankers became furious: "another fabrication from Takenaka."

Luckily, Japanese language is one of the few clean languages in the world, with no swearing, because speaking against any of Japanese gods is not in our genes. For God's sake, gods are to be revered and not to be reviled against. Bear in mind that we do not even have obscene words.

Bankers retaliated by leaking the off-the-record details of the meeting. The duel was not over yet.

The second meeting was held on October 25. All this time, the bankers were frustrated and uptight because they didn't know what was in store for them. If Minister Takenaka kept bulldozing his way, their career, if not their banks, might be finished.

They could get political help, but politicians in Japan do not come cheap. For example, in 1997 the Liberal Democratic Party owed ¥9.1 billion ($91 million) to the Federation of Bankers Association of Japan. I believe that this debt occurred in connection with the 1997 election. Did they repay that debt? You never ask that kind of question when you extend loans to politicians. If they repay, they will immediately ask for another loan.

Be that as it may, the buck stops at Prime Minister Koizumi. His supreme goal is to dispose of big loans, each in excess of ¥10 billion ($83.3 million), within one year. The countdown already began when Prime Minister Koizumi appointed Takenaka.

At the meeting, Takenaka naturally did not show his hand. He is shrewd. He said something to the effect that he wanted a general exchange of views. This made one president of a major commercial bank so mad that he was about to leave. However, the neo-feudal discipline of other presidents got the better of them and they held him back.

Nearly two years later, in May 2004, this president must be feeling unlucky, for his bank was reporting such a huge deficit that he had to resign..

Back to October 2002, the mainstream media reported on an interview with seven banks held at 10:00 PM the same day. They expressed their frustration and reiterated their logic to avert responsibility: "Any sudden change of rules regarding assessment, reserve appropriation techniques and calculation of equity capital would constitute a major restraining factor to the bank's function of creating credit and may possibly induce a serious credit crunch. Corporations and manufacturers may also be greatly affected in an adverse way.... Circumstances where the economy suffers a blow by a hasty change of the system, thus hampering the national interest, should be avoided."

This statement sounded threatening to Minister Takenaka because it alluded to possible effects upon the Japanese economy as well as businesses. What about the consumers' reaction? Financial institutions were given sufficient time to do something about their bad loan circumstances. They stopped lending money to small companies and peeled back the loans they had already extended, thus aggravating the state of the economy. The tug of war between the Financial Services Agency and the bankers was still going on until 2003. Now in 2006, the picture is different as we see later in Part 2 and Part 3.

$2000 Interest per Annum for $1 Million Deposit

Regardless of bankers' complaints, the truth is that these commercial and other banks benefited greatly from the past hasty changes of the system which helped pour in trillions of dollars of taxpayers' money to save their skin. Take the zero prime rate, for example. When they extend loans to consumer credit companies, their rate is about 2.5%, while the deposit rates are laughably low. An ordinary deposit gives an interest rate of 0.005% and a fixed deposit 0.2% per annum.

Suppose you have $1 million worth of yen placed in a fixed deposit account for a period of 10 years. The 0.2% interest per annum generates only $2,000 in interest per year. And don't forget the government. The Japanese government wants their share. This $2000 is subject to an 18% withholding tax, so you actually get $1,640 per year for your 10-year deposit of $1 million in Japan.

Where in the world can you get only $1,640 on a $1 million fixed deposit per year? No wonder retirees living on pensions suffer mercilessly as the recession continues.

Complaints About The Takenaka Scheme

There are many complaints against Minister Takenaka. One critic wrote in an economic journal: "Fire Takenaka!" Of course, ten years before, the same was being said about Finance Minister Miyazawa. Some 50 years ago, articles were pointing to then Prime Minister Yoshida as a villain. Some things do not change. Minister Takenaka is ideal for the scapegoat role since he is neither a former government official nor a politician.

One bank president complained, "It's like changing the soccer rules or the rules of American Football in the middle of the game." Nevertheless, the Financial Services Agency released the findings of the inspections carried out by these banks themselves. The self-assessment of the banks turned out to be 36% less rigorous than the inspection of the Financial Services Agency. These commercial and other banks are in no position to complain, since they are the ones who changed rules.

Not everyone is sympathetic to the banks which had postponed and postponed all these years any thorough measures for liquidating bad loans. The *Nihon Keizai Shimbun*'s editorial described these complaints as "gibberish," and the *Asahi Shimbun*'s editorial rightly cried aloud, "This is the last chance!"

Adverse Reaction to the Scheme

How was the reaction within the Financial Services Agency? Its director, S. Takagi thought that such a Scheme for hard landing to dispose of bad loans would have disastrous effects and told Prime Minister Koizumi so. Takagi was reported to have shouted in Minister Takenaka's office, "Either I go, or you go!"

This remark, if true, is very interesting, for it is indicative of a sense of envy, chagrin, or some other mixed feelings for one of the most coveted positions in Japan, called "Daijin," or Cabinet Minister. Shucks, here is an outsider by the name of Takenaka in a spot that is naturally out of reach for one Takagi, the out-and-out MOF official. Let them argue. A project of this scale is bound to be a journey on a bumpy road. If you cannot take the hard knocks of travel, you shouldn't be in this business.

In today's Japan, becoming a cabinet minister or the head of a major corporation listed in the stock exchange is a sign of achievement; everyone dreams of it. It is also indicative of the elite consciousness of the MOF officials who don't give a dang about outsiders like Minister Takenaka. One thing is certain: Minister Takenaka has many enemies within the Financial Services Agency, so the bankers certainly have no trouble getting secret information from them.

However hard the commercial and trust banks may try, their options are limited. If they become reluctant in lending, or continue peeling back the loans already extended, that would be like strangling themselves since that decreases lending— which is the source of their earnings. (They will only hurt hapless small- and medium-sized companies by creating a credit crunch and loan peel-back).

Besides, the Financial Services Agency can counter them. There are many ways for government officials to do so. For example, such mean tactics would go counter to the Sound Banking Management Program, which entitles the Financial Services Agency to issue an order to the bank in question to improve its business performance. Should the bank ignore or disobey the order, the Prime Minister is authorized to revoke its license to operate a bank by invoking Article 17 of the Banking Law. And, judging from the independent way Primer Minister Koizumi has been operating, with an over 60% approval rating, he might very well do just that.

Third Meeting

A meeting with the bankers was held a third time on October 28. It is reported that President Maeda of Mizuho Holdings said to Minister Takenaka, "Please, do not mix politics with economics." Minister Takenaka had had enough. He hit the ceiling and said, "Are you against the policy of the Koizumi Administration? If that's the case, say so. I will relay your message to the Prime Minister."

Takenaka's Comment

While critics and retired government officials said one thing or another, on November 23, 2002 Takenaka had a chance to make a speech at a town meeting held on the Mita campus of Keio University, Prime Minister Koizumi's alma mater.

Takenaka vowed then and there that he would forge ahead with the Scheme because it was right. His students sent him off with a message "We love you and Prime Minister Koizumi," a bit of support he sorely needed after what he had been through.

The Takenaka Scheme

The Financial Reconstruction Program known as the Takenaka Scheme as compiled by Heizo Takenaka, Minister of Economics and Minister of Financial Services, is made up of six points. This is central to the financial restructuring plan whose implementation has been successfully ongoing.

- Stricter Appraisal of Bank Assets

The assets of financial institutions will be appraised even more rigorously. The banking world is naturally worried about this measure which would increase their loss due to disposal of bad loans.

- Quality of Equity Capital

The Equity capital of financial institutions will be made solid by examining carefully and qualitatively what actually makes up the capital.

As described above, The Takenaka Scheme focuses on the deferred tax assets which amounted to a total of ¥8.2 trillion ($68.3 billion) on the part of major banks, occupying over 47% of equity capital. Takenaka's original plan of limiting these assets up to 10% of equity capital was toned down to a provision that they "be reviewed without delay," and yet, the banks are already taking steps to compress lending.

- Special Support

This will be instantly applied in the event of any management difficulty, shortage of capital or similar circumstances confronting any of the financial institutions.

The "Special Support" is made up of three steps: a special loan by the Bank of Japan, injection of public funds, and dispatching government inspectors to the board meeting.

The Financial Services Agency set up by the end of 2002 a new "Financial Problem Task Force" which will check to see if plans to dispose of bad loans are proceeding smoothly in the banks. The results of work by the Task Force are very positive as the bad loans of the major banks were halved at the March 2005 term.

- Corporate Governance

This means a watchful eye to the management of the financial institutions to make sure that the top management does not neglect its duties to dispose of bad loans and improve profits.

What is alarming to the financial world is the government's policy of converting the preferred stock of banks, which is held by the government, through injection of public funds, into common stock that entitles the stock owner, the government, to vote on the selection of directors and other important matters.

- IRC to Be Established

To tackle the revitalization of corporations, manufacturers as well as industries, a new organization called the Industrial Revitalization Corporation (IRC) will be established, and from among the bad debts of corporations, those debts considered most likely to be recovered will be purchased from the financial institutions.

- Small- and Medium-Sized Companies

A safety net will be worked out to prevent financial circumstances surrounding the small- and medium-sized companies from drastically deteriorating.

The last point about the small- and medium-sized companies is highly important since they account for at least 80% of the corporations operating in Japan.

Every bank that received infusions of public funds has a loan target to meet in regard to small- and medium-sized companies. However, about 60 percent of questionable loans extended by major commercial and trust banks to the small- and medium-sized companies are uncollectible, and many people are afraid that any further increases in lending to these companies may produce bad loans.

Time Table Announced

The timetable for implementing the Financial Reconstruction Program was officially announced on November 29, 2002. It is designed to apply stricter rules to asset appraisals of banks beginning with the settlement of accounts at the term ending March 31, 2003.

To increase reserves for huge, bad loans, the American accounting technique of discounted cash flow (DCF) is used. This looks at the value of expected cash receipts and expenditures at a common date in the future. The DCF will be incorporated in the Inspection Manual of the Financial Services Agency.

The guidelines for restructuring, increasing capital, and taking other steps to urge management improvement before a bank falls into a crisis were revised by the end of 2002. Unless the bank can maintain the 8% BIS requirement of the equity capital ratio for international banking and the 4% BIS requirement for domestic banking, the bank will be required to turn in the Business Improvement Plan. The BIS requirement must be reached within three years.

The "Early Warning System" monitoring the state of management in terms of profitability is in operation. And an inspection to verify the reconstruction plans of debtor companies will be made after January 2003. A special inspection will also be made in time for the March 2003 term of account closing in view of stock price drops by companies with huge loans outstanding.

What about the Special Support that would inject public funds into a bank that is in trouble? It is specifically designed to apply the funds immediately, if required, making it very clear that quick action will be taken to meet any financial crisis under the framework of the existing law.

To clarify classification of major debtors among the banks, guidelines will be prepared and applied to the inspection beginning in January 2003. The Task Force monitoring the status of bad loan disposal will be selected from a list of CPAs, attorneys, scholars and industry experts. Are there enough experienced people for this job? Many doubt it, but the Program must go on.

Industrial Reorganization

Under a budget of ¥10 trillion ($8.33 billion) the Industrial Revitalization Corporation (IRC) began operations on May 8, 2003 for both disposal of bad debts and the reorganization of debt-ridden companies. For the capital, private financial institutions also chipped in some ¥50 billion ($423.7 million, 118/$1). IRC selects a company heavily in debt, which shows a good possibility of recovery through infusion of funds, and buys out credits for that company from parties other than its main bank at the prevailing rate. Whether the company is recoverable is determined by the committee. IRC functions to lend, invest, and guarantee. It focuses on buying up credits for two years since its inception in 2003 and thereafter resells such credits until it disbands at the end of March 2008.

Borrowers with Bad Debts

What about those companies immersed in bad debts, particularly real estate, construction, distribution (including supermarkets and department stores), and trading companies? Department stores and supermarkets that did well in the golden 1980s saw their sales decline in the 1990s and the new millennium, to say nothing of their overspending for real estate development. This industry is notorious for debts of astronomical proportions.

In 2002 total department stores sales amounted to ¥8 trillion 344.6 billion ($69.5 billion), a 2.3 % drop from the previous year, while supermarket sales totaled ¥14 trillion 370.1 million ($119.75 billion) in the same year, a 2.1% drop from the previous year. The first step was taken by IRC in August 2003 to support three companies including one local department store.

Daiei used to be Japan's No. 1 supermarket chain and No. 1 retailer, boasting sales in excess of ¥3 trillion ($30 billion) per year. However, founder O. Nakauchi over-borrowed for expansion and in the mid 1980s it was rumored that Daiei's debts amounted to some ¥1.5 trillion (probably worth $10 billion then). In 1999, its balance of liabilities with interest including those of its subsidiary turned out to be ¥3.7 trillion ($38.8 billion). In 2001, Daiei's outstanding balance was reduced to ¥2.3 trillion ($19.2 billion), still a considerable sum.

In September 2001, the Japanese government let MYCAL, a major supermarket chain with more than 20,000 creditors, go down the drain. It was saddled with ¥1.1 trillion ($9.17 billion) of liabilities with interest. On the other hand, the Japanese government decided to help bail out Daiei because of possible far-reaching consequences. On December 2, 2002, four banks jointly set up a corporate reconstruction fund with a total of ¥60 billion ($500 million). This fund became the majority shareholder of Daiei. It took the form of a limited company with a capital of ¥3 million ($25,000).

Each of the major commercial banks of Sumitomo Mitsui, Mizuho, and UFJ and Dai-Ichi Life Insurance carry 2.4% of its shares, to say nothing of the loans each extended.

Daiei's petition under the Industrial Revitalization Law was approved by the Ministry of Economy, Trade and Industry in April 2002. Accordingly, Daiei and its financial institutions could carry out a debt equity swap in the amount of ¥230 billion ($1.92 billion).

Debt swap equity is a technique used in connection with reconstructing a company through a refinancing arrangement in which a holder gets an equity position by exchanging for cancellation of the debt. In Japan, many general contractors used this method to avoid bankruptcy. What the debt equity swap does, in short, is exchange debts with stocks.

In lieu of exempting liabilities of $1.92 billion, Daiei issued stocks to be handed over to the financial institutions. Thus loans were exchanged for stocks.

When the bank's credit is converted into stocks, interest payment is not required of the borrower company. Furthermore, should the borrower company show better business performance, the bank can also get a dividend. In return for the use of the Industrial Revitalization Law to implement the debt equity swap, Daiei was required to carry out the 3-year reconstruction scheme that is to reduce its liabilities with interest to the level below 10 times the operating cash flow. According to the *Weekly Economist*, there is a good chance that this criterion of "liabilities with interest 10 times the operating cash flow" may very well become a yardstick to measure the reorganization of a company.[27]

Daiei's current target is to get its liabilities with interest under ¥1 trillion, hopefully to ¥900 billion ($7.5 billion). Did Founder O. Nakauchi contribute any way to reducing the Daiei's debts?

He sold his houses, villas and other holdings rumored to be worth some ¥30 billion ($300 million) in an effort to clear his debts. Even after this, his outstanding debts would probably remain at about ¥20 billion ($200 million). He passed away in 2005.

After a number of twists and turns, in April 2005, a group consisting of Marubeni, one of the leading trading houses, and an investment fund, Advantage Partners, was selected out of the three candidates (including Walmart) to reorganize Daiei. This group paid a total of over ¥60 billion ($545.4 million) to acquire one-third of the voting power along with IRC. At the February 2005 term, Daiei posted sales of ¥1.8338 trillion ($16.67 billion), an 8% drop from the previous term with a deficit of ¥511.1 billion ($4.46 billion), the worst in its history.

This huge deficit puts Daiei deep in a quagmire where debts far exceed its assets at this term. This fact notwithstanding, financial institutions provided loans of some ¥400 billion ($3.63 billion) in March 2005, while its capital was

27. September 3, 2002, the *Shukan Economist*.

increased by ¥112 billion ($1.01 billion) in May 2005. Consequently, this situation on the brink of insolvency was avoided. Accordingly, sales of ¥1.67 trillion ($14.5 billion, 115/$1) with a current profit of ¥23 billion ($153.3 million) are forecast for the February 2006 term as the reconstruction program gets underway.

IRC completed supporting 21 cases at the end of 2005. The remaining 20 cases are made up of big companies and manufacturers, each with sales exceeding ¥100 billion ($870 million), and selection of sponsoring corporations in charge of dealing with these cases is finished. Collection of debts is proceeding well. IRC is now looking forward to closing its business a year sooner than the intended end of FY2007. The end of FY2006 which is the end of March 2007 is the target closure date.

IRC spent over ¥600 billion ($5.45 billion, ¥110/$1) for purchase of credits and ¥400 billion ($3.63 billion) for investment as the stockholder.

Other Aspects of the Takenaka Scheme

The Takenaka Scheme proposes to take a second look at the deferred tax assets in tax effect accounting. These assets are recorded under the assumption that corporation tax and other taxes paid by the bank have probably been overpaid as a result of bad loans and thus are to be refunded to the bank. The entire amount is considered part of the bank's equity capital.

Takenaka's project team has a policy of limiting this addition to no more than 10% of the equity capital, as is the practice in the United States. This limit would cause the equity capital ratio to drop by a big margin. Most major commercial and trust banks would be in hot water, since their equity capital would drop below the BIS requirement of 8%.

In view of proper accounting procedures, tax effect accounting assumes importance in the Takenaka Scheme. Tax effect accounting itself is a new term for most of us. Since proper understanding of this accounting procedure is essential in the proposed scheme, let us see what it means.

When a bank considers extending a loan to a company that is not doing well, the bank sets up a reserve in case the proposed loan becomes uncollectible. However, since the loan is not yet in a collectible state, such a reserve cannot be treated as a loss; hence, a tax must be paid for the reserve. This is called "taxable amortization."

Suppose the company goes bust and the loan becomes uncollectible. The reserve would then be used to cover the loss. The reserve thus becomes a loss which can be deducted from the bank's income. The corporation tax is levied on the income; hence, a reduced income means a reduced corporation tax.

Should the bank report the closing of deficit accounts as a result of such losses, it is eligible for tax reductions for the next five years. The bank assumes that the loan is uncollectible and that deficit accounts occur in the future because of bad loan processing. "Deferred Tax Asset" is, therefore, recorded in advance as part of the bank's assets. It is as if no tax were paid, and so the amount corresponding to that asset is incorporated in the bank's equity capital as "Tax Effect Capital." In this way, assets and equity capital remain relatively unaffected by bad loan disposal, thus assuring the stability of bank management.

The Takenaka Scheme proposes to execute stiffer accounting principles in regard to tax effect accounting. One possible consequence is that the banks will find themselves putting up more reserves for bad loans. Then the equity capital of all the top four commercial banks would suffer and drop below the BIS ratio of 8%. That would force them out of international banking. Nationalization (the injection of public funds from the government) would prevent that possibility. At that time, the top management of major banks subjected to the injection would be asked to leave — without a retirement allowance. The Scheme originally intended to enforce this "no pension" provision.

Removal of the retirement allowance is a key item in the Scheme since these senior bank executives get a hefty sum for retirement without taking any responsibility. Take, for example, former Chairman Sugiura of the now defunct Japan Long-Term Credit Bank. This bank went belly up in 1998 after pouring its assets of ¥27 trillion ($270 billion) into land, stocks, and resorts, losing most of them, using up all its equity capital of ¥780 billion ($7.8 billion), and further leaving liabilities that exceeded assets in the amount of ¥2 trillion 650 billion ($26.5 billion).

Chairman Sugiura took no responsibility for all the bank's dressed up accounting records — and this was long before Enron. He succeeded in getting ¥900 million (about $7.5 million, ¥120/$1) as his retirement allowance. This drew fire from many quarters. He returned ¥200 million and retained the remaining ¥700 million ($5.83 million), still an excessive amount of money for him.

For a good example of the use of tax effect accounting, we can look at Nissan Motor, at one time Japan's No. 2 automaker. It was quite heavily in the red in 1999 when it had to tie up with Renault of France. It had debts of ¥684.3 billion or about $5.7 billion, close to the State of California's deficit of $6 billion in that same year. Renault threw in some ¥600 billion ($5 billion). However, when Nissan closed its accounts at the end of March 2002, it reported a whopping ¥370 billion or $3.08 billion for its consolidated net profit. Even its separate balance sheet reported a net profit of ¥180 billion ($1.5 billion). True, the cost cutting measures implemented by Carlos Gaun, the CEO sent by Renault — shutting down five plants, firing over 20,000 workers, reducing the number of subcontractors, and negotiating with steelmakers for price cuts — all played a dominant role in this bonanza. But there was more — deferred tax assets through tax effect accounting.

In terms of tax management, once you are in the red, the deficit can be carried over for five years. Nissan's separate financial statements at the March

2000 term came out with a deficit of ¥790 billion ($6.58 billion) and, in terms of tax accounting, its deferred deficit grew to ¥320 billion ($2.67 billion). Actually, this worked as savings, as far as Nissan was concerned.

At the term ended March 31, 2000, Nissan did not decrease its tax liability in terms of accounting because Nissan was not sure then if they could make enough money in the future to pay for the deferred tax. This is why they did not set up, at that time, deferred tax assets in tax effect accounting. Instead, at the next term ended March 31, 2001, they showed a profit and, thereafter, they figured that they were very likely to make enough money to recover taxes. So, the deferred tax assets were calculated and set up all together. As a result, future taxes were reduced and that portion works as a profit, thus pushing up the net profit.

Nissan is in the black and certain to stay there as evidenced by sales of ¥6.8 trillion ($56.66 billion, ¥120/$1) with a net profit of ¥495 billion ($4.12 billion) in the succeeding March 2003 term. Furthermore, sales of ¥9 trillion ($78.26 billion, ¥115/$1) with a net profit of ¥521.7 billion ($4.53 billion) are projected in the March 2006 term.

Bad Loans Reduced for the First Time

At long last, here is good news. Bad loans are on the decrease.

On February 7, 2003, the 132 commercial, trust, and regional banks in Japan reported that, as of September 30, 2002, there was a decrease of ¥3 trillion 100 billion ($28.83 billion) of bad loans in six months from March 31, 2002. The total bad loans dropped to a still very colossal sum of ¥40 trillion 100 billion ($334.17 billion) as far as these 132 banks are concerned. This is the first time the balance of bad loans decreased since the end of September 1999. This occurred chiefly because major commercial banks separated their bad loans from their balance sheets.

As for the seven major banking groups, their balance of bad loans decreased from ¥27 trillion (¥270 billion) that peaked as of March 31, 2002 to ¥12 trillion (¥11.3 billion, ¥105/$1) at the end of September, 2004.

In 2005, the mega banks merged to form three financial groups—Mitsubishi Tokyo UFJ Financial Group, Mizuho Bank and Mizuho Corporate Bank, and Sumitomo-Mitsui Banking.

Table 7-1 Mega Banks After Mergers in 2005

Banks	Total assets	Number of domestic branches	Number of employees	Profit from banker's commissions
	March 2005 term	March 2005 term	March 2005 term	March 2005 term
Mitsubishi UFJ Financial Group	¥149 trillion ($1.355 trillion)	667	31,100	¥379.7 billion ($3.452billion)
Mizuho Financial Group (Mizuho Bank + Mizuho Corporate Bank)	¥126 trillion ($1.145 trillion)	492	22,700	¥280.4 billion ($2.55 billion)
Sumitomo-Mitsui Banking Corp	¥91 trillion ($818 billion)	492	21,000	¥298.1 billion ($2.71 billion)

Source: Compiled from May 26, 2005, Yomiuri Shimbun, p. 3
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Chapter 8. Racketeers in Business

As everybody knows, Japan has its share of shady characters in banking, stock brokering, and politics, some enlisting the help of mobsters, particularly for the general meetings of shareholders. In 1997 and 1998, the Special Investigations Unit (SIU) of the Tokyo District Public Prosecutors Office uncovered many cases of scams, rip-offs, and malpractice committed by corporations, government officials, stockbrokers, and banks involving the mob.

Sokaiya

There is a leech sucking the corporate blood of many companies, called "Sokaiya." He is a person having a few shares in a number of well-established companies, making him eligible to attend their general meetings of shareholders. He, with his colleagues and associates, can help sway the course of a general meeting either way — for the company if he and his cohorts are receiving some form of benefits, including money, or against the company if they intend to get some benefits.

Most of these professional trouble makers are connected to the mob in the sense that they turn in protection money to the mob. For example, in 1994, a Fuji Photofilm executive was killed near his home. Later, the police caught a mob chief who had ordered the killing upon request of one Sokaiya who didn't like his way of handling the Sokaiya. (The chief was sentenced to 10 years in prison.)

Full of Dinosaurs

The *Nihon Keizai Shimbun* carries a well-known column entitled "Shun Jyu" or "Spring and Autumn" on page 1, at the bottom, lying three rows above the book ads.

On August 12, 1997, it expressed Japan's frustration over rip-offs and mob-related scandals involving leading commercial banks, brokerage houses, and even the Japanese Prime Minister by saying that there are dinosaurs in the business and political world.

There were many suicides and even the chairman of a Japan's major commercial bank committed suicide in June, 1997. A managing director of another commercial bank was killed in Nagoya, probably by someone from the mob to put an end to his rigorous pursuit of bad loans.

In this front page column, the *Nihon Keizai Shimbun* likened the overall situation to the abundance of dinosaurs that go one step further than the lizard that does not mind its tail being cut off when caught by its enemy. When the life of dinosaurs is in serious danger, they even have their heads cut off. They have been variously dubbed "Nomura-no-don," "Ichikan-saurus," and "Yamaichi-keratopus" to boot.

Nomura refers to Japan's largest brokerage house of Nomura that paid over $300 million to mobsters, Ichikan refers to Dai-ichi Kangyo Bank that also paid an equally staggering amount of money to racketeers, and so did Yama-ichi Securities, the fourth largest brokerage house in Japan, which, by the way, folded in 1998.

Let's look at one good example of "Sokaiya" — the case of Sokaiya, Ryuichi Koike. He is a notorious example of how Sokaiya found its way into the top management of Dai-Ichi Kangyo Bank (DK Bank), one of the leading commercial banks in Japan during the bubbling 1980s. On May 20, 1997, the SIU raided the DK Bank's head office with a search warrant that listed DK Bank as "a party involved in a favor granted by Nomura Securities to 'Sokaiya' Ryuichi Koike."

A favor in this case is a euphemism for financial gains. (In Japanese law, giving benefit to "Sokaiya" is illegal and the party giving such aid is subject to criminal prosecution as well.)

Prior to this raid, on March 25, the SIU raided the head office of Nomura Securities and over a dozen other locations, together with investigators of the Securities and Exchange Surveillance Commission. Charges were on suspicion of granting undue benefits to R. Koike.

What happened may be summarized as follows. By some magic, "Sokaiya" Koike was able to get a huge loan from DK Bank with no collateral whatsoever. With the loan, he bought massive shares of four major brokerage houses, Nomura, Yamaichi, Nikko, and Daiwa in Japan — 300,000 shares per house for a total of 1.2 million shares which were naturally held by the lending bank as collateral.

Yet, the 300,000 shares were sufficient to enable Koike to exercise his rights as the shareholder to present proposals at the shareholders' general meeting. He could, for example, propose discharging any company officer the management appointed. He had a dummy company whose account was used by

Nomura Securities and other brokerage houses to transfer profits obtained by illegal transactions with Koike.

DK Bank extended to Koike loans totaling ¥46 billion (approx. $460 million). This included some ¥3.2 billion ($32 million) to purchase the shares of four major brokerage houses. When a bank provides a loan to any individual or company, lengthy, cumbersome procedures are always required to establish the credit standing of the borrower. It is downright unfair and illegal for DK Bank to extend special, collateral-free loans to this "Sokaiya".

The name of the game was Koike's connections that helped him get such loans from one of Japan's leading banks.

R. Koike began his career as Sokaiya when he joined the then largest Sokaiya group, the Ogawa Group. This was known as a militant group which specialized in attending general meetings of shareholders of corporations and causing a chaos.

For instance, at the shareholders' general meeting of one manufacturer in 1975, Koike and three other members of this group strongly dissented from one measure on the agenda and countered it by shouting "Nay, Nay, and Nay" and peppering the presenters with silly questions. And the company did not have Sokaiya on its side powerful enough to counter their filibustering.

What any company (except Sony, which at one time took eight hours at its general meeting to listen to shareholders' opinions) fears is for its shareholders' general meeting to break up in confusion with proposed measures barely approved. So the company gave in and, instead of continuing the meeting and patiently arguing with those who held different views, decided to cancel the particular measure in order to end the meeting smoothly.

As a result, Koike was arrested by the Tokyo Metropolitan Police on suspicion of coercion and received a guilty sentence. This incident provided a chance for Koike to get to know R. Kijima who was reputed to be directly connected with that rightist kingpin, Yoshio Kodama. Kodama later became world famous because of the Lockheed Scandal involving and eventually causing the downfall of Premier K. Tanaka.

Kijima's close relationship to Kodama was highly conducive to making him an influential fixer, and expanded his operations as a magazine publisher, soliciting advertising fees and deepening his connections with the top management of DK Bank and the four major brokerage houses. Kijima was aware of Koike's business acumen and tried to groom Koike to be his right hand.

In October 1982, the Commercial Code was amended to make it illegal for corporate bodies to give benefits to Sokaiya. Then, Koike switched his allegiance to another powerful Sokaiya group that took charge of the shareholders' general meetings of the top four brokerage houses (for a handsome fee, of course, made available under disguise).

This group was not a militant one but a group that specialized in defending the interests of the client corporations. According to *What Made the*

Chairman Commit Suicide,[28] written by the staff of the *Yomiuri Shimbun*, a newspaper with the largest national circulation of more than 10 million readers, the last time Koike showed his militant tactic was at the Nissan Motor shareholders' general meeting held in June, 1984. There he filibustered by arguing and talking two hours as one of the shareholders.

Koike left the shady trade of Sokaiya, realizing that intimidating corporations and manufacturers to get some money had no future and still maintained his contact with the rightist R. Kijima, and upon Kijima's suggestion, he began dealing in stock.

In 1983, Koike reopened his Sokaiya activities, backed by Rikiya Kijima reputed to be a mastermind in some quarters, and continued expanding his relationships with executives of leading corporations including DK Bank and four brokerage houses.

Koike had a letter of introduction from this fixer, Kijima, and, by March, 1989, received loans from DK Bank which were used to buy up massive shares of the top four brokerage houses.

As the bubble broke down, his loans could not be adequately covered by the security he put up. Short of funds, Koike approached the top four brokerage houses to offer a profit to him. He also propositioned the DK Bank executives to extend an additional loan up to ¥3 billion ($30 million).

Naturally, DK Bank's executives thought that whatever loans extended to Koike was a matter that involved DK Bank in the seamy side of life, so that unless it was rooted out then and there, serious consequences would be in store. This consideration notwithstanding, according to the SIU, on September 4, 1992, a dinner party was held at Kitcho, the leading, if not the best, Japanese restaurant (charging $500 to $1,000 per guest), between Kijima and the five executives of DK Bank including chairman and president. Kijima said something to the effect to take good care of "that matter" and that changed everything.

Kijima passed away and then Chairman Miyazaki committed suicide in the middle of the investigation. This case left some details yet to be unraveled. However, the court judgment certified that both chairman and president had been involved, as the loans were extended to Koike later.

On April 21, 1999, the Tokyo District Court sentenced Koike to nine months in prison with a penalty of some ¥694.6 million ($6.31 million, ¥110/US$1). Filing no appeal, Koike served the sentence. In connection with the Koike case, there were a total of 31 defendants from Nomura, Daiwa, Nikko, and Yamaichi Brokerage Houses including 11 from DK Bank.

The DK Bank case is unique in that 11 top management personnel including former and current company officers were prosecuted on charges of

28. Local News Section, Yomiuri Shimbunsha, *What Made the Chairman Commit Suicide* (Naze Kaicho wa Jisatu Shitaka), Tokyo: Shinchosha, 1998.

violating provisions of the Commercial Code (granting illicit gains) and sentenced guilty. And one top management personnel committed suicide.

According to the results of the DK Bank's in-house investigation carried out later, the roundabout loans via the non-bank affiliate amounted to a total of ¥18.6 billion ($169 million, ¥110/US$1) plus direct loans of ¥27.4 billion ($249 million) were provided to Koike. In other words, during a period of 11 years and a half up to September 1996, the total sum of ¥46 billion ($418.2 million) found its way to a single Sokaiya.

Are Sokaiya Still Active Today?

Once in a while, companies and their Sokaiya are caught even today. A recent case in point is what happened to Nihon Credit Corporation whose management was subjected to criminal prosecution. Its President resigned and was charged with giving money to one Sokaiya Kondo in the total amount of ¥27.54 million (approx. $230,000, ¥120/$1) spread over 34 times during a period from December 1999 to September 2002. This amount does not represent all the money. It is only the amount discovered, representing the tip of the iceberg.

On March 26, 2003, four former executives of Nihon Credit Corporation (Nihon Shinpan) and the Sokaiya stood trial at Tokyo District Court. A prison sentence of 10 to 12 months with a three-year stay of execution was given to the four former executives and a prison sentence of two years with a five-year stay of execution for the responsible Sokaiya.

The Sokaiya's role is sometimes that of a shrink. The chief executive is a lonely man, because he has no one to confide in. There are things he cannot talk about to his men. So, some talk to their buddies, and others talk to their wives. Still others talk to their consultants. There are psychotherapists in Japan but consulting them is not quite as much accepted as in the United States. We do it the old-fashioned way: we go to our favorite bars and complain about the things we cannot talk about with wives; to none other than the ladies running the bars. These "Mama-sans" could sometimes be compared to a Catholic priest who listens to confessions. Some executives chat with their Sokaiya. Eventually, if the chemistry is right, they might start confiding in their Sokaiya.

Hush-Hush Matters

If you have the Sokaiya on your side, you can do a lot of things with the company expenses. The president of a well-known department store chain used his girl friend as a supplier and eventually got kicked out because of this. He originally got that position by promising the retiring president that he would take good financial care of his mistress. He had the strong backing of the Sokaiya group, so he was able to use the services of his girl friend. However, since the board was not under the Sokaiya influence, it unanimously voted to kick him out.

One chairman (now retired) of a big corporation liked opera. Every fall, he went to New York City to see the Metropolitan Opera with his men who carried his luggage. The annual trip was naturally financed by the company. His Sokaiya saw to it that this matter was not brought up at the shareholders' general meeting.

Another infamous case involved the president of a leading corporation founded by his father. Because of years of overeating and over drinking, he was diabetic and, therefore, impotent. But once in a great while, he had an urge always in the daytime. There would appear to be more convenient ways to ease the urge, but this president insisted on doing it the right way. So he installed his mistress as one of his secretaries on duty next to his executive suite, naturally on the company payroll. When those rare occasions arose, he signaled one of his stocky male secretaries, a former rugby player, who would swiftly move into the presidential suite while the mistress was getting ready. Then he would grab her and lift her up, and ever so gently ease her down on the president's lap.

Many men often ask stupid questions in a case like this. Was she good looking? No, she wasn't. My information has it that the president liked slightly plump girls and the looks were of secondary concern.

Keeping the mistress this way at the company expenses is a misappropriation. But it is often done. As long as the Sokaiya is on the company side, there is no fuss at the general meeting. By the way, this secretary in charge of this heavenly mission later took over as president after the one-track mind president retired. He recently retired as chairman.

How the Mob Operates

Since any discussion of Japanese business is incomplete without explaining how the mob operates, let's take a look at how some racketeers operate particularly in regard to real estate dealing, promissory notes and debt collection. By the way, the names of the mobsters are withheld and given in initials for the obvious reason.

A word of caution in understanding the underworld in Japan. The mobsters do not control Japan in the sense that they operate widely in other countries. Some Western researchers on Japanese underworld as well as Japanese mass media like to overstress the role of the underworld in Japan. It is not as extensive and influential as in other countries. Furthermore, a new anti-racketeering act passed in March, 1992, to let the racketeers know their place in society. (The trouble now is more with the Chinese thieves, armed bandits, and gangsters as well as Korean pickpockets operating in Japan.)

For one thing, mobsters do not control the trade unions in Japan. Neither do they control distribution, since truck drivers are mostly not unionized. Some

90% of trucking companies are small operators with a few drivers. They either work as subcontractors of big trucking companies or take orders directly from the shippers. In other words, most of them are independent drivers, and if unionized, they are company-wide unions and not part of nation-wide federation of unions. Even liquor distribution is not controlled by the underworld. (Musicians are not subject to mob control, although their work is threatened by the popularity of "Karaoke.")

The recession is naturally hurting the mob. Their main source of income in legitimate work has included controlling manual workers in civil engineering and construction works, mining, and handling longshoremen and stevedores in ports and harbors. But mechanization moved in to replace workers. Bulldozers and other machines took over much of muscle work. Mining is nearly extinct.

The recession has produced many seeking to borrow money but too risky for legitimate lenders to provide loans. As a result, some racketeers are deeply involved in loan sharking.

Gambling provides some means of livelihood to the racketeers. Since "pachinko" or pinball machine business has an estimated annual revenue of ¥30 trillion (approx. $27 billion, ¥110/$1), some percentage of that goes to the mob as protection fee. Horse racing might seem to be a lucrative field for the mob, but it's not so.

The Japanese Government runs horse racing. As one mob chief once remarked: "Our great government is threatening our means of livelihood." National horse racing is run by the Ministry of Agriculture, Forestry and Fisheries which takes 25% of the gross proceeds. Some gamblers complain, "When we sponsor a gambling party, we take 5% of the money in the pot as the banker's fee. But look at the government! They rip off 25% in horse racing."

Yet, illegal book making off the race track is done by the mob. Baseball gambling, professional baseball and otherwise, is also handled by the mob.

At the time of buying land for the construction of Tokyo Disneyland in the 1970s, the coastal area of a small fishing village, Urayasu, near Tokyo, was booming. A lot of money was spent and paid to the fishermen for acquiring their fishing rights, since their underwater fishing area was to be filled. When huge amounts of money were poured in, the mob wasted no time to wangle their money through dice games. Many fishermen love gambling. For the first few games, fishermen won, then, they started losing. Some lost whatever they got from selling their property and fishing rights.

These examples mostly occurred before the passage of the anti-racketeering act in 1992. Before we see their operation, let me introduce a recent Supreme Court ruling that puts screws to every member of the mob as well as their chiefs.

A Mob Chief Saddled with Employer's Liability

Sometime in the 1990s, there was some danger of a full scale war breaking out between gangs in the ancient capital of Kyoto, so a police captain was on duty to make sure that innocent people would not be hurt. Unfortunately, he was mistaken for a rival gangster and was shot to death by a subsidiary group of the Japan's No. 1 mob family.

The unfortunate captain was 44 years old. His wife and three children filed a suit for compensation in the amount of ¥164 million ($1.5 million) against the Capo of that mob family. The higher court ruled that the captain's family be awarded a compensation of ¥80 million ($727,700). While the mob family appealed, on November 12, 2004, the Supreme Court of Japan endorsed the high court's ruling and dismissed the Capo's final appeal. The presiding judge stated that inasmuch as the killing was caused to maintain the prestige of the family, the Capo shall assume the employer's liability.

This was the first time in Japan that the Supreme Court acknowledged the employer's liability of the leader of the parent mob family in regard to warfare among the subordinate groups.

According to the Yomiuri Shimbun,[29] from 1995 to October 2004 there were 71 cases of gangland warfare, and 10 innocent citizens were injured or killed. The new ruling is certain to put a damper on the mob activities.

How Many Mobsters in Japan?

Like many other countries, Japan has its share of mobsters, con men, professional thieves, gamblers, "Sokaiya," and politician-turned money grabbers. Today, there are over 1,000 organizations of some 84,000 mobsters in Japan. Many belong to one of the 24 families designated by the police as racketeering organizations. The top three families are Y, I, and S. These three control the mob on five islands of Japan.

There are still some who remain independent because they have been regionally operating for many years, some since before World War II, so that there is no need to belong to any of the three families. A high school friend of mine was one of the sons of such family in Kobe where the No. 1 Y family is headquartered with over 30,000 members spread all over Japan. His family is doing fine as the independent family. (By the way, he died of a stroke at age 42 after years of drinking.)

In the 1960s, the law enforcement authorities got tough with mobsters (called "Boryoku-dan", boryoku meaning violence, and dan meaning a group or organization of people, also called "Yakuza"), wasted no time raiding their joints,

29. October 13, 2004, the *Yomiuri Shimbun*.

and many chieftains were arrested and put into prison. Groups disbanded one after another, during this period, and key members often divorced their wives.

Even the Japanese Military Unable to Stop Them

In the 1970s, they started coming back, and they had a field day in the 1980s bubbling with the real estate boom. You cannot really exterminate them. Before the war when militarism was the order of the day, the Japanese Imperial Army was invincible and they could do almost anything. In fact, they even fooled Emperor Hirohito, the Supreme Commander of the Japanese Imperial Army, on several occasions.

The last time the Japanese Military fooled His Highness was when they gave false information to him on the atomic bomb after it was first dropped over the skies of Hiroshima in 1945 with a devastating effect. The Army did not say that it was an atomic bomb but a new type of bomb. I remember that newspaper headline at that time.

The emperor had some suspicion about the news fed by the military, and he sent one of his brothers who had many friends in the military. The brother came back with shocking information. Then and there, Emperor Hirohito made up his mind to cease fire as soon as possible. Yet, even the almighty military was not almighty when it came to getting rid of the mob. They survived just like the Mafia did in the United States.

How the Mob Operates in Land Deals

Suppose a tenant of a dilapidated building does not vacate the premises despite a certainty of receiving good money for moving out. Then, the tenant may get strange telephone calls for harassment. Some tough-looking guys may show up in broad daylight, asking them to get the heck out. These goons might pay mysterious midnight visits. Or the tenant might get a call from someone he knew years ago, and the call was about the benefit of vacating the building.

Sometime in the 1980s, I remember reading an article about a small eating place the owner wanted to sell. Since the operator did not want to leave because of thriving business, the owner took action, got a construction crew and machinery, and started demolishing the eating place. Although the police usually stay away from private disputes, this case involved destruction of property, so they came and filed charges against the owner who drove a Mercedes-Benz, a Rolls Royce, and a Ferrari. The owner had no ties with the mob, but when a normal, decent man freaks out, he can be worse than mobsters.

There is a much worse case involving a restaurant in Kobe, one of the leading port towns in Japan, known for the home of the No. 1 Y family with a host of independent bands of mobsters. Some credit union (having close ties with the mob) hired racketeers to intimidate the tenant and make him vacate the premises. The mobsters (led by the chief himself, who was a Chinese but a permanent resident of Japan) destroyed the restaurant. While they were demolishing the place, the owner called the police. When the police arrived, the chief quietly told the police that everything had been done legally, because appropriate procedures had been filed with the local authorities. Half convinced, the police left. After making a few calls back at the police station, they found out that the mob chief's claim of filing appropriate procedures was a blatant lie. The irate cops returned to the scene, and the chief was taken to the station, charged with a number of offenses, and hauled into a detention house. It was later found out that the local credit union hired the mob at a fee per tsubo (a traditional unit of size of land roughly equal to 4 square yards) that would have netted the mob something equal to $500,000. This sort of story abounded in the late 1980s.

In another case, a TV documentary showed a mob chieftain in his Osaka office surrounded by two of his senior goons, talking over the phone with a finance company to the effect that he would handle "ji-a-ge" of a particular place at a fee of ¥30,000 ($200 or so) per tsubo. If a mob chieftain of his caliber was hired, it could not be a small lot. It should be a deal involving at least 2,000 or 3,000 tsubo of some urban land (about 2 to 2.5 acres). This Ji-a-ge deal would mean a remuneration of about $900,000 plus a bonus of at least $100,000 if successfully carried out.

In the 1980s, there were many land deals worth $10 to 200 million or 300 million, and it was common, particularly in Tokyo, that when a land deal of over $1 million was involved, both buying and selling parties had mobs represented at their sales meetings to close the deal. This way, in case of any trouble between the two parties, these mobsters, each belonging to a different family, would come out and settle any dispute — naturally at a handsome fee. As everyone knows, attorneys could be expensive and time-consuming, and in real estate deals, time is of paramount importance.

Examples of Mobsters in Action

In the early 1960s, there was a private toll road construction project between a hot spring and two large neighboring cities to provide an access for tourists. The project called for building a road through a tunnel and a road bypassing mountains that stood between the hot spring and the cities. The project was completed, and the hot spring enjoyed an increase in tourist trade particularly since the mid-1960s when motorization caught Japanese consumers.

In the mid-1960s, I had a chance to have a talk with someone connected to this project. While chatting, I asked a question, "How did you get the land for road construction?" He answered matter-of-factly, "Oh, some land owners sold land, but there were others who never wanted to sell." "What did you do, then?" "We had no alternative but to use the mob to force them to sell. They came by truck and threatened these land owners. In no time, we got the land, all right. Mind you, we never robbed anyone of their land. We paid a fair price."

In the 1960s and 1970s, IBM was a sole giant computer maker and distributor operating in Japan, while the MITI (Ministry of International Trade and Industry) was hard at work promoting domestic computer manufacturers. In those days, Hitachi was considered to lead the Japanese computer industry in the future.

In the late 1960s, Mr. A needed a computer for his business in Tokyo. While he was shopping around, suddenly, half a dozen computer makers showed up with their sales pitches. One of them even made a special offer, to make available one particular piece of computer software which the company had custom designed for another customer — at the customer's expense — and which was not supposed to be provided to other customers. The manufacturer offered to provide to Mr. A, saving him a bundle. The competition among Japanese computer makers was so fierce that they even issued a memorandum to that effect to clinch the deal.

A few years passed by, and one day two impeccably dressed gentlemen with sharp eyes and an odd demeanor showed up, each presenting a business card from a legitimate corporation. Mr. A wondered what brought them to his small operation. Were they hoods specializing in corporate scandals?

After exchanging pleasantries, they explained that they had come for the memorandum issued to Mr. A by that computer manufacturer to the effect that they would provide, at no cost, the software custom made for the other customer. Mr. A did not ask why they wanted the memorandum. He knew that it was probably worth a few million yen to ten million yen (about $10,000 to $30,000, a considerable sum at that time) or more depending on how they applied pressure; they probably wanted to use it for extortion. Mr. A excused himself and left the room to make a few phone calls. His mob contacts told him that one of these two gentlemen came from a well-known mob families and the other was a member of a right wing party. After returning to the meeting, Mr. A told them that he did not have such document. There was an exchange of threats, but he did not budge. When the worst should come, he could always call his high school buddy who was also a member of a mob family.

The two impeccably dressed men left empty-handed. After this incident, Mr. A got rid of the document; the software had been provided free and was operating well. He still wonders even today how they got the information.

If you threaten someone and get money from him, that constitutes an act of extortion. But if you open a current account with a bank, it is different from an ordinary account in that, if it is overdrawn, then any shortfall is automatically covered by a credit extended by the bank at a certain rate of interest. Suppose a bank sets up this current account for an intimidator and puts the amount asked for in this account; it becomes a legitimate loan offered by the bank.

This is also called a trade credit account, because it is used to get a loan from a bank. Now, if a racketeer opens this account, threatens a bank, and the bank transfers money for settlement with the racketeer, then it is a legitimate loan. It is not money gained by extortion. Of course, it is not easy to set up this account, but there are ways. The police cannot intervene in this case.

An interesting example of blackmailing is introduced in a book entitled *Tricks Played by Racketeers* ("Shinogi no Teguchi")[30]. A mob chief in heavy debt was looking for ways to make some money. One day, someone he knew came asking for his help. This man was a regular guy, honest, hard working fellow not like the mob chief. He bought an import car from a car dealer who's engaged in parallel imports bypassing the regular channel. Since this is a separate route from the authorized agent of the import car, prices are naturally cheap. The car he bought turned out to be full of defects, so he talked to the car dealer. But the dealer gave a flat refusal.

He went to see the mob chief and begged him to get even with that dishonest dealer, because all that money for that fancy car went down the drain. The chief went down there and tried to see the dealership president without success. The mob chief became suspicious. Something was funny about this dealership, so he began sniffing around.

Bit by bit, the truth came out. The president was the dealership owner and he was a nephew of a regional bank president. Actually, this bank president must be the owner, using his nephew as a cover.

The mob chief smelled rats about the whole thing from his years of dealing with shady characters. Since many small regional banks and credit associations are family-run, some of their top management personnel are known to be involved in questionable business. He continued sniffing around by calling his friends and acquaintances who, in turn, called their friends and acquaintances.

It turned out that this nephew was a certifiable moron, spreading his name-cards bearing his name as president and hitting one bar after another. He was apparently hoping that some young girls might be interested in his title. Many girls are. So the mob chief dispatched to him one of his young and lovely angels who wouldn't mind getting men to rush into where angels fear to tread.

In no time she was in bed with him, and her pillow talk included the usual line, "I wish I had money." He grabbed the bait and said something to the effect that she could borrow as much as she wanted with no security.

"You're so sweet, darling. Let me know how." Well, he whispered happily into her ear that the president of that bank was his uncle, and the dealership borrowed from that bank, too. Pretty soon, it was found out that the loans to that dealership supposedly for business funds had trickled their way back to the bank president himself. That would constitute misappropriation!

30. Natsuhara, Takeshi, *Tricks Played by Racketeers* (Shinogi no Teguchi), Tokyo: Data House, Inc., 1999, 117-118.

The chief wasted no time and went to see the bank president. At first, the president said that he had no money to lend to a hood, and that with no security. So the chief casually mentioned, "Ah, you have a nephew running a dealership, haven't you. He was telling me ...." Suddenly, the president changed his attitude and suggested payment for settlement.

The chief was too cagey to catch that bait. He said that he just wanted a business loan. So, the regional bank allowed him to open a current account, to which the loan was remitted. This is one trick played by racketeers. In return, the bank benefited from getting to know this mob chief because of his services of fending off other mobsters trying to muscle their way into the bank on a slight pretext.

One man I knew ran a service company with 500 customers, mostly bars and clubs. He supplied flowers and o-shibori, a wet towel served for each guest that comes into a bar. For the customer, he also provided the bouncer service. If any guest starts getting rough and quarrelsome, the bar would call his company and two or three muscle-men would rush over and throw the guy out.

In another entertainment district of Tokyo, one mob family set up a company for bars and clubs with a monthly membership fee of ¥35,000 or a little over $300 per month. This is really a fee for protection from unpleasant guests. When certain guests start picking on someone in the bar in a loud voice, the other guests stop coming. This is a loss of business that bar operators want to avoid. So this association provides nothing but a bouncer service.

Here is a recent example of the mobster working in consort with a construction company[31]. On July 7, 2005, the Counter-Organized Crime Section 4 of the Tokyo Metropolitan Police arrested four executives of Katsumura Construction, general contractor listed in the First Section of the Tokyo Stock Exchange, and one racketeer on suspicion of obstructing business of bidding by force.

The bidding was a water pipe laying project issued by the City of Tokyo in November, 2004. There were about 10 bidders. However, the executives of Katsumura Construction organized a rig-bidding group, so that others outbid one contractor rigged to be the winner. This pre-arrangement or bid-rigging is called "Dango" in Japan and often done in construction projects. Naturally, it is illegal. One contractor rebelled against participating in this collusion. This is where the racketeer moved in. Immediately before the bidding began on November 10, 2004, the racketeer met with this rebel, urged him to join the bid-rigging, and intimidated him, saying "We've got a lot of young people willing to go to the prison."

The rebel first played along with this intimidator, but revised his bid price immediately before the bidding began, to underbid all others. The rebel won the bidding at a contract price of ¥614 million ($5.85 million, ¥105/$1).

31. July 8, 2005, the*Yomiuri Shimbun*, 39.

The use of promissory notes in Japanese business is explained in Chapter 6. Remember that promissory notes are often stolen. This is one of the reasons many corporations and manufacturers try to use less bills and notes. Still, many transactions are traditionally settled this way in Japan. Now, if a promissory note drawn by your company is stolen, what are you going to do about it? Suppose a stolen promissory note, say, in the amount of ¥1 billion (or roughly $10 million), gets in the hands of someone who is not aware that the note in question was a stolen note. Then, this is a third party in good faith, and the party legally becomes a "holder in due course" of this note which the issuer promises to pay the entire amount of ¥1 billion on a certain date. Legally, the party issuing that promissory note must pay ¥1 billion when the maturity date arrives. Out of several examples of racketeers handling promissory notes described in Tricks Played by Racketeers cited above, let's take a look at one example.

A crook specializing in stealing promissory notes is known as a "sinker," because he sinks a promissory note. On the other hand, there is a fellow specializing in getting back stolen promissory notes — "salvager." This is the world beyond the reach of the police force.

Once the note is stolen, it is circulated through several hands, and then it becomes very difficult to prove who stole it. Some sinkers are professional con men, but most are racketeers. Someone posing as a third party in good faith approaches the party responsible for issuing the stolen note, saying, "I have a promissory note drafted by you. Since you have a good reputation, I discounted it. But I understand that this is a stolen note. The note carries a large sum, so I cannot possibly return it to you. What shall we do?" Naturally, this gentleman knows the sinker very well.

There are not many options for the corporation; they can pay this party for settlement or go to court charging the other party with a criminal act. The latter decision is not wise. Since a promissory note trial determines whether the note in question is genuine or not, it takes only one day; then the case moves to full-scale legal proceedings which require a deposit of about two-thirds of the face value of the note.

This means that it is quicker and cheaper to settle and get the stolen note back by paying cash. How much cash? The other party does not mind getting 20% or 30% of the face value. Even so, 20% of ¥1 billion would be ¥200 million (about $2 million). This is where the salvager enters. No company can afford to pay ¥200 million or $2 million for a stolen note. The salvager, from a mob family, may fix the deal so the company pays ¥50 million (about $500,000) to the other party and half the ¥50 million or ¥25 million (about $250,000) to the salvager for the salvage fee. It's up to the salvager to make more money so long as he works within the budget goal set at ¥50 million plus ¥25 million or a total of ¥75 million ($750,000).

If he succeeds in working out a deal with the sinker so that the sinker is happy with ¥40 million ($400,000), then, that is a gain of ¥10 million for the salvager and not the company. In other words, the salvager makes a fee of ¥35 million ($350,000) in total. When the deal is made, the company pays the salvager ¥75 million ($750,000), the salvager pays the sinker ¥40 million ($400,000) in exchange for the stolen promissory note, and the company recovers the note from the salvager.

All these negotiations take some time but are considerably speeded up in recent years with the use of cell phones. The salvager checks out the other sinker party. If no racketeer is involved, the salvager can play hardball. Suppose the sinker party insists on payment of a higher amount; the salvager might use violence. For example, the salvager may grab and lock him up in a room or just threaten him saying something like, “The water in Tokyo Bay is real cold this time of the year. Some crazy people may want to be down there.”

The legal community including judges, DAs, and attorneys did not like the mob moving into their territory. They did not sit idly by as the mob gained influence in debt collection and other quasi-legal fields. That was one of the reasons for passing an anti-racketeering law in 1992 designed to curb the mob activities, “The Law Pertaining to Preventing Illegal Activities by the Racketeers.” This is proving effective, and yet the fact remains that legal proceedings take too much time with no assurance of enforcing the payment of the debt.

PART 2. REBUILDERS

Chapter 9. A Pro-Business Environment

Part 1 showed how Japan's policy-makers made one mistake after another. Part 2 will show Japan on the rebound with dedicated businessmen, scientists and engineers, and equally dedicated government officials in place.

Meanwhile, from 1990 to 2003, due to asset deflation, Japan lost some ¥400 trillion (about $3.63 trillion) worth of stock value and ¥800 trillion (about $7.27 trillion) of real estate value — all for a total of some ¥1200 trillion (about $11 trillion). Now, let's see how we are swinging back.

Consumption, Exports, and Stock Prices up

When you consider the Japanese economy, you watch out for at least five major indicators — exports, the exchange rate between the Yen and the US Dollar, the Nikkei Stock Average, consumption, and the spending for new plant and equipment. Consumption or consumer sales occupy 60 to 70% of GDP, and exports continue to play an important role in the economy.

Exports Vital to Our Economy

Exports are vital to many companies because of their cashing power. As you know from Part 1, a large number of Japanese companies issue promissory notes maturing in at least three months. This means that you get paid in cash three, four, or five months later. On the other hand, when a product is exported in terms of, say, Letter of Credit (LC), if you show the LC to your bank, you can borrow 80 to 90% of the face value in cash. This quick convertibility to cash is a major attraction of exports for funding operations, and this is why many Japanese companies like to export. American businesses seldom have this kind of problem.

Both domestic sales and exports are doing well. Domestically, thin-type/flat screen TV (such as liquid crystal display panels, plasma display panels, and rear projection TV), mobile phones, digital cameras, as well as digital home appliances are doing good business. So this also means good business for semiconductor manufacturers, glass makers, lens makers, and many others because these burgeoning industrial sectors eat up semiconductors and other component parts like we eat rice or you eat potatoes.

Exchange Rate

Coupled with this advantage of exports lies the exchange rate between the yen and the US dollar. This is very critical. In 2003, it stayed in the range of ¥120/$1 to ¥110/$1. But, 2004 saw this rate hover between ¥110 and ¥102. The range of ¥118/$1 to ¥110/$1 appeared in 2005. The more yen you get per dollar means you can buy more in one dollar: hence the terms, “strong yen” or “weak dollar.”

Conversely, fewer yen per dollar indicates a strong dollar and weak yen. This condition is detrimental to Japanese exports, even though we can buy more goods per dollar from abroad.

The ¥100/$1 marks the vital line for Japan. Suppose we get ¥100 per dollar. This is a 10% decline from ¥110/$1, and for some manufacturers, even a downturn of ¥1 in the exchange rate means the loss of a revenue of $50 million or more. For example, just a difference of ¥1 stands for a difference of ¥6.5 billion or about $62 million for Sony, ¥25 billion or about $238 million for Toyota, ¥550 million or about $5.2 million for Nikon, ¥1.25 billion or about $12 million for Takeda Pharmaceutical Industries, and ¥2.1 billion or $20 million for Tokyo Gas because of importing natural gas from abroad.

Nikkei Stock Average

Another indicator is the Nikkei Stock Average. This index is composed by averaging the share prices of a total of 225 issue names. (Although 300 or 500 issue names are used occasionally, the 225 average remains the norm.) In other words, the share prices of 225 issue names are totaled and divided by a divisor which is modified to assure continuity. We have another index, TOPIX, but many investors including those overseas seem to like the Nikkei Stock Average better.

Currently in 2006, the Nikkei Stock Average is well above ¥10,000, the line between victory and defeat. If this mark is crossed downward to the ¥9,000 or ¥8,000 level, it means that the Japanese economy is in trouble. These figures of the Nikkei Stock Average, the TOPIX and the Dollar-Yen exchange rate are shown at the upper right-hand corner of a TV screen during the news hour of every major TV station.

Exports are still key to Japan's economy. For example, Matsushita Electric or Panasonic makes about 70% of capacitors for all the cell phones in the world, and good sales of cell phones are directly related to good sales of their capacitors.

Hence Tamron, a well-known lens manufacturer, enjoys brisk sales because of increasing demand for its camera-mounted cell phone lenses, as well as for its digital camera lenses. Hoya Glass, Japan's largest producer of optical glass and eye glasses, is thriving with earnings per share of ¥351 ($3.34, ¥105/$1). When personal computers sell, so do printers. Epson (now, Seiko-Epson, world-famous for photo-quality prints) enters the picture, here, as Japan's No. 1 manufacturer of printers. Canon also wages a neck-and-neck competition in the printer field.

Exports to China Shot up

Exports are growing, particularly to the ever-expanding market of China. For example, exports of recycled paper and old newspaper to China are continuously increasing. Some observers attribute this to the growing use of quality toilet paper among Chinese. In terms of steel prices, H-shaped steel, indispensable for building construction, has shown marked price hikes since the fall of 2001. That kept Japan's steelmakers, formerly suffering from poor steel sales, swinging up fine. In September, 2001, it was available at ¥35,000 (about $300, ¥120/$1) which meant red-ink for steelmakers. By April, 2004, the price had ramped up to around ¥75,000. And prices are still moving up at ¥2,000 or so every two or three months.

Reflecting brisk steel demand from China, scrap iron prices shot up. In 2001 or 2002, a ton of scrap iron cost ¥7,000 or so ($70). In 2004, it tripled with a price tag of ¥20,000 ($190, ¥105/$1). This means that scrap yards are enjoying good business. When I put my car out for scrap in 2004, one of the scrap yards came, picked up my car, and only charged ¥5,000 (under $50) for hauling. It used to cost ¥10,000 to ¥15,000 ($95 to $143) depending on the distance covered.

One benefit of high scrap prices is a decrease in abandoned cars. In 2003, nearly 170,000 cars were found abandoned, while this decreased to some 30,000 cars in 2004. Abandoning is the most economical way of getting rid of cars. If your abandoned car is traced to you, you can say, "It was stolen," and show the paperwork.

The inconvenient effect of this scrap iron boom is high prices of used auto parts, because serviceable cars, once they are scrapped, are immediately shipped to China. Prices for replacement parts tripled in just a few years because of the shortage of junked cars remaining in the country.

Investment in Plant and Equipment

What about capital investment? It seems to be picking up now, since industry, thus far, tried to get the most out of their existing equipment and facilities. For example, Panasonic recently built a $1 billion plant for manufacturing plasma flat screens so as to corner a 50% share of the domestic market and a 40% of the US market. And Sharp is building another plant exclusively for liquid crystal (LCD) TVs. Plans are underway for adding even more plants. In June, 2005, Canon announced plans to spend ¥80 billion ($727.3 million, ¥110/$1) for a new domestic plant producing cartridges and ink for its line of copiers.

Japanese ocean transportation trade is thriving due to China's trade with the US and Japan. Nippon Yusen, Japan's No. 1 shipping company, is investing nearly ¥1 trillion (a little under $10 billion) in new ships — up to the period ending March 31, 2008.

While the rate of increase of the capital investment in the main sectors of the manufacturing industry has shown a decrease in FY2001 (-11.4%) and in FY2003 (-14.0%), according to the Ministry of Economy, Trade and Industry, it showed a 0.2% increase in FY2003 and a hefty 22.5% increase in FY2004. The industry as a whole showed a 0.2% increase in 2003 and a 10.4% increase in 2004. The upward trend of the investment in plant and equipment is expected to follow in the coming years. This is an encouraging sign since this investment represents some 20% of Japan's GDP.

Another survey by the Development Bank is also encouraging. This survey of the 2005 plans of the private sector for this investment showed ¥8.727 trillion ($79.336 billion, ¥110/$1), up by nearly 20% over 2004. This is a two digit increase for three consecutive years.

Unemployment is slightly improving. In FY2001, 2002, and 2003, the jobless rate was on the 5% level. This decreased to the 4% level in FY2004—4.6%, 0.5% less than prior year. According to the Ministry of Public Management, Home Affairs, Posts and Telecommunications, the number of completely unemployed persons for the FY 2004 average turned out to be 3.08 million, a drop of 340,000 from prior year. As of August 31, 2005, the number of completely unemployed person was 4.4% for men and 4.2% for women.

The Ministry of Health, Labour and Welfare has a set of data available on the effective opening-to-application ratio. In FY2004, this showed 0.86 times, an 0.17 percentage point from prior year. Job openings have been gradually increasing for 33 consecutive months.

Consumption

When I told an American friend that Japan was on the rebound after all these years, he asked me how. Well, it's like what happened to the US economy in the first half of the 1990s. Japan is split between the Haves and Have-Nots.

Japan's young people have a hard time finding work, and some point out that one out of five in this age-group is unemployed. Others maintain that two in every three young workers are unable to find jobs, depending, of course, on one's definition of "young workers."

In 2006, the jobless situation of young people is improving. as a reflection of the upward tone of the economy. Because of the many factors involved in assessing consumption, we will now see how Japan is swinging up.

Rallying Stock Market

There are two good indicators of the stock market — volume of trading and the amount of trading volume. The volume of trading in the first section of the Tokyo Stock Exchange is about 700 to 800 million shares per day. The volume of trading of 350 million shares per day is considered the minimum volume of shares to assure profitability for the stockbrokers. The daily average volume of trading during the bubble used to be 1 billion shares. On July 6, 1988, there was a record breaking volume of trading of 2.8 billion shares. After the bubble, during the 1990s, the stock market was understandably sluggish. The average daily volume was 260 million shares in 1992, 340 million shares in 1993, 330 million shares in 1994, increasing to 617 million shares in 1999, 684 million shares in 2000, 811 million shares in 2001, and 1.253 billion shares in 2003. The average amount of trading volume per day reached a peak of ¥1.3 trillion ($13 billion) in 1988 but gradually declined to the 2003 level of ¥971 billion ($9.7 billion).

Individual investors buying and selling accounted for 5 to 8% of those trading, the volume of trading per day being less than 400 million shares or less as explained above, while stockbrokers did the buying and selling among themselves to keep the market going. This was like playing catch in those lean days. One stockbroker throws a ball in the form of shares of a company, then another stockbroker buys them. A few days later, that stockbroker sells them, which are bought by a different stockbroker and so on. Eventually, the original stockbroker may buy them back — or may not, depending on the situation.

In FY1988, the individual shareholders numbered about 21.6 million for the total 22.7 million shareholders including corporations, central and local government, brokers, and foreigners, but in FY1994 this inched up to 27.2 million for the total 28.4 million shareholders. However, in FY2002, this increased to 33.7 million for the total 35 million shareholders.

Today, the daily volume of trading is often crossing 1 billion shares, occasionally hitting 1.5 billion shares, much of the increase due to an increase in individuals trading on the Internet.

Net trading securities brokers are reporting increased profits. For example, at the term ended March 31, 2004, Matsui Securities, with some 143,000 Internet accounts, reported a 1.6-fold increase over prior period with a recurrent profit crossing the ¥10 billion (about $100 million) for the first time. Its financial assets including securities received for guarantee, which is a good yardstick of the size of operations of a stockbroker, is ¥944.4 billion ($$9.44 billion), up 2.5 times over prior year.

Matsui's operating profit at the March 2005 term continued to soar to ¥22.6 billion ($142 million). Another good indicator of the stock market is the aggregate market values or the market capitalization values of all corporations listed as determined in terms of the market prices of their issued and outstanding common stocks. It clearly tells the ups and downs of the Japanese economy. In 1989 when the bubble peaked, this was a whopping ¥630,122 billion ($6.30 trillion, ¥110/$1), dropping to ¥267,784 billion ($2.67 trillion) in 1998, and moving up to ¥309,290 billion ($3 trillion) in 2003.

Foreigners are now aggressively buying shares of major corporations and manufacturers, the total holding ratio of foreigners having crossed the 20% mark in FY2003. Japanese stocks are still cheap from the international standpoint, so that high expectations are entertained for the continuing growth of Japanese economy as well as expansion of corporate performance.

Foreign buying tends to focus on the select few blue-chip companies. The 7.6% of the issued Hitachi shares were bought by a US investment fund. As of March 31, 2004, the foreigners' ratio of Hitachi shares reached nearly 35%. NEC reports that 36% of its shares are held by foreigners. Some 18% of the Mitsubishi Electric shares are owned by foreigners. These days, take a good look at Seiko-Epson, world's No. 1 maker of color printers, with only 16% of its shares held by foreigners. That company went public in 2003. This means that there is room for more foreign investments. If you are looking for a stock very popular among foreign investors, FANUC is it. It is the world's No. 1 manufacturer of factory automation backed by cutting-edge industrial robots.

FANUC caters to the industrial needs of mass production at all major automakers in the world including Toyota and GM. In FY2002, the share of FANUC's foreign shareholders was a modest 17.6% but it shot up to 43.7% in FY2005.

After a number of scams involving stockbrokers disregarding the individual shareholders came to surface in the 1990s (as briefly covered in Chapter 8 of Part 1), there was a gradual decline of investment by Japanese individuals over the years. In 2003, individual investors held 20.5% of the total number of shares and remained cool, while the ratio of foreign shareholders climbed to 21.8% (¥90.647 trillion or $9.4 billion).

Hitachi's director Y. Yagi once deplored the fact that as of March 31, 2004, the ratio of its foreign shareholders increased 6% over prior year to 35%, while the ratio of its individual shareholders decreased to a little shy of 30%. Director Yagi had mixed feelings because there was no increase in individual investors; others might feel that Hitachi should be happy with the current 30%.

Some shrewd individual investors are buying more carefully. Some are very successful. In the spring of 2004, a young man was arrested for throwing cash away on the streets in Tokyo — he was disturbing the peace. He must have wasted a few million yen ($20,000 or $30,000). Was he out of mind? No, he had just made ¥30 million ($300,000) or so dealing in stocks and it was his way of celebrating. The government does take 25% of the profit as tax.

Stock transactions on the Internet are drawing individual investors back to the stock market. The ratio of Net trading to the total volume of trading by individual investors reached 74%. The five top stockbrokers specializing in Net trading racked up some 70% of the volume of trading by individual investors. For one thing, the commission is cheap. For another, stock trading is instantaneous. You can also place stop loss orders in no time.

One investment advisor working for an investment advisory firm in Tokyo must have declared an income of ¥10 billion ($95 million), since it was reported in May 16, 2005 that his 2004 income tax amounted to ¥3.6 billion (approx. $34 million). Nothing is more indicative of the booming stock market than this.

Chapter 10. Upheaval on a Massive Scale

Everything is now changing fast in Japan's business and industry. What was unthinkable a decade ago is happening now. The regular pay raise in every April is still there but not like it used to be. For example, in November, 2003, Hitachi, one of the major corporations, sent an email letter in the name of President E. Shoyama to every one of some 30,000 employees (excluding middle executives). He explained that the regular, seniority-based pay raise would be waived and that future pay raises would be determined by an employee's job performance rating. It seems to me, this action came a little late since many other companies had taken that step a long time ago.

Since 2000, Hitachi, Toshiba, Fujitsu, NEC, Sharp, Sanyo, Panasonic (Matsushita Electric) and other electric/electronics manufacturers "in the red" have been hard at work restructuring by firing tens of thousands of employees, closing down subsidiaries, ordering vendors to cut costs, and by moving their manufacturing operations over to labor-cheap China.

Part-time employees and those employees on contract are on the increase.

The Haves and Have-Nots

Corporate profits have been on the increase, due mainly to cutting down labor costs—firing, moving plants to China, buying parts from China — and to exporting. In FY2003, a total of 42.5 million workers were employed in corporations not connected with banking institutions. Of this total, 51% were employed by small and medium-sized companies and manufacturers with a capital of ¥10 million (roughly $100,000) to ¥100 million (roughly $1 million). About 21% worked at very small businesses with a capital under ¥10 million ($100,000). This means that 72% of the workforce was employed by very small to medium-sized companies and manufacturers.

Gap Between the Haves and Have-Nots

What about their income? The figures are ¥3.8 million ($36,190, ¥105/$1) per year for those working for small and medium-sized companies, and ¥2.8 million ($26,666) per year for those working for very small businesses. Divide them by 12, and you get about ¥230,000 to ¥320,000 per month. In other words, each employee makes about $2,000 to $3,000 per month including taxes.

However, since these statistics include twice-a-year bonuses (and some don't get bonuses), the actual amounts are really less. Can people live on $2,000 to $3,000 a month? If you are single, you can manage in an expensive country such as this. It's an altogether different story, though, if you have children. Luckily, there are part-time jobs galore, even today. Supermarkets, convenience stores such as Seven Eleven, filling stations, discount stores, MacDonald's, Starbucks, TullY's Coffee, Walmart Japan, and many other shops are always on the lookout for part-time workers, at ¥650 to ¥850 ($6 to $8) per hour. These places traditionally employ a lot of wives who work there to supplement the family income.

Some economists conclude, even in 2006 when the breeze of an upturn is wafting ever so gently, from the above figures that prospects are bleak when it comes to the growth of personal consumption. Net disposable income has been slipping for seven consecutive years — from ¥303 trillion 159.4 billion ($3 trillion 48 billion, ¥87/$1) in 1995 to ¥295 trillion 462.2 billion ($2 trillion 46 billion, ¥120/$1) in 2002. Nobody can deny the decrease in personal income. At the same time, savings are also on the decline, from ¥34 trillion 767.5 billion ($399,626 billion, ¥87/$1) in 1997 to ¥18 trillion 375.0 billion ($183.75 billion, ¥100/$1) in 2002.

What's amazing is that Japanese consumers, despite hard times, continue to save at all. This reminds me of the remark made on TV by a well-known, 100 year-old lady. When somebody asked her why she continued to save, she replied very, very seriously, "That's my protection for when I get old!"

Another statistic from the Ministry of Health, Labour and Welfare indicates that the average annual income per household was ¥5.1 million ($51,000) in 2001, which was ¥910,000 ($9.100) less than 1995. Households with an income under ¥3 million ($30,000) per year occupy 39.6% — an increase of 10 percentage points from 1995. It is true that on-going deflation somewhat softens the impact of a decrease in annual income. Still, the majority of consumers are making less money.

There was a TV program in January of 2005, which showed two examples of how housewives saved. One family with two children has a take-home pay of ¥300,000 ($2,857, ¥105/$1) per month. The wife takes out ¥70,000 ($666) and saves it, so the family lives on a monthly budget of ¥300,000 minus ¥70,000. Another family with two children has a take-home pay of ¥275,000 (¥2,619) per month. Likewise, ¥70,000 ($666) is deducted for savings, so the family lives on a budget of ¥275,000 minus ¥70,000 per month. The name of the game is that each family keeps an itemized record of spending in the housekeeping accounts book.

Tokyo vs. Other Areas

Signs of recovery are mostly prominent in Tokyo. But take Nagoya, located between Tokyo and Osaka, which is the home of Toyota Motor and its associated companies. This area is also prospering.

In areas other than Tokyo, where living expenses are much less, it is not uncommon to have to make do with ¥1.5 million ($14,286, ¥105/$1) or ¥2 million a year. In particular, lots of young women manage in this income bracket by living with their parents. Some people live in their cars and use friends' or relatives' addresses to receive mail.

There are homes available for this income level, for a monthly rent of ¥30,000 ($286) or so, with a community toilet and no bath. If you have friends, they can let you use a bath, or you can use a public bathhouse available at a nominal fee.

A young woman may hold an office job for about 10 years and if she is a good worker, her annual salary is likely to run in the range of ¥3 to 3.5 million ($28,570 to $33,333). At that rate she can have a decent life. Those who work part-time might have two jobs, producing a combined income probably under ¥2 million ($19,050).

Sometimes, when a company is about to go under but is saved by a merger, salaries may drop by at least 20%. Take a trip from Tokyo to Osaka, Kobe, or to Sendai or Sapporo, and you'll hear people complaining about the business slowdown. These urban areas, as well as other rural regions, suffer when public works spending and other government spending have been slashed drastically. It will take some time for good business performance of many corporations and manufacturers to show tangible effects in these places.

There are many homeless people. In the late 1990s, some slept on the underground sidewalk from Shinjuku Station to the Tokyo Metropolitan Government Buildings. They were moved out, and ended up living in squatter cottages.

But, what seems interesting is that very few of them die of starvation because plenty of food is available on the streets. Convenience stores sell lunches, pre-cooked food, salads, sandwiches, and other perishable food, and many of these items are disposed of within 12 to 48 hours to prevent food poisoning after their freshness dates expire. This practice of dumping perfectly good-to-eat food means that no one ever gets food poisoning from these convenience stores, and the food items are picked up by the homeless. (Of course, there are no statistics on that.)

What About the Haves? How Much Are They Making?

In sharp contrast to the "have-not" statistics, the same source gives ¥7.4 million ($70,476) per year on an average for those working for big businesses which include companies with a capital exceeding ¥100 million (a little less than $1 million). These big businesses consist of manufacturers and non-manufacturers alike. Only big manufacturers show an 8% increase in personnel expenses, and their employees make up 7.3% of the total workforce. In other words, as far as these statistics indicate, the employees of big manufacturers are enjoying increases in their salaries. The rest have suffered a decline in their income.

Now, let us take a good look at the following figures drawn from the FY2004 FIES (Family Income and Expenditure Survey) conducted by the Statistics Bureau of the Ministry of Public Management, Home Affairs, Posts and Telecommunications. This is known for providing reliable data.

Table 10-1 Annual Income per Household in Five Income Brackets (¥107/$1)

Income Bracket	Persons in Household	Persons Employed	Annual Income	Savings	Debt	
					Overall Debt	Homes and/or land-related debt as part of overall debt
Under ¥3.66 mil. ($32,000)	2.61	0.85	¥2.76 mil. ($25,794)	¥12.16 mil. ($113,644)	¥1.56 mil. ($14,579)	¥1.16 mil. ($10,841)
¥3.66–5.09 mil. ($32,000–47,570)	2.93	1.13	¥4.37 mil. ($40,841)	¥15.20 mil. ($142,056)	¥2.80 mil. ($26,168)	¥2.33 mil. ($21,776)
¥5.096.79 mil. ($47,570–63,460)	3.37	1.50	¥5.91 mil ($55,234)	¥14.74 mil. ($137,757)	¥5.54 mil. ($51,776)	¥4.86 mil. ($45,421)
¥6.79–9.31 mil. ($63,450–87,000)	3.57	1.73	¥7.96 mil. ($74,392)	¥16.76 mil. ($156,636)	¥7.23 mil. ($67,570)	¥6.37 mil. ($59,533)
Over ¥9.31 mil. ($87,000)	3.73	2.04	¥13.24 mil. ($123,738)	¥25.556 mil. ($238,841)	¥9.73 mil. ($90,935)	¥8.83 mil. ($82,523)
Average	3.24	1.45	¥6.83 mil. ($63,832)	¥16.88 mil. ($157,757)	¥5.37 mil. ($50,186)	¥4.71 mil. ($44,019)

The *Weekly Economist* conducted a survey of 253 companies in various lines of business in regard to average annual salary of their employees. The table below shows the average annual salary of the 36 sectors of industry out of the 56 surveyed. This table indicates differences in pay scale among those working for big businesses.

Table 10-2 Differences in Pay Scale by Type of Industry (¥110/$1)

Industry	Average Monthly Salary (average age of employees)	Industry	Average Monthly Salary
Marine shipping	¥10.747 mil. (39.4) $97,700	Chemical	¥7.594 mil. (41.6) $69,036
General trading	10.648 mil. (41.5) $96,800	Steel	¥7.572 mil. (43.3) $68,836
Non-life insurance	¥10.116 mil. (39.9) $91,963	Airlines	¥7.498 mil. (38.2) $68,163
Oil	¥9.773 mil. (43.1) $88,845	Home building	¥7.300 mil. (38.7) $66,363
Stock Brokerage	¥9.772 mil. (41.0) $88,836	Auto	¥7.251 mil. (40.5) $65,918
Banking	¥9.726 mil. (39.6) $88,418	Glass	¥6.965 mil. (42.5) $63,318
Pharmaceutical	¥9.307 mil. (41.1) $84,609	Fisheries	¥6.932 mil. (40.7) $63,018
Real estate development	¥9.168 mil. (40.8) $83,345	Paint	¥6.810 mil (42.4) $61,909
Communications	¥8.589 mil. (37.1) $78,081	Shipbuilding	¥6.808 mil. (41.7) $61,2890
Optical	¥8.341 mil. (41.3) $75,827	Gas	¥6.775 mil. (42.6) $61,590
Semiconductor fabrication	¥8.333 mil. (38.9) $75,754	Cement	¥6.708 mil. (41.0) $60,981
Construction	¥8.321 mil. (43.5) $75,645	Internet-related	¥6.623 mil. (31.9) $60,298
Beer breweries	¥8.251 mil. (40.7) $75,009	Information processing	¥6.592 mil. (35.4) $59,992
Motion-picture companies	¥7.899 mil. (41.4) $71,809	Machine tools	¥6.504 mil. (40.2) $59,127
Electric power	¥7.889 mil. (38.9) $71,718	Supermarket chains	¥558.0 mil. (40.3) $50,727
Appliance/TV	¥7.674 mil. (40.7) $69,763	Land transportation	¥5.406 mil. (39.8) $49,145
Electrical machinery	¥7.666 mil. (41.5) $69,690	Hotels	¥4.631 (36.1) $42,100

Source: August 9, 2005, Weekly Economist.
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The top five earners include marine shipping companies (ship captains make good money), international trading companies such as Mitsui, Mitsubishi, and C. Itoh, non-life insurance companies, oil companies, and stock brokers. At an average age of 40 or so, the employee in any of these businesses makes about $90,000 per year.

Supermarkets, trucking companies, and hotels are on the bottom of the scale, and the average income of their employees is anywhere from $40,000 to $50,000 per year.

Let us take a look at another set of statistics released by the National Taxation Agency on September 28, 2005. The average annual income of those working in the private sector was ¥4.39 million ($41,800, ¥105/$1) in 2004 (¥5.41 million or about $51,500 for male and ¥2.74 million or about $26,000 for female). This represents a loss for seven consecutive years. Chemical companies, banks, and insurance companies are the top earners in this survey.

What about the average annual salaries of those working in the information technology or IT service trade in 2003? According to the Nikkei Solution Business,[32] No. 1 is NRI (Nomura Research Institute) with ¥9.85 million ($89,500, ¥110/$1). No. 2 is ISID (Information Service International Dentsu) with ¥8.91 million ($81,000), and No. 3 is Unisys Japan with ¥8.36 million ($76,000). The average annual salary of employees of the 104 companies listed in the First Section of the Tokyo Stock Exchange and with sales in excess of ¥10 billion ($900 million) is ¥6.1 million ($55,400).

Now, let us look into how much some workers earn per month by referring to the Basic Statistical Survey of the Wage Structure by the Ministry of Health, Labour and Welfare in 2003. This gives data on a variety of trades.

A programmer, average age 28.6 years, makes ¥289,000 ($27,500, ¥105/$1) with a yearly bonus of ¥712,000 ($6,780). A welder, average age 40.5 years, earns¥306,000 ($29,000) with a yearly bonus of ¥550,000 ($5,230). A machinist (lathe), average age 43.2 years, makes ¥327,000 ($3,100) with a yearly bonus of ¥692,000 ($6,590).

What about cargo truck drivers? A truck driver, average age 42.7, makes ¥332,000 ($31,600) with a yearly bonus of ¥357,000 ($3,400). An auto mechanic, average age 33.5, makes ¥276,000 ($2,530) with a yearly bonus of ¥686,000 ($6,530).

A doctor, average age 42.5, earns ¥942,000 ($89,700) with a yearly bonus of ¥1,378,000 ($13,120). This is in agreement with the results of other similar surveys. On the other hand, a nurse, average age 35.0, earns ¥313,000 ($2,980) with a yearly bonus of ¥891,000 ($8,480). A pharmacist, average 35.0 years, makes ¥322,000 ($3,060) with a yearly bonus of ¥885,000 ($8,400).

A high school teacher, average age 44.7 years, makes ¥464,000 ($4,420) with a yearly bonus of ¥2,262,000 ($21,540). Note that in Japan, the high school teacher gets paid 12 months of the year.

A department store salesperson, average age 34.4, makes ¥232,000 ($2,210) with a yearly bonus of ¥642,000 ($6,100). A salesperson (excluding department store salespersons) earns, average age 37.0, earns ¥218,000 ($2,070) with a yearly bonus of ¥343,000 ($3,260). A cook, average age 39.2, makes ¥300,000 ($28,500) with a yearly bonus of ¥476,000 ($4,530).

There is interesting information in another set of statistics entitled "Actual Conditions of Wages in Private Enterprises" released by the Bureau of Remuneration and Employment Environment, the National Personnel Authority. A tele-

32. July, 23, 2004, the *Nikkei Solution Business*, Tokyo: Nikkei BP, 2004.

phone operator, average age 42.1, earns ¥299,961 ($2,850, ¥105/$1) per month. A carpenter, average age 40.3, ¥301,203 ($2870).

Despite too many doctors and dentists, a hospital superintendent, average age 60.8, makes ¥1,515,570 ($14,4340). In this survey a doctor, average age 38.7, makes ¥900,528 ($85,760). A dentist, average age 38.4, makes ¥785,676($74,820). A college professor, average age 56.5, makes ¥722465 ($68,880). A captain of an ocean-going ship, average age 51.6, makes ¥1,056,448 ($100,614).

Not Much Consumption Anticipated? Yes and No…

First, let us consider the consumer price index. It just happens that because of deflation, the movement of the index is unimpressive. With the consumer price index of 2000 set as 100, it is 99.3 in 2001, 98.4 in 2002, and 98.1 in 2003. The 2004 and 2005 indexes were on the same level as prior years. This indicates negative growth, although in the early part of 2006, the index showed a slight increase.

Yes

The fact that there is a general decline of personal income is the basis for contentions that any drastic increase in consumption cannot be expected. Therefore, the current resurgence of the Japanese economy owes a great deal to brisk exports and the bullish stock market spurred on by growing foreign investments. I admit that this is true…to some extent; but this argument assumes that consumers do not spend out of their savings. The fact of the matter is that they have a lot of money stashed away. It depends on how you stimulate their desire to spend.

No

Japanese consumer behavior is quite enigmatic; some areas are noted for brisk consumption: for example, designer goods and new electronic products such as flat panel TVs and DVD recorders.

That many Japanese women, regardless of social status and income level, continue to shop designer brands is a fact well known among apparel makers. How can young working women and wives afford such goods? They save and buy one item at the twice-a-year bonus time. Sometimes, parents buy designer brands for their children. Despite hard times, certain European (mostly Italian) and American brands enjoy good sales.

Retail Revolution

Name-brand outlet stores are sprouting up all over Japan. Gotemba Premium Outlets nearby the foot of Mt. Fuji is one.

A few years ago, at the site of an old amusement park, this outlet center was built under the management of an American company. In the beginning, some 75 stores handled name brands such as Bally, Brooks Bros., Coach, Benetton, Marina Rinaldi, and Timberland. For months, especially on weekends, people showed up out of nowhere, by the droves, and went on shopping sprees. The American marketing manager there described it as "crazy shopping." Were these the same people who were supposedly half-broke because of the recession?!

Management added facilities to accommodate 75 more shops including Paul Smith, Hawkins, Eddie Bauer, Gucci, Armani, A. Testoni, Salvatore Ferragamo, Lanvin and Bruno Mali. With 150 shops and restaurants, the Gotemba Premium Outlets now stands as Japan's largest shopping mall — another, bigger mall is already under construction elsewhere, aiming to take its place.

Some years back, Louis Vuitton opened a store at Tokyo's Omote-sando. Some people waited in line all night. More than 1,500 supposedly price-conscious, wise consumers, both men and women, shopped there on the opening day. Louis Vuitton Japan reported sales of some $1.5 million on its first day. Today, Omote-sando bulges with designer shops (not outlets) like Loewe, Donna Karan, Celine, Fendi, and Dior. Nearby, at Aoyama-dori, Prada has a beautiful glass building. Countess Mara also operates a store nearby.

Louis Vuitton considers Japanese purchase patterns as something independent from the state of the economy, when it comes to the purchasing of name brands. Contrary to the popular notion of not buying anything expensive, the "lost generation" made sure that sales of Louis Vuitton's high-priced dresses and bags, with 47 stores all over Japan, jumped four-fold — to the tune of ¥150 billion ($1.27 billion) per year.

In May, 2004, Louis Vuitton's chairman came from France and said, "We have a regular clientele, and they buy Japanese merchandise, again and again. Herein lies Japan's sales strength. During recession, Japanese consumers buy fewer items but never cease to buy. I think that Japan is out of recession now…."

Because of recession, it is now affordable to set up shops at Tokyo's famed Ginza. Hermes, with its golden building, and Cartier operate shops there. Nearby, you'll find Ferragamo, Prada, Channel, and Gucci. Better still, Dior bought a building where there was a well-known bookstore. Dior can afford it, because its Japanese 2003 sales reached some ¥20 billion ($181.8 million).

Underlying this craze for designer apparel are two noticeable changes that took place in the 1990s. Young Japanese men and women began dying their hair in the second half of the 1990s. Today, you find many blond-haired or brown-haired men and women.

The other change which has been conspicuous since the 1980s is that Japanese men and women are taller, with longer inseams. Young and middle-aged men and women have longer legs, to speak nothing of well-proportioned young girls. Most of their faces are no longer moon-shaped but smaller. These two factors contribute to their looking well in Italian or French fashion. And for girls who are short, there are still many products of French or Japanese fashion that cater to them.

What caused these changes? Obviously a change in diet and living style. The Japanese used to eat a lot of rice, about 120 kg per year per person. This is now down to 62 kg per year per person, replaced by more bread, noodles, and pasta. As a result, restaurant portions are small (some people say that when they eat at a French restaurant, they have to eat a sandwich or a bowl of Japanese noodles in advance!).

Most children and young people today have their own rooms and sleep in the same kind of beds Westerners use. This may also encourage the growth of longer, straighter legs. Houses are now built with wooden floors and usually have only one tatami room.

Underground Economy

Let us not forget the existence of the underground economy. Takashi Kadokura, a research economist for a major bank, has been focusing on this subject. According to his *White Paper on Japan's Underground Economy* (Nihon Chika Keizai Hakusho)[33] published in 2002, he estimates the scale of the underground economy to be in the neighborhood of ¥23.2 trillion ($211 billion, ¥110/$1).

Judging from the fact that bar girls, wives and girlfriends of politicians and wealthy businessmen are a part of the regular clientele of designer dresses and accessories, the role of the underground economy cannot be ignored in shoring up retail business.

Some teenagers sell sex for money, and Kadokura estimates their tax-free income at ¥63 billion ($572.7 million). Now, there were 1,270 registered Soapland houses as of the end of 2002. (This institution used to be called Turkish bath houses, but over the protest of a Turkish man it changed its name to Soapland, because of the abundant use of soap used in taking a bath with girls.)

When major league baseball players and other American athletes come to Japan, some head straight for these places. Kadokura estimates a tax-free income of ¥700 billion ($6.36 billion) in the Soapland business, because the women get tips from their customers in the amount of $100 to $500, depending on the class of a house.

Tax evasion cannot be effectively prevented. At least ¥3 trillion ($27.3 billion) is estimated. A gesture of thanks for helping someone out may amount to something in the range of $1000, just to relieve any ongoing sense of indebtedness. That kind of money usually disappears in no time, especially if a couple of people head out to a posh night club in the Ginza. An acquaintance of mine

33. Kadokura, Takashi, *Japan's Underground Economy* (Nihon no Chika Kerizai), Tokyo: Kodansha, 2002.

once gave another friend a tip on horse racing. He won about ¥1 million ($10,000), which made me think that whoever gave him the tip might very well have been mob-related. Since he asked my opinion, I told him to give that man one quarter of his winnings; he did, and that other person was happy, and my friend was especially happy to be sure that he didn't owe the other fellow anything after that.

This sort of payment is very often carried out among politicians for favors granted. And what about the racketeers? Kadokura's estimate is ¥2 trillion ($181.8 billion). His estimate of the scale of the underground economy totaling ¥23.2 trillion seems conservative. And all that money is circulating, serving as a lubricant, to some extent, to relax the tight money situation.

Some legal way must be found to enable business-types to legally thank their customers or politicians. This is especially needed for the construction industry, where huge amounts are spent for kickbacks. The construction industry employed some 6.04 million people in 2003 out of the total workforce of 63.16 million in Japan; total construction spending in 2003 was ¥54 trillion ($514 billion, ¥105/$1).

As it is now, these politicians clamor for more spending for public works, road construction projects, and railroad construction works depending on who is working on them; they are supposed to declare contributions in the accounting reports but there are many ways to lose all trace of such funds.

Former Prime Minister R. Hashimoto once was given a check in the amount of ¥100 million (a little under $1 million), in the presence of two key members of the ruling party. He put it into the inside pocket of his jacket. They decided not to declare it as a political contribution, because the amount was too conspicuous. But it came out in the open later. When queried, Hashimoto replied, "I don't remember." What sums does he handle every day, if he could forget a check like that!

Conveniently, there is one title in the ledger of the accounting system that allows a certain amount of leeway. It is called "Expenditure Unaccounted For" (shito fumei kin). This is accepted, but the amount is taxed — some 50% or more — which is tantamount to a penalty.

For example, suppose a $200 million project entails 3% of that (or $6 million) to be kicked back. If this $6 million is recorded under the title of "Expenditures Unaccounted for" the tax is paid, then it is legal. Of course, the details of such cases are highly confidential. This kind of transaction is probably not included in Kadokura's estimate of ¥23.2 trillion for the underground economy, because they are simply beyond estimation.

Despite all the discussions and proposals for tax code revision, no one has touched this provision.

Discount Stores

Another factor to consider with regard to the current retail revolution is the birth of many nationwide discount store chains. Drug stores, nationwide as well as regional chains, carry everything from commodities including instant noodles and coffee, children's clothes, socks, stockings, watches, stationery, to pots and pans.

The situation here is becoming more and more like that of the United States, even in terms of home improvement centers of nationwide chains that operate in the style of Home Depot. The difference is that Japanese chain stores handle almost anything except perishable food — you can buy over-the-counter drugs, clothes, dog food, cat food, home furnishings, TVs, appliances, motor oil, bicycles, and the like, all at discount, and they handle more electric, electronic, TV/appliances, camera and other related products.

Yamada Denki, noted for efficient management, is the No. 1 home electronic/TV/appliance sales company, boasting FY2004 sales exceeding ¥1 trillion ($9.5 billion) in 200 stores, with a total floor space of 606,000 square meters (size of many football stadiums). Every year, Yamada has been growing, with a yearly sales increase of some $1 billion. It is no wonder many small discount stores have gone under.

Yamada's success is echoed by that of two other mass discount home electronics chains — Yodobashi Camera and Bic Camera. On top of these, a host of regional chain stores handle TVs and appliances at discounts.

These huge discount stores capture 60% of the sales of electronic/electrical/information/TV/appliances (that amounts to ¥5.5 trillion per year or $44.78 billion, ¥115/$1). Furthermore, when a new such center opens, it has ripple effects. When Yodobashi Camera opened its huge shopping center in Akihabara in October, 2005, the land prices in that neighborhood doubled from ¥5 million ($43,500, ¥115/$1) per tsubo (3.954 sq. yds) to ¥10 million. More and more consumers are visiting the area with their families.

Traditional System on the Way out

The Japanese lifetime employment system excels in providing a sense of security for the employees of a company — since they are not subject to outright dismissal. So long as they come to work on time and do their work — even if there isn't any, as is often the case with local government offices — they won't get fired. After 30 years of work, they get approximately ¥30 million (or a little short of $300,000) in cash as a retirement allowance (some wives divorce their husbands at this time because they have money). In terms of human resources, this helps keep highly capable executives, engineers and technical staff in the company regardless of the negative influence of those incompetent workers.

However, what is not known abroad and well-known in Japan is that the system breeds incompetent people inside the organization. Those staying long, however incompetent they are, have some say in matters of vital importance to the growth of the company. This is due mostly to Japan's traditional culture that sets store by age and experience.

One top executive of a medium-sized company once mentioned that some 30% of the employees of a Japanese company were people not really needed, and the remaining 70% were split between those whose function was sometimes, but not always, needed and those precious few whose expertise, experience and capability were sorely needed.

Naturally, the top management has devised ways to modify such system by appointing those incompetent middle executives with at least 10 or 15 years of service to positions with big titles but lacking power, with no one reporting to them. Outsiders would be dazzled by such titles as Specialized Manager or Professional Manager of the Department, titles which help retain an employee's image to his friends, clients, and, above all, to his wife.

I remember a case of a major manufacturer where, whenever I paid a business call to one of my clients, I met with the section manager in charge, but another senior-looking gentleman always attended the meeting. The name card the older man gave me said his title was "Professional Manager." He did not have much to say, because he had no one reporting to him. So I asked a girl working in the same section, "Who's that schmuck? He always says the wrong thing at the wrong time." "Oh, him? He's got the title, but that's a temporary title that remains temporary. He's due to retire in a few years."

Another way to bring fresh air into an organization is the frequent transfer, every one or two years, of section and department heads. I often observed this phenomenon in the 1970s when I worked with Nippon Steel in connection with its plan to set up a nuclear quality assurance program for heavy plates. Key engineers on one assignment were transferred to other jobs in other places once their current assignment was over.

What happened to an acquaintance of mine gives some interesting insight into how the corporate mind works. This man was working for a big company in the 1960s, and did not get along with his department head. If his situation had occurred in the United States, looking for a job with another outfit would solve his problem. But, in Japan, this was hard to do so in those days. A few months went by, and one morning, when he went to work, someone whispered to him that the department head was due to transfer to the New York Office. That saved the day. Soon he was promoted and became a supervisor.

But, as they say, good things never last long. His section head didn't like him (actually no one liked the section head), although he thought the section head was a standup guy. There were some awkward moments, so the supervisor (my acquaintance, that is) dropped by a Judicial Scribner's office on his way to work, had a letter of resignation written, and turned it in. The letter reached the

Vice President; he read the supervisor's employment record, because he would have to stamp his approval on the request for resignation. When his attention came to the column on reference(s), his eyes stopped. Oh, My Goodness! The reference turned out to be a major figure in mass media. "Can't let him go," thought the VP.

His secretary came down and told the supervisor that the VP wanted to see him right away. When a call comes from "upstairs," everybody in any company, in any country, knows it is either good news or bad news. So, the supervisor went up to the fourth floor, and the VP greeted him jovially — a rare phenomenon, because this man always looked serious, as if he carried burden of the entire company upon his shoulders.

It turned out that the VP owed one to the big shot who was the supervisor's reference so that the VP could not let him go: "How could I explain to him that the man he recommended wanted to quit? I would lose face." So the VP arranged the man's transfer to another section, one specifically set up for those like the supervisor who needed time to move to another position.

How Are They Rewarded?

Westerners often question how the Japanese system works to reward those who do outstanding work. There certainly are many ways. If you and your team are working on an important project, you get enough manpower and funding. When you walk around, everybody knows that you are on a key project, so they are respectful.

There are in-house gossips galore. (If you know that you won't get fired, you gossip about your superiors, immediate and otherwise.) So gossip would float around about how nice you behave despite your elevated status, about how slow someone in the other section works, about whether one manager is having an affair with somebody in another section, and so forth.

At Sharp which is one of the world's leading LCD manufacturers, if you are a member of a special team on a special assignment, you wear a badge so that anyone can easily identify you as one of the elite engineers participating in a top-secret project. Naturally, even if you join the company at the same time your friend did, and if your friend is a better worker in the eyes of his superior, he will get more pay than you.

I remember years ago when Kawasaki Steel was around, before the merger, a supervisor who was obviously incompetent worked there. Later, I found out (through gossiping) that his annual income from the company was about ¥500,000 (approx. $5,000) less than his associates were getting. Apparently, one time, while he was having a drink with his friends after work, he complained about this difference in salary, and the word got around.

Another route for sidelining you if you are an incompetent employee is that you may make the section head called "kacho," but that's as far up as you can go.

You retire at age 60 as the section chief. And if you happened to be a good worker, your company could arrange a job after retirement. This custom is changing quickly now. Before you reach 50, companies often will make arrangements to ship you off to one of their subsidiaries where the chances are good that you'll make less money than you did at the parent company. It is not uncommon for a man making about ¥10 million or $100,000 a year at age 50 to be asked to step down as general manager and accept a transfer to a post at a subsidiary, where he will make ¥6 million or $60,000 or so.

Now Workers Being Fired and They Are Switching Jobs

Can you imagine these big companies and manufacturers once noted for life-time employment are now firing employees? Take, for example, Matsushita Electric, long known for taking good care of workers. In 2002, they fired 13,000 people through early retirement plans and other persuasive means aimed at easing employees out. Sony is in a class by itself; they're different from other manufacturers because their operations are global with a host of work in other fields. In the winter of 2002, Sony's charismatic chairman Nobuyuki Idei ("e-day") described their situation as "something like dousing a fire with water by passing buckets of water from one person to another." Someone in that industry remarked, "Even Sony is passing buckets of water to douse a fire, so it's no wonder we are at the mercy of a raging fire."

The tables below indicate that 2001 was marked by wholesale firing:

Table 10-3 Restructuring steps by major electric/electronic/ information companies

	Number of Employees Dismissed
Fujitsu	21,000 workers dismissed from the group in FY2001. Retreat from overseas production of semiconductors
Hitachi	16,350 workers dismissed from the group in FY2001. Retreated from making PC Braun tube.
Toshiba	17,000 workers dismissed from the group. Retreated from making general DRAM.
NEC	Some 9,200 workers dismissed from the group in FY2001.
Sony	No workers dismissed yet but cutback of costs of materials and supplies by 5 to 15% in FY2001

Source: January 11, 2002, Nihon Keizai Shimbun

Table 10-4 Management Index of Panasonic, Sony and Hitachi
(Term ended March 2001, on consolidated basis, ▲ negative) (¥120/$1)

	Matsushita Electric	Sony	Hitachi
Sales	¥7,681.5 billion ($64,013 million)	¥7,314.8 billion ($60,957 million)	¥8,416.9 billion ($70,141 million)
Pre-tax Profit	¥100.7 billion ($839.17 million)	¡¡ ($2,215 million)	¥323.6 billion ($2,697 million)
Ratio of Overseas Sales	47.5%	67.2%	31.2
Return on Equity	1.4%	5.5%	▲ 2.3%
Number of Subsidiaries	320	1,078	1,069
Number of Employees	292,700	181,800	323,897
Number of Shareholders	145,698	687,403	295,287
Aggregate Market Value of Stock	¥3,743. 2 billion ($31.183 billion)	¥6,044.0 billion ($50.367 billion)	¥3,174.3 billion ($26,453 billion)

Source: January 11, 2002, Nihon Keizai Shimbun
Note: 1. In compliance with the US Accounting Standards (SEC)
2. ROE is an average of prior three periods.
3. The number of shareholders is as of September 2001.
4. The aggregate market value of stock calculated from the closing price of January 10, 2002
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From the standpoint of young college graduates, many surveys indicate that they expect to switch jobs two or three times in the course of their careers. This is certainly something you never would have expected to hear back in the 1960s and 1970s.

Furthermore, many corporations and manufacturers are staying away from hiring on a regular basis. Temporary help is now in the main stream of Japan's labor force. Of some 50 million employed workers, over 15 million workers are part-time employees, temporary workers sent by temporary employment agencies, and other workers than regular, full-time workers.

In 2001, those working less than 35 hours a week numbered about 11 million, a 1.5 times increase from ten years earlier. This came to about 12.5 million in 2004. About one-third of total employees in service trade including wholesale, retail, and restaurants/fast food outlets are part-time workers. Their wages are low — 51 to 66% of the wages of full-time workers.

Overseas Production

In addition to curtailing overhead and labor, other methods include insisting that vendors cut costs of goods and services, as well as moving manufacturing overseas. The overseas production ratio of the manufacturing industry reached 23% in FY2000, according to a survey by the International Bank of

Cooperation. This marks a 21.1% increase over the year in FY2000, and the number was expected to reach 30% in FY2004.

Since China with its population exceeding 1.3 billion as of 2004 has a potentially growing domestic market, production in China shows a large increase. Japanese production bases outnumbered the United States for the first time in FY2000, occupying some 20% of the production bases.

Inexpensive production in China is not the only factor. Through direct investments from abroad, China has made a considerable improvement in technical levels, and some products made in China include high value-added products.

Overseas production by Japanese manufacturers began picking up in the 1990s. Particularly since 1995 when the exchange rate of $1 exceeded ¥80, the exodus gained momentum. In 1998, marked by the Asian currency crisis, the ratio dropped for a while but eventually resumed an upward trend. However, according to the January 13, 2002, issue of the *Nihon Keizai Shimbun*, the Japanese ratio of overseas production is not as much as that of the United States, which was 48.6% in 1997.

Steelmakers

NKK and Kawasaki Steel used to be Japan's No. 2 and No. 3 blast furnace steelmakers. Hard hit by slow business, they merged to form JFE Holdings whose steel production is now on a par with Nippon Steel, Japan's No. 1 and the world's No. 2 steelmaker. Furthermore, JFE's engineering division leads other steelmakers. (Its liabilities with interest, nonetheless, remained over ¥2 trillion or some $18.1 billion, exceeding Nippon Steel's ¥1.6 trillion or approx. $14.5 billion in 2003.)

Camera Manufacturers

A most surprising merger brought together two camera manufacturers: Konica and Minolta. On August 5, 2003, they officially became Konica Minolta Holdings. This event marked the first time two major companies merged.

Looking back on the history of mergers, we see that a camera maker Yashica absorbed and merged with Kyocera in 1883. In 2000, a copier manufacturer Mita Industry joined with Kyocera and formed Kyocera Mita as Kyocera's subsidiary.

Konica's consolidated balance sheet as of March 31, 2003 showed sales of ¥559 billion ($5.08 billion, ¥110 to the dollar) with an operating profit of ¥42.8 billion ($389 million) and net profits of ¥16.3 billion ($148 million). Minolta had sales of $528.1 billion ($4.80 billion) with an operating profit of ¥34.3 billion ($322.8 million) and net profits of ¥12.6 billion ($114.5 million). So the merger of these two going concerns in good standing meant the birth of a ¥1 trillion corporation, a profitable enterprise with its ratio of operating profit to sales exceeding 7%.

Digitalization and Networking

What precipitated the merger where Konica absorbed Minolta reflects a recent trend of digitalization and networking of office automation equipment, cell phones, and PCs using the Internet. Konica makes photographic films while Minolta is well-known for its high-grade cameras. However, as digital cameras dominate the photo industry, demands for conventional film products and cameras have hit a snag. Even non-camera manufacturers such as Sony and Panasonic make very good digital cameras.

While Canon moves ahead in high-tech copiers and printers, Ricoh offers fax machines and digitalized copiers. Fuji Photo Film has made up for a drop in conventional film sales by promoting its highly popular line of digital cameras. Olympus is also quite successful in the digital camera arena. One answer for Konica Minolta Holdings is to consolidate their spending and beef up their R & D for high-tech printers and copiers, products packed so full of high-performance semiconductors that they are not that far removed from being classified as computer-related equipment.

Pharmaceutical Manufacturers

Not long ago, No. 3 pharmaceutical manufacturer Yamanouchi announced that they were discussing a possible merger in the near future with No. 5 pharmaceutical manufacturer Fujisawa. The combined sales of the two amounted to ¥888.6 billion ($7,405 billion, ¥120 /$1) at the period ending March 31, 2003, and this would place the combined two firms at No. 2 in the industry, following No. 1 Takeda Pharmaceutical Co., Ltd. whose sales exceeded ¥1 trillion($8.33 billion).

Their merger, realized in 2005, was a necessary step in expanding their scale to compete with giant overseas pharmaceutical makers such as Pfizer, with its sales of over $3 billion. Now that the market share of foreign pharmaceutical companies operating in Japan is close to 40%, No.2 Sankyo is working out plans to merge with Daiichi Pharmaceutical Company to beef up their sales.

Today, China, the largest consumer marketplace on the planet, is attracting worldwide attention. The Japanese manufacturing industry has long sought the world markets including China as a way of disposing of its excess production capacity. Since Japan's culture has been related to the 5,000-year-old Chinese culture since 2,000 years ago, certainly there have been many opportunities for exchanges of people and business between us. Now, Japanese investments in China have gained momentum over the past 20 years. China needs Japan's products, know-how and technology, as well as its knowledge of distribution setup and other aspects of business structure. And we need their market to supply our materials and products.

This market is now helping Japan climb out of recession. The growth rate of the Chinese economy was 9.1% in 2003, and 9.5% in 2004. Such high growth calls for more production of cars, TVs and home appliances, as well as raw materials including steel. Demands for component parts such as plastics and semiconductors are also sharply increasing.

On January 26, 2005, the MOF announced that Japan's exports to China including Hong Kong reached ¥22.2 trillion ($211.43 billion, ¥105/$1), up 17% over the prior year. This indicates Japan's exports to China exceeding Japan's exports to the United States by ¥1.7 trillion ($16.2 billion).

This export boom is benefiting Japanese ocean transportation trade which had been plagued by deficit operation due to a drop in the shipping business during the depression. I was talking to an old friend of mine in the steel trade, and he told me that China's voracious appetite for steel to expand its domestic economy is even affecting ocean-going freight rates. A ton of slab for shipping from Brazil to China used to cost $7 FOB, but now the price has jumped to $35. So Japan's maritime shipping industry is benefiting as well, since ocean cargo business is not China's forte. Another factor is that China shuns the use of Taiwan's huge fleet of cargo ships.

Nippon Yusen, a member of the Mitsubishi Group, has been Japan's No. 1 shipping company with a century-old tradition. Record sales (¥1.606 trillion or $14.6 billion) were racked up in the period ending March 31, 2005. President K. Miyahara said in December, 2004: "All areas of container ships, iron ore/coal bulk carriers, and tankers registered considerable increases in earnings. Spurred by the Chinese and the US economy, movements of both materials and finished goods are very brisk. It's like tens of belt conveyors laid out across the Pacific Ocean between the United States and China, and we are on that flow."

He added, "Particularly, China whose economy expanded with an explosive force has played an enormous role... It is our judgment that the stable growth of Chinese economy will continue...."

According to the February 17, 2004, issue of the *Weekly Economist*, producer's goods account for 70% of Japan's exports to China. In 2003, exports of electronic parts including semiconductors for local production increased by 36.0% over the previous year; steel exports increased by 17.5%; and exports of chemical products rose by 23.5%.

Currently, a number of public works projects are underway in China, and with the upcoming 2008 Olympics in Peking, even more are in the planning stage. Consequently, exports of construction machinery such as hydraulic shovels increased by 83.9%, and exports of all types of machine tools grew by 27.2%. The Japanese materials industries, steel, chemical and shipping, are booming to meet the ever-expanding demands of the Chinese market. Japan's maritime shipping has been busy transporting raw materials, semi-finished products, and ready-to-sell items to and from China.

The Chinese market flourishes around the areas of Peking, Shanghai, and the coastal regions near Hong Kong, with a population of over 400 million. Other inland areas, much to their chagrin, remain out of the current boom. As a center of consumption, China has also attracted the attention of the Japanese auto and electric/electronic/appliance industries. In 2003, Japanese exports of auto parts to China doubled, and the number of cars exported increased by 57.9%. This percentage-jump reflects increasing auto sales not only for companies, but for average consumers, as well.

The Chinese love to talk, probably even more so than the Japanese, and the end of 2003 saw the number of cell-phone contracts zoom to 269 million or a saturation rate of 20.5%. By 2004, industry-watchers expected this number to surpass 300 million. In the auto world, Honda is spending some $200 million to build a plant in China, set to be operational in 2006. By 2006, then, the capacity of the top three Japanese automakers in China will exceed 1 million cars.

Because of the increases in steel exports to China and other Asian countries, Japanese steelmakers succeeded in getting price hikes, and this shows in the improved earnings of Japan's top four steelmakers for the period ending March 31, 2005. Each is reporting a record consolidated current profit: ¥400 billion ($3.81 billion, ¥105/$1), up 83% over the prior period, for JFE Holding, ¥320 billion ($3.05 billion), up 85%, for Nippon Steel, ¥120 billion ($1.143 billion), up 75%, for Sumitomo Metal, and ¥100 million ($952.4 million), double from the prior period, for Kobe Steel.

In terms of steel prices, a ton of hot rolled sheet for cars was about ¥40,000 ($380, ¥105/$1) in January, 2004, but doubled to about ¥80,000 ($760) in 12 months. No wonder steelmakers are reporting profits.

On the other hand, just a while ago, at the period ending March 31, 2002, the combined current profit of these four steelmakers saw a loss of ¥16.3 billion ($135.8 million, ¥120/$1). Steel demand from China is certainly responsible for the current profits.

Crude steel production in the world was about 700 million tons per year from 1970 to 1999. The number ramped up to the 800 million-ton level in 2000, reflecting the high growth of the Chinese market, and further climbed to the 900 million-ton level. This rate exceeded the 1 billion-ton level in 2004.

Such brisk demand for steel has its drawbacks, for example, a worldwide shortage of steel materials. Many steelmakers curtailed their production over the past few years because of recession, and it takes a few years before their expanded facilities go into operation. For instance, Nissan announced that the steel shortage was affecting its production schedule, so that production of some 60,000 cars would be delayed until March, 2005. Suzuki has also reviewed its production schedule as a result of the shortage.

Chapter 11. Adequate Government Action and the Stock Market

After all these months of intensive investigations of financial institutions, a glimmer of light seems to be making its way in. The cost of change has been high, with suicides of many of those involved in the industry. (32,000 people committed suicide in 2003, part of a 4-year record average of 30,000 suicides per year.) In addition, business and industry have undergone painful restructuring efforts, not to mention the woes and tribulations of small and medium-sized companies subjected to the credit crunch.

Fewer and Fewer Bad Loans

Bad loans are finally going down. The determined efforts of the Koizumi administration amid the cries of "Fire That Bloody Minister Takenaka," as well as the endeavors of these banks to reduce bad loans, seem to be working, regardless of what many economists complain about from their text-book soap-boxes.

On August 3, 2003, the Financial Services Agency reported that bad loans of major commercial, trust, and regional banks as of March 31, 2003, dropped by 18% from the previous term to a total of ¥35 trillion 300 billion ($162.67 billion, ¥217/$1). This is one of the many things previous administrations failed to accomplish. In addition, several promising events boosting the Japanese economy have taken place since 2003.

The total bad loans held by all banks as of September 30, 2003 crossed down the ¥30 trillion mark to ¥28 trillion 330 billion ($236,08 billion, ¥120/$1), for the first time in three and a half years.

On January 21, 2005, the Financial Services Agency reported that the total bad loans held by the 127 banks in Japan as of September 30, 2004 diminished to ¥23 trillion 791 billion ($226.6 billion, ¥105/$1), a drop of ¥2.803 billion ($26.7

billion) from March 31, 2004. This represents about half of the peak amount of some ¥43.2 trillion ($36 billion, ¥120/$1) as of March 31, 2002. Clearing bad loans on the part of financial institutions is proceeding at a faster rate than expected, ever since they had realized that Minister Takenaka meant business by playing hard ball. Further, I think that Japan should also express its appreciation for Lawrence Summers' insistence on shaving off bad loans as described in Chapter 6.

Significance of the China Trade

It was reported that the bad loans of Japan's four mega banks sharply decreased, as illustrated below.

It is stunning, isn't it? This downward trend of bad loans held by the banks caused the Financial Services Agency to conclude that the special inspection of major banks was not needed for the account statement at the March 2005 term. (This was supposed to be carried out once a year since the March 2002 term.) The ratio of bad loans held by the banks peaked at 8.4% at the March 2002 term and dropped to as low as 4.6% at the September 2004 term. Since it was apparent that the target of halving the ratio of bad loans (4.0 — 4.5%) at the end of March 31, 2005, would be accomplished, it was thus decided to let the banks to liquidate the remainder of bad loans.

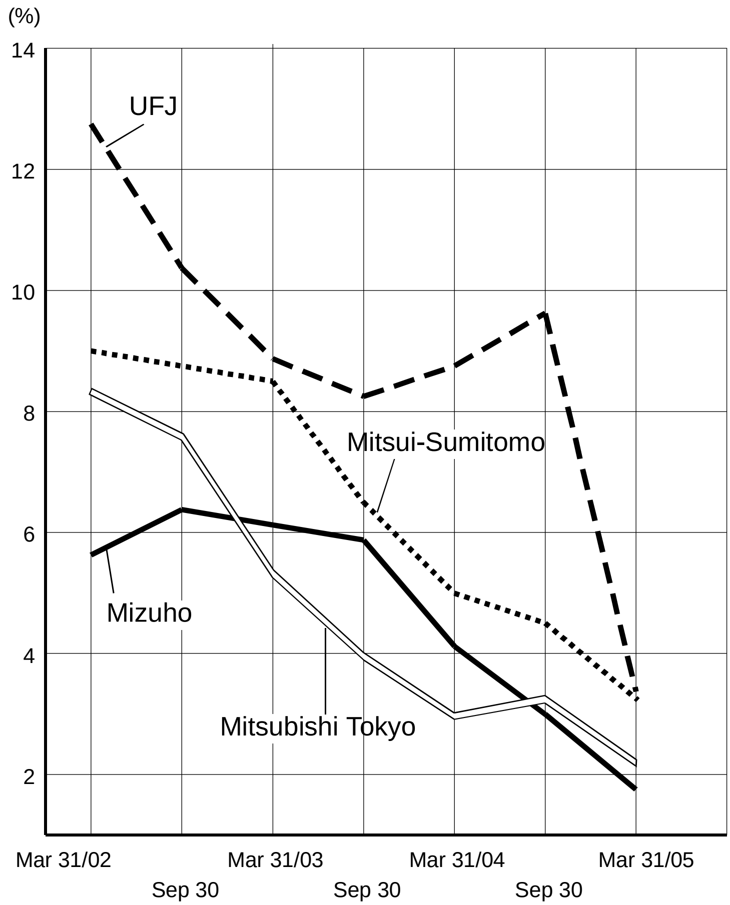
The Financial Services Agency announced on July 29, 2005 that the total balance of bad loans of all financial institutions in the private sector amounted to ¥24.9 trillion ($226.36 billion, ¥110/$1), a decrease of 28% from prior year. The ratio of bad loans registered 2.9% in mega banks, and 5.5% in regional and second regional banks, respectively showing decreases from prior year. The goal of the Financial Services Agency was to halve this ratio of bad loans at mega banks at the March 2005 term from the 8% level, and it was met.[34]

Now, before we look at what's happening, we should recall a government measure that paved the way for such reduction of the bad loan levels in Japan. The Takenaka's Scheme (Financial Reconstruction Program), officially announced November 29, 2002, stipulated that the ratio of bad loans to the total loans extended by major banks should be halved by the end of March, 2005. Unlike Minister H. Yanagisawa (Takenaka's predecessor, who was dismissed), Minister Takenaka, backed by Prime Minister, meant business this time. Japan's four mega banks have been in full swing to meet the deadline on that requirement.

David Atkinson of Goldman Sachs Japan estimated that under certain conditions, if operating profits were to be used to write off these bad loans, it would take eight years (see Chapter 7). By 2005, it was clear that this was a quite accurate prediction.

34. July 30, 2005, *Nihon Keizai Shimbun*, 4.

Figure 11-1 Ratio of Bad Loans at Four Mega Banks



Source: April 26, 2005, Nihon Keizai Shimbun
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BOJ Governor Retired

BOJ Governor Masaru Hayami's term expired on March 19, 2003. Many greeted this event with glee because of Hayami's poor performance in the last five years, more specifically because of his indecisive, "too little, too late" approach. In February, 2002, when easy money was much needed, he kept a tight rein on money. Minister Takenaka said publicly that money would be abundantly made available until the current minus level was brought up to zero inflation (to use Roger Bootle's term).

Hayami notoriously remarked, "You can take a horse to water, but you can't make him drink," despite the fact that the horse he was alluding to, Japan's business and industry, was very thirsty and would surely have been willing to drink deeply. Under his leadership, BOJ continued to err. For example, in 1999, he released the zero interest rate on grounds that the economy "was on the road to recovery." The economy was in no way recovering, and releasing the zero interest rate yanked the emergency brake.

BOJ was never good at taking steps in advance. When the economy started plummeting again, BOJ hastily restored the zero interest rate, but that measure had nipped the recovery in the bud.

Finally, due to government pressure, Hayami took on an easy money policy in August, 2001, but it was too late. BOJ has always been afraid of inflation. In September, 2001, he advised Prime Minister Koizumi that "if we eased the money supply, we would have a hyper-inflation!"

The BOJ governorship receives an annual stipend of ¥36 million ($300,00 to $360,00 depending on the exchange rate, subject to over 50% income and resident taxes), twice as much as Feds Chairman Greenspan receives. What is aggravating is that no one can fire him. The highest decision-making body at the BOJ is the Policy Making Committee, and because of the new BOJ law, no representative from the MOF or the Prime Minister's Office can participate in voting. There also remains the fact that the Prime Minister has the right to appoint the BOJ Governor but has no right to fire him/her.

The New Governor of the Bank of Japan is Toshihiko Fukui, a 1958 graduate of the Law Department of the University of Tokyo. Fukui represents the mainstream, financially conservative faction of the BOJ. In that sense, many took a premature notion that little could be expected from him as governor to produce any tangible change in the framework of financial policy. As a result, the dollar was sold by some hedge funds of the United States, funds which had been selling the yen and buying the dollar in line with their reading of the exchange market. This caused the yen to become cheaper and the dollar to get stronger.

The news of Fukui taking over made those hedge funds switch to selling the dollar so that the rate of ¥118/$1 moved up, at one time to the ¥116 /$1 level.

What about the Deputy Governors? The BOJ has two. The MOF succeeded in sending its former undersecretary T. Mutoh to the post of Deputy Governor. It is a ministry long known for farsightedness on personnel matters, and Mutoh was installed with an eye to the future, positioned, most probably, to become the next BOJ Governor after Fukui's five-year term expires. Mutoh's role is that of managing government bonds approaching some ¥450 trillion ($3.75 trillion) which is close to Japan's GDP. This man is also known for taking a negative view toward the BOJ's purchase of external bonds.

The overall impression is that Fukui was an "acceptable" choice in spite of the fact that Fukui has been dead-set against inflationary measures, a step many consider key to countering the current deflation. I remember reading one of his articles in 2002, while he was serving as the Executive Director of the Fujitsu Research Institute. He minced no words when he indicated his opposition to inflationary measures as a way to correct the current deflation. Later, at a Lower House Finance Committee meeting on March 18, 2003, he reiterated a similar, cautious view that the use of the inflationary target, although a helpful tool for the BOJ, offered no clear-cut ripple effects.

On the other hand, another Vice-Governor K. Iwata, Cabinet Policy Making Coordinator and faculty member at the University of Tokyo, strongly indicated that he was in favor of adopting the inflationary target and working out plans accordingly. Hence, the new BOJ Governor Fukui, being part of the main faction of the BOJ, was accepted as one of those diehard conservative BOJ types.

These misgivings notwithstanding, Fukui's performance is best described as highly efficient. He's clearly seeking ways to revamp the financial policy, something his predecessor, who liked to take an independent position from the government, grossly lacked. Fukui is aware that funds are not necessarily flowing straight to where business is actually being carried out, as he mentioned to US Treasury Secretary John W. Snow at the G7 Conference. It was reported that some people were afraid that if he ushered in needed measures too quickly, Fukui might get bogged down, since not many options were left for him. When a man is in critical condition, the doctor does not stick to one medicine but tries all sorts of treatment. This is what is needed, and this is what Fukui is doing much to the joy of mass media, since this approach gives them a lot to comment on.

Be that as it may, on March 25, 2003, only five days after taking office, BOJ Governor Fukui called an extraordinary meeting, its purpose being to lay out financial policy, and this would be held prior to the regularly-scheduled meeting of the Policy Making Committee. Fukui, then, would be the first governor after the new Bank of Japan Law took effect in April, 1998, and this would be the first meeting.

In view of the uncertain international situation brought on by the War in Iraq, at this meeting members determined to supply even more ample funds to the market. In September, 2002, BOJ decided to purchase shares of stocks held by the banks, and a total of ¥1.323 trillion (about $11 billion) was expended. This decision increased the current upper limit of ¥2 trillion ($16,6 billion) by ¥1 trillion to ¥3 trillion.

The group made another noteworthy decision on July 22, 2003 — the BOJ would purchase asset-backed securities as a means of eliminating clogged-up channels of funding. In other words...purchasing private assets to supply funds for the private sector.

On July 23, Fukui presented a lecture in Tokyo. At a post-lecture question and answer session, Governor Fukui vowed to take necessary steps to overcome deflation, explaining that the BOJ would take an unlimited risk until consumer prices are brought up to a positive level. In the event of an anticipated inflationary rate moving upward due to an improved state of economy, he mentioned that when that moment should come, he would like to clearly show which action the BOJ should take.

"Gear up for inflation" seems to be the consensus among the majority of financial experts, and setting up the inflationary target has been a common talking point. Regarding introduction of the inflation reference value to exhibit a desirable price level, the conservative trait so typical of the BOJ man revealed itself as he was not so enthusiastic about it, responding "It shows a different picture from the current target…"

On the other hand, the BOJ Governor offered up this statement as a request to the government: "Accumulation of vested interests is impeding redistribution of the budget. There is still big room for working out ways and means, for example, by taking a second look at the contents of the expenditures from a radical standpoint to urge redistribution of resources of the private sector."

Here, he's talking about a host of pressure groups working in consort with powerful politicians to get their shares of the budget. They want more deficit spending for government-backed projects such as road construction, farm subsidies, and the like. This is truly a problem in Japan's vote-centered political system called "democracy."

One of the Earliest Critics to Point out Deflation

In 1998, Josen Takahashi of the Mitsubishi Research Institute published his translation of Roger Bootle's pioneering work on deflation, *Death of Inflation* (Japanese title, Defure no Kyohfu, or Fear of Deflation). Subsequently, Takuro Morinaga wrote *Bubble and Deflation*, in Japanese. Today, Morinaga is one of the influential critics who point out that we are in deflation and urging that anti-deflation measures be implemented together with the setting of some inflation target.

Morinaga's book came out but the subsequent administrations remained ignorant of, or reluctant to admit (particularly the Economic Planning Agency) the underlying deflationary current in the economy; thus they took none of the necessary actions and let deflation ravage the Japanese economy. This has made the work of the current Koizumi Administration that much harder.

Take, for example, Taichi Sakaiya, a noted critic, historical writer, and former MITI official. Appointed by Prime Ministers Obuchi and Mori as General Director of the Economic Planning Agency of the Prime Minister's Office from 1998 to 2000, he was reluctant to admit the fact of deflation; hence, he did, or advised, nothing about deflation while he served in that capacity.

Sakaiya was primarily the mouthpiece for the cabinets of these two prime ministers who were admittedly ignorant of the ABCs of economics (a good example of political brainlessness in picking them up). Yet, in magazines and journals, Sakaiya praised the work of the past administrations he served, despite the increase of bad debts during this period. In the June 10, 2003, issue, of the *Nihon Keizai Shimbun*, he continues his pitch that Japan's economy and society are in crisis and that the first order of the government is to get the country out of depression. For Pete's sake, everybody knows that. Besides, this very thing was something he and the administrations he served failed to accomplish.

It is against this background that whenever T. Morinaga comments on the status of the Japanese economy, it is always a breath of fresh air, since he uses both macroeconomic and microeconomic approaches, something most government economists were unable to do. He works for the research institute of a bank, so his reticence about the banks' malpractice is naturally understandable — just as critics representing brokerage houses who call for more government spending to pep up the economy and raise stock prices suddenly quiet down when it comes to the topic of brokerage house malpractice.

Japanese society still tends to classify people according to where they received their final education. The University of Tokyo, for instance, is considered the best. So, if you are a graduate of Keio University (alma mater of Prime Minister Koizumi), and probably the best private school, you are accepted and tolerated by University of Tokyo graduates, but, in their minds, you are certainly not on the same level with them. It is possible that the frequent harsh criticisms of Prime Minister Koizumi put out by T. Sakaiya (despite his being special advisor to the Koizumi cabinet) stem from this mindset, since Sakaiya himself is a University of Tokyo graduate with a major in welfare economics.

There may even be an element of envy involved, since Prime Minister Koizumi is enormously popular, despite his being a Keio (instead of a University of Tokyo) graduate. In addition, Sakaiya is older than the Prime Minister, and Japan still has a neo-feudal custom of older people taking a superior attitude towards their juniors.

Like Sakaiya, fellow University of Tokyo graduate Morinaga studied economics there, but he is no stuffed shirt. He worked for the Japan Tobacco Monopoly Corp. (currently Japan Tobacco, Inc.), the Economic Planning Agency of the Prime Minister's Office, and Sanwa Research Institute, where presumably he learned the vagaries and difficulties of the business world and government service. He currently works as senior researcher at UFJ Research Institute, a research arm of UFJ Bank.

One more thing I noticed about Morinaga is that, unfortunately, sometimes he talks like a nitwit — on purpose, to evoke a good response. For instance, there was an interesting interview in September 2001 between him and Minister Takenaka, shortly after Takenaka's appointment to the cabinet. I think some weekly magazine must have carried that article. I read it while dining at a noodle shop in Fuji Yoshida.

In this interview, Morinaga said to Minister Takanaka, “Many people are out of work, the jobless rate being over 5% and all that. What are you going to do about that?” Obviously, Minister Takenaka was not directly responsible for such a mess, but he said something in reply. Then, Morinaga continued, “You know, the fact that they are unemployed constitutes an infraction of the Constitution of Japan.... You are breaking the law of the land.”

When I read that, still munching on hot Chinese noodles at the time, I thought that of all the interpretations of Japan’s Constitution, this one was the most unique, bordering on gibberish. This annoying tactic is a trap. To argue for argument’s sake, he deliberately used chop-logic (the kind that made a president of another country notorious).

Like many of us, Morinaga is impressed by the flexible performance of BOJ Governor Fukui, as he gave his assessment on p. 14 of the April 1, 2003, issue of the *Yomiuri Shimbun* (although Gov. Fukui was expressing doubt as to the use of the inflationary reference target). As we are all painfully aware, much of the course of Japan in the coming five years depends, for better or worse, on the action and policy of the Governor.

In this article, Morinaga cuts directly to the point, with no chop-logic this time, and it is packed with interesting data, information, and, above all…reasoning. Here is an excerpt in translation.

Morinaga’s assessment of Governor Fukui

New Organization at the Bank of Japan

— Rooting Out “Reverse Bubble” Is the Mission —

What do you think of the New Governor?

I thought of Mr. Fukui as the conventional type of BOJ banker, but it seems he is not. Someone who knows him well tells me that he is flexible, not bound by previous statements, and oozing with an irresistible charm in that no one can tell what he might do next. Former BOJ Governor Hayami was a “stickler for BOJ principles” in that he ignored the economic condition while stubbornly repeating tight-money measures.

On the other hand, I have a hunch that Mr. Fukui might take some bold action. That he makes an announcement of carrying out the buying operations of the exchange traded funds (ETF) interlinked to the stock index and the real estate trust funds (REIT) operating with earnings of buildings, etc., this itself delivers a tremendous announcement effect.

What should the BOJ do first?

Set up an inflationary target of 2 to 3% over the prior year for the increase rate of the Consumer Price, and increase supplying funds accordingly. Since the Consumer

Price comes out a little higher statistically, the inflationary target in this case means actually 0%. The focus should be on stopping the deflation. Together with government bonds, buying operations of the ETF and the RET will become good tools.

Would it not damage the BOJ finance?

Of course, when the deflation halts, government bond prices will plummet. A look at the BOJ's financial status shows that BOJ has government bonds in the amount of ¥87 trillion ($737 billion, ¥118/$1), thus producing a huge appraisal loss. However, with a rapid increase in prices of stocks and land, any corresponding portion of that would be offset. The aggregate market value of stocks is now about ¥220 trillion ($1.864 trillion). Suppose the BOJ buys the ETF ¥5 trillion ($42.37 billion) more per month.

The total comes to ¥50 trillion ($423.7 billion) in 10 months. This would bring about a considerable impact. Once the asset prices start moving up, they gain momentum and get back to the original level. In terms of the mechanism of the normal economy, stock prices and land prices would more than double the current levels.

Infusion of Public Funds

Resona Bank, the fiscal bank of No. 2 Osaka Prefecture, had been on the rocks, and in June, 2003, without holding the bank's top management responsible for the mess, the Japanese government made an infusion of ¥1.96 trillion (nearly $16.6 billion, ¥118/$1). This means that Resona Bank is now a government-owned operation. The 75% of the Resona Bank customers are small and medium-sized corporations and manufacturers, and the government had to take this step to bail it out just like they did for sagging Daiei, the formerly No. 1 supermarket chain.

There were a lot of anecdotes concerning this step. An auditor of the previous auditing corporation committed suicide to be "true to himself" in rendering a report which evaluated Resona Bank's financial condition as something grossly short of meeting the 8% BIS requirements, and a different audit corporation took over. After the infusion, it was discovered that two years before, Resona Bank had also fallen short of ¥200 billion ($1.66 billion).

Be that as it may, the action of the Financial Services Agency was appropriate — to show the world that the Japanese government was dead serious about improving the current woeful situation. Many overseas investors agreed and began investing in Japanese stocks, which had been sorely undervalued.

Furthermore, for the first time, a regional bank called Ashikaga Bank became the subject of intense scrutiny over its financial condition, and on the night of Nov. 29, 2003, it was determined that because of excessive outstanding loans and in view of possible effects on its regional customers and economy, Ashikaga Bank would be temporarily nationalized with an infusion of some ¥1 trillion ($9.23 billion, ¥108/$1).

Japanese corporations and manufacturers have been forging an all-out effort to improve their financial condition over the decade by restructuring, firing employees, selling useless facilities, land, and even their operating divisions or subsidiaries, and positive results are finally showing up.

On July 1, 2003, the BOJ published its June Report of the Short-Term Economic Survey of Enterprises in Japan, commonly known as "Nichigin Tankan" (Nichigin is an abbreviation of BOJ and Tankan, an abbreviation of Short-Term Survey). The report contained encouraging results concerning the current status of the Japanese economy, results far better than anticipated. Electrical machinery, auto, and general machinery form the core of giant corporations and manufacturers, and their business climate improved. This is particularly true in the field of exports of electronic component parts.

True, fears over the Iraqi War and SARS — fears that played an adverse role in bringing down the business climate — are gone, and you have to take into account that all the years of restructuring are now bearing fruit. Spending for new plants and equipment of the manufacturing industry holds the key. If it goes up to such an extent as to stimulate the non-manufacturing sector of business and industry and build up domestic demand, a business upturn will occur by itself, not to mention the beneficial effects it'll have on stock prices. Of course, there is a fear of a resultant increase in the interest rate, particularly, long-term interest rates, which would cause government bond prices to plummet.

In the July 11, 2003, issue of the *Asahi Shimbun*, S. Takumori, chief economist for Sumitomo Mitsui Asset Management, said, "Since capital investment is moving up, by the year-end, stock prices will hit the ¥10,000 mark," on the Nikkei Stock Average. (This prediction turned out to be right on the money.) On the other hand, as usual, some sour apples feel that stock prices have now peaked, going downward to the ¥7,000 yen level towards the fall of 2005.

How Stock Prices Soared

Near the end of the 1990s, if any Japanese individual said he'd never thought of a divine wind blowing in to pep up the Japanese economy, he would be lying. The divine wind dates back to the 13th century, when the Mongolian army led by Kublai Khan, grandson of Genghis Khan, tried to land on the Japanese island of Kyushu twice. Their first attack in 1274 failed because a typhoon sank their ships. A second attack in 1281 also failed because the samurai fought back like the devil, following a well-planned defense strategy and buildup. This typhoon that saved Japan is called "kamikaze" or a divine wind.

You may recall that the Nikkei Stock Average was ¥22,469.80 on September 3, 1991 (Forget the record high of ¥38,915 in 1989). It edged down to ¥18,735.17 on September 3, 1997, and plummeted to ¥10,409.68 on September 3, 2001 when Prime Minister Koizumi took over. It sank to its lowest after the breakdown of the "bubble." Sharp drops in stock prices affected every financial institution that held many shares of stock whose prices dropped to aggravate their balance sheets.

If this trend continued for an extended period of time, it was rumored that only two major banks — Tokyo Mitsubishi and Sumitomo Mitsui — could survive. Disposal of bad loans by the banks had been discussed for many years, but the banks kept on postponing decisive action, thinking that the values of real estate holdings would increase one of these days, and the government kept on spending money by issuing bonds.

This thinking resulted in a weakening of the banks' position, furthering the recession and low stock prices and causing a slump in business. (Not a word of deflation mentioned then...) Some critics talked about a possible drop to ¥8,000 or as low as ¥6,000 and painted a dismal picture of what would take place next.

The Nikkei Stock Average kept on dropping. On April 10, 2003, it was ¥7,980.12, crossing down the ¥8,000 mark. Then, Christopher Columbus! It started going up to ¥8,190.20 on May 13, ¥8,980.64 on June 13, and, yikes! ¥10,027.60 briefly on July 8. By July 9, it rested at ¥9,990.95. But the next day, July 10, ¥10,070, scored as the highest. At that point, adjustments including profit-taking took over for a while.

While investment analysts predicted a decline to the ¥9,200 level followed by an increase to ¥10,000 or more, lo and behold, August 14 saw the Nikkei Stock Average crossing the ¥10,000 line, or ¥10,033.43 to be exact, (if only temporarily). Outside, it was raining cats and dogs all over Japan because of a strange weather pattern affecting the world over.

On August 15, we had another high of ¥10,038, though only temporarily. The divine wind and rain seemed to be continuing. Now, the best was yet to come on Monday, August 18. On that glorious day, the Tokyo Stock Market showed another rally with the Nikkei Stock Average hitting ¥10,203.19, and, another index, TOPIX marking an 11.22% gain of 990.67.

On August 11, 2003, the MOF announced that overseas investors pumped ¥1.7 trillion (approx. $14.4 billion, ¥118/$1) into the Japanese market during the month of July, a record high — since the beginning of recording statistics in March, 1998.

So, the divine wind finally hit Japan in June in the form of soaring stock prices. No one could give an adequate explanation. In fact, nobody had predicted it. The trend continued, and many banks as well as corporations and manufacturers, because of increased values of stocks they held, were saved from reporting losses in the next closing of accounts at the end of March, 2004.

The recent rally of the Japanese market is the result of a return of foreign investors who realized that many Japanese stocks were undervalued in the world money markets.

Several factors played into the rally:

- Foreign investors felt the Japanese Government was quite serious in tackling the job of restructuring the financial system by pouring nearly ¥2 trillion (nearly $16.6 billion, ¥118/$1) into the Resona Bank — without holding the top management responsible for the debacle.

- BOJ's Tankan (Short-Term Survey of Enterprises) published a favorable report showing improved performance of some corporations and manufacturers which would bring about increased capital investments.
- The yen had been stably weak and contributed to the competitive edge of Japanese products in the world markets.

In the second half of 2004, new factors surfaced to shore up share prices:

- Investors felt relaxed, thinking the excellent performance of Japanese corporations and manufacturers would continue in the next year, negating a fear that the corporate performance may show loss.
- A slight downturn of the economy was considered possible in the fall, 2004 but this should not last long.
- Japanese share prices were still undervalued, and individual investors were making note of this fact and have begun investing more.

Three-Pronged Events to Boost the Economy

There are three salient features—the buying on balance of foreign investors, individual investors participating in the rallying stock market, and the BOJ's easy money policy.

Here is proof of the buying spree of overseas investors — buying on balance figures. If an investor buys more than he/she sells, it is called buying on balance. If he/she sells more than he/she buys, it is called selling on balance.

The Tokyo Stock Exchange announced on Dec. 26, 2003 that foreign investors' buying of Japanese stock on balance in the year 2003 amounted to some ¥8 trillion ($7.4 billion, ¥108/$1), the second highest after the more than ¥9 trillion ($9.1 billion, ¥100/$1) of 1999 when high-tech stock prices jumped.

As Japan swings back upward, those investors who once showed little interest in buying Japanese stocks — Asians and investors of the oil-producing countries — are now investing. This buying on balance by foreign investors continued in 2004. Foreign investors' buying of Japanese stock on balance as of December 27, 2004, amounted to some ¥7.35 trillion ($7 billion, ¥105/$1), the third highest ever.

In addition to the buying on balance by foreign investors, individual investors pushed hard, too, in 2004, with their share of the market amounting to 32%, next to the 48% share by foreign investors. Together, foreign and individual investors accounted for a whopping 80% of buying and selling for that year.

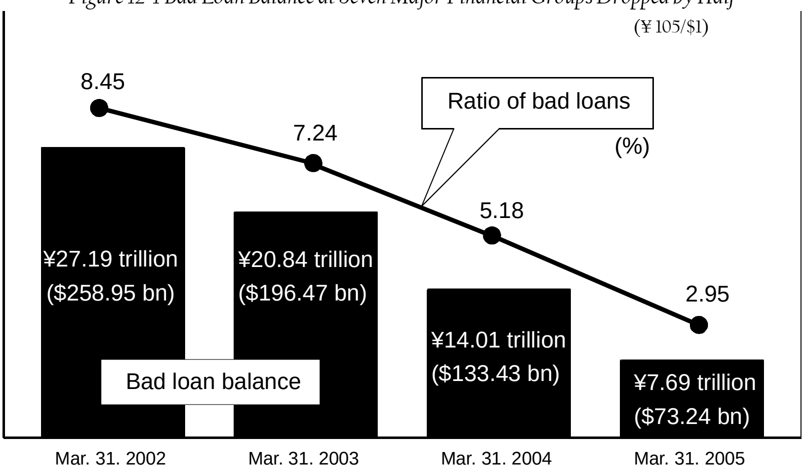
On January 13, 2005, the MOF reported the buying on balance by foreign investors (including stocks and government bonds) totaled over ¥15.3 trillion ($145.7 billion, ¥105/$1) in 2004 — the biggest amount since 1981 when the statistics began. This is clear evidence of the dependence of the bullish market of 2004 upon foreign investors.

Meanwhile, the BOJ boosted its efforts of making a great deal of funds available—easy money. Pumping funds into the ailing monetary system by the BOJ has taken the form of buying up government bonds. Since the prime rate is already at zero, there is no way to cut the interest rate below zero. There must be other ways to further boost the economy. So the BOJ has been buying up bonds and bills and notes, amounting to trillions of yen or billions of dollars, in an effort to supply ample funds. This is called "Ryoteki Kanwa" (meaning Quantitative Relaxation, which is another name for "easy money").

On Dec. 10, 2003, the Japanese government and the BOJ jointly intervened in the foreign exchange market by selling the yen and buying the US dollar in the neighborhood of ¥500 billion ($4.6 billion, ¥108/$1) to some ¥1 trillion ($9.3 billion).

The 2003 supplementary budget and the 2004 annual budget allocated ¥60 trillion ($55.6 billion, ¥108/$1) to be spent on yen-selling and dollar-buying in order to maintain current levels. From January to the end of November 2003, intervention in the exchange market amounted to ¥17 trillion 800 billion ($16.5 billion).

Figure 12-1 Bad Loan Balance at Seven Major Financial Groups Dropped by Half



Source: May 26. 2005, Yomiuri Shimbun, Re-printed with permission.

The intervention continued through December, so the total amount for 2003 reached a little short of ¥200 trillion ($18.52 trillion). This is more than double the amount spent in 1999 — approx. ¥7.06 trillion.

At the same time, both the Japanese government and the BOJ with its new governor have been working together — by means of intervention in the currency exchange market — to keep the yen exchange rate from falling. In the supplementary budget and the 2004 budget, some ¥60 trillion ($555 billion, ¥108/$1) was allocated for buying the dollar and selling the yen.

The dollar bought this way is used to purchase US government treasury bonds, thus shoring up the stability of the US dollar. The result was that holdings of the US dollar at the end of March, 2004, reached almost $820 billion.

Bad Loan Balance Cut in Half

On May 26, 2005, all mainstream media carried a headline — at the last account closing of March 31, 2005, the seven major financial groups reported their success in meeting the target set by the Financial Services Agency to cut the bad loan balance into half.

Table 11-1 Business is Up at the Seven Mega Banks/Financial Groups (term ended March 31, 2005 and forecast for the next term ending March 31, 2006) (¥105/$1)

Banks/ financial groups	Net operation profit	Loss due to bad loan liquidation	After-tax profit	Ratio of equity capital to total assets
Mizuho	¥800 bn ($7.82 bn) *¥1,034 bn ($9.85 bn)*	¥61.2 bn ($583 mil) *¥152.0 bn ($1.445 bn)*	¥627.3 bn ($5.97 bn) *¥500 bn ($4.76 bn)*	11.91% *11-12%*
Mitsui Sumitomo	¥940.4 bn ($8.96 bn) ¥ *950.0* bn *($9.05 bn)*	¥ 954.8 bn ($9.09 bn) ¥300.0bn ($2.86bn)	▲ ¥234.2 bn ($2.23 bn) ¥460.0 bn *($4.38 bn)*	9.94 *approx. 10.5*
Mitsubishi Tokyo	¥709.6 bn ($6.76 bn) *¥1,190.0* bn *$11.33 bn)*	¥ 134.2 bn ▲ *5 ($4.76 mil)*	¥338.4 bn —	11.76 *
UFJ	¥767.5 bn ($7.31 bn) —	¥789.0 bn ($7.51 bn) —	¥554.5 bn ($5.28 bn) —	10.39 —
Resona	¥365.2 bn ($3.48 bn) ¥300.0 ($2.86 bn)	▲ ¥39.3 bn ($374.3 mil) ¥ 71.0 ($676.2 mil)	¥ 365.5 bn ($3.48 bn) ¥200.0 ($1.90 bn)	9.74 Approx. 9
Sumitomo Trust	¥148.2 bn ($1.41 bn) ¥150.0bn ($1.43bn)	▲ ¥1.4 bn ($13.3 mil) ¥20.0 bn *($190.4 mil)*	¥ 96.8 bn ($921.9 mil) ¥80.0bn ($761.9mil)	12.50 approx. 11.5
Mitsui Trust	¥ 191.1 bn ($1.82 bn) ¥ *190.0* bn *($1.81 bn)*	¥ 43.9 bn ($418.1 mil) ¥35.0 bn *($333.3 mil)*	¥ 94.0 bn ($895.2 mil) ¥120.0 bn ($1.14 bn)	10/34 approx. 11%
TOTAL	¥3,922.2 bn ($37.35 bn) ¥3,81 bn($36.32bn)	¥1,942.4 bn ($18.50 bn) ¥57 bn ($5.46 bn)	¥733.5 bn ($6.99 bn) ¥1,900 bn ($18.1bn)	—

Source: May 26, 2005, Yomiuri Shimbun, Re-printed with permission.
Figures in italics refer to estimated financial results at the term ending March 31, 2006.
▲ *Stands for deficit. In the loss due to bad loan, liquidation means that the gains returned from the reserve for bad loans exceeded the loss.*
* *Mitsubishi Tokyo and UFJ merged in October 2005, forming Mitsubishi Tokyo UFJ, so the forecast for the next term is omitted.*

Chapter 12. Companies Doing Well

First, let us take a look at digital appliances, which are selling well. What are digital appliances? New products of digital cameras, DVDs, thin type/flat-panel TVs such as plasma panel displays, liquid crystal displays, and even game machines are included as digital appliances.

DVDs

Introducing new products is a good way to help consumers loosen their purse strings, particularly, during the year-end sales season. DVD shipments numbered 3.38 million units in 2003. December of that year saw expanded sales of DVDs with hard-disks. These types eliminate the need for tapes or disks, making recording easier. You can record 100 hours, with some models even as long as 325 hours. And prices are decreasing. An 80 GB (gigabyte) model sells for ¥60,000 to ¥70,000 ($550 to $650), while even higher GB models of 120 GB sell for about ¥100,000 (a little under $1,000).

DVD shipments exceeded 4 million units in 2004, double the VCR shipments of 1.848 million units, and these models included even longer recording times. Panasonic has been pushing hard for its DVD models named DIGA; these are hawked in ads by a huge American male spokesman. This hunky guy stresses the DIGA's extended recording capacity — a capacity so large that you can go on vacation and never worry about missing a single episode of your favorite programs. DIGA E500H can record pictures for as long as 30 days with 709 hours with a fast speed of 64 times. If you want to record a one-hour program, you can do the dubbing in some 56 seconds. You can also simultaneously record two programs. And portable DVD players have now come on the scene.

While Panasonic is going strong with DVDs, another giant in the field, Sony, is running behind and feverishly panting to catch up. Actually, since its Play Station had a DVD playing function, Sony, to some extent, took it easy. That is... until Panasonic staged a DVD sales drive, and Sony quickly countered with their Digital Recorder "Sugoroku." (By the way, this is a sleek, beautifully-designed recorder.) Furthermore, Sony has introduced the PSX — a Play Station 2 with a hard disk for DVD recording.

This PSX came out in December, 2003, but didn't sell well, so that probably only 200,000 to 300,000 units were shipped. Then, in September, 2004, Sony suddenly announced PSX price cuts — for example, they slashed the price of PSX DESR-5100 with 160GB by 30%; that's down to a little less than ¥50,000 (¥476, ¥105/$1). Sales took off, and Sony was the No. 1 DVD seller for some time.

Sony's recent entry in December, 2004, was the PSP (Play Station Portable). On December 12, its sales began at a price of ¥20,790 ($198, ¥105/$1), and many retail stores reported that the first model sold out in a few hours. At one giant discount store in Tokyo's Ikebukuro, some 1,200 consumers waited in line from the day before, and the PSP sold out in no time. No one knows when the next shipment is going to arrive. Now, you can expect vultures operating like ticket scalpers. Some stores specializing in second-hand products were selling the PSP at about ¥50,000 or a little under $500 which is double the price of a new PSP.

This PSP is Sony's answer to Nintendo's new portable game machine "Nintendo DS," introduced on December 2, 2004. In three days, 570,000 Nintendo DS units were shipped. Nintendo's initial schedule of shipping 2 million units by the year-end was raised to 2.8 million units including shipments to the US market. By December 22, 2005, Nintendo DS sales in Japan reached a cumulative total of 5.44 million units.

Kodak first developed a digital camera in the 1970s. But film cameras were still popular then, so Kodak's digital camera was primarily used for military purposes. In Japan, Casio was one of the manufacturers to develop the digital camera in Japan. I saw a TV program showing how they developed it. Since the earlier models had many bugs and were expensive, Casio's top management decided to drop it.

Yet, several Casio engineers secretly continued development work. While no funds were earmarked for the secret project, they managed to get funds under a project bearing a different name. (This is one of the advantages of Japan's lifetime employment system because even if it should be discovered, the engineers in charge would not be fired.)

Finally, they completed the development of a digital camera, and this model had a slot for connection to a personal computer, and soon they broke the news to the top management. President Kasio asked him, "Are you sure we can sell it this time?" "Yes, sir."

This all happened in the mid-1990s. Despite the engineer's emphatic reply, the Japanese market was not yet ready for this product. However, the US market is willing to gamble on innovative products. Let's show this digital camera at a convention in Las Vegas! Casio engineers carried out a demonstration in Las

Vegas. Americans liked it, and orders started pouring in. That little slot for connection to a PC proved to be an indispensable feature.

Seeing Casio's success, a host of other manufacturers began developing digital cameras. In 2003, some 45 million were shipped the world over, and 90% of those were Japanese-made cameras. As a result of cheaper prices, the Japanese market seems to have now reached some maturity, but other markets are still growing. The US market is naturally promising due to consumers who are first-time buyers, as well as to those who own older digital cameras with under 2 million pixels and want to upgrade to newer models with higher pixel counts.

The European market seems equally promising as new prices are set up low enough to keep an addition of the value-added tax from raising the total prices too high. China, of course, remains a huge, promising market.

Sony and Canon are the leading digital camera manufacturers. Some 15 million units of Sony's digital cameras were shipped to the world markets in FY2004, while Canon seems to have shipped 14.7 million units[35]. Japanese digital camera industry is very likely to ship at least 70 million units to the world markets in 2005, so that Sony and Canon have a combined 50% share of the world market.

Thin type (flat-screen) TVs include PDPs (Plasma Display Panel), LCDs (Liquid Crystal Display), projection TVs, rear projection TVs, etc. Sharp is the leader of LCDs with some 50% share of the market. Panasonic makes good profit by selling its PDPs, gearing up to capture 40% of the US market according to the statement of its top management in August, 2005. Hitachi is belatedly in this market with a 30" model. Seiko-Epson is selling its rear projection TV at low cost because of direct sales, while Victor is pushing its bigger sized versions over 50". Even Canon is getting ready by buying NEC's two subsidiaries in 2005.

Panasonic and other makers should be making money on DVD recorders, but because of price cuts resulting from severe competition, DVD recorders are not really money-makers. On the other hand, thin type TVs are....

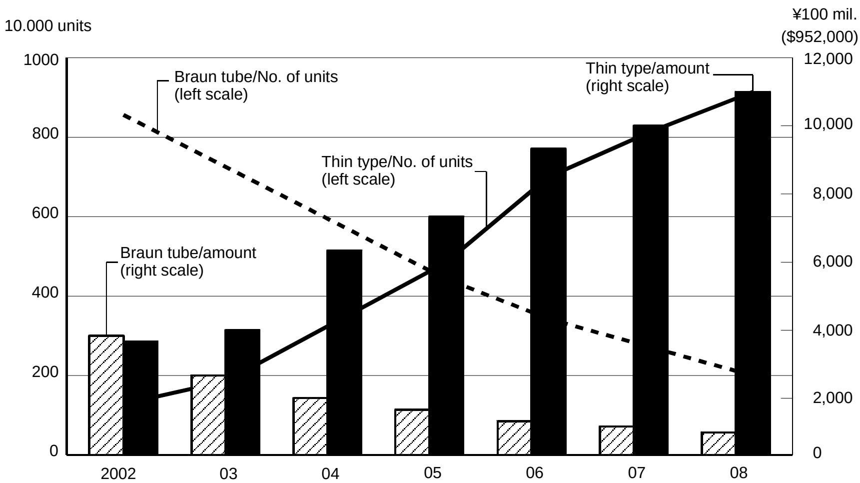
On December 20, 2004, the *Nihon Keizai Shimbun* reported that Sony was contemplating a retreat from manufacturing its PDPs to focus on the production of LCD TV, since they have an LCD plant in joint venture with Korea's Samson. This news proved to be ill-timed, breaking just before the year-end sales season. It sent a shock wave throughout the entire TV/appliance industry, not to mention the effects it had on die-hard Sony freaks making plans to buy Sony's PDP. Sony met this scoop with something akin to denial. Aware of the effects this news would have on year-end TV sales, they insisted that the company would continue producing the PDP.

The PDP is a big-ticket item with a price range of ¥300,000 (about $3,000) to ¥800,000 (about $8,000). The average price is ¥10,000 (about $100) per inch

35. January 5, 2005, *Nihon Keizai Shimbun*.

of a screen. I wonder how this kind of news ever leaked out of Sony in the first place. On p. 95, the May 17, 2005, issue of the *Weekly Economist* shows as follows.

Figure 12-1 Domestic Shipment of TVs



Source: May 17, 2005, issue, Weekly Economist and Data Garage Inc. Re-printed with permission.

All this time, Sony engineers were quietly at work developing a new LC TV with liquid crystals supplied from the LCD plant jointly set up with Korea's Samson and S-LCD frames made by Sony. What is the brand name of this new Sony TV? It's BRAVIA. Introduced to the Japanese market and the rest of the world in September 2005, BRAVIA was an instant hit. Sony reports worldwide sales of about 1.25 million sets from October to December 2005.

Cell phones — actually mobile phones, since they operate on a different principle than cell phones — are naturally popular in Japan. One statistic indicates a saturation rate of over 86%. By the same token, pay phones are disappearing. What is interesting is the use of cell phones with Internet access. This feature allows users to do everything from sending email to directing the bank to transfer funds to accounts — all through the cell phone.

Many teenagers are hooked, and I have seen many of them standing on street corners, sending email or instant messages. In fact, one college student, reprimanded by his mother for excessive cell phone bills, went so far as to stab her to death.

Of the 125 million Japanese people, some 28 million use cell phones to access the Internet. This form of internet connection is on the rise. Taking pictures with camera-mounted cell phones and sending photos through the Internet are all the rage. Another function on the rise is the use of the cell phone as a means of identification — you can literally hold the phone screen up to a sensor in the place of using the old-fashioned bar-coded pass.

Furthermore, the use of broadband is rapidly expanding in Japan, since it enables massive volumes of data to be transmitted at high speed. Monthly rates are also very cheap (about $20 to $40 per month) so that more and more people are switching. For instance, Japan has some 70 million Internet users, and nearly 30% of them use broadband services of optical fiber, ADSL, cable Internet, or wireless.

Third-generation cell phones featuring faster transmission of large volumes of information — animation and moving images — are spreading. Work is now underway to build a fourth-generation phone system by 2010, this one capable of transmitting information at even greater speeds.

Moreover, a shift to the Internet protocol version 6 or IPv6 is being carried out to realize a ubiquitous network — an Internet environment anyone can access from anywhere. For digital home appliances, this technology means a jump from the current experimental stage to one of practical application.

Is IT a Money Maker?

Five years ago, the top management at major electronic/electric manufacturers all hollered, "Shift to Information Technology, IT." But the prices of personal computer servers, supposedly the core of IT, plummeted because of neck-and-neck competition. Now, servers are sold at cut-rate prices on the ¥30,000 level (under $300). As a result, there's hardly any Japanese manufacturer making money on IT.

Still, one money-maker has emerged from an unexpected direction. It's the washing machine, a product supposedly having reached maturity years ago. Technological innovation has also begun in the areas of vacuum cleaners and air conditioners. The growth market is all around. "No sense sticking to IT that doesn't make money." But, when it comes to IT-related products, if they are backed by unique technology and meet the user's needs, they never fail to hit pay-dirt.

"Good bye, IT" is somewhat of an extreme statement. It seems that even a mature product, if an idea is incorporated into it from a different angle, is sure to catch the fancy of consumers and become a smash hit. For example, at the moment, a vacuum cleaner spewing out exhaust from the rear is making a big splash.

Another example is Panasonic's drum-type washer/dryer initially called the "Love." By setting the drum at a 30-degree slant, the machine uses less water, and the angle makes it easy to get the wash in and out. The "Love" is priced at ¥160,000 to ¥180,000 ($1,455 to $1,636), 30 to 40% higher than other makes. Despite the stiff price tag, sales are so big that a production schedule of 20,000 units per month — double the original schedule — can't keep up with increasing orders. Panasonic later introduced cheaper versions and sold 300,000 units of the new washer/dryer backed by over 100 patents.

The 38 Companies with a Current Profit of over ¥100 Billion[36]

According to this survey of the consolidated current profits for FY2003, there was an increase of corporations reporting over ¥100 billion ($9.091 billion, ¥120/$1). In FY2002, only 10 companies were in this bracket, and this number jumped to an all-time high of 38 companies in FY2003.

In the electric/electronic industry, Hitachi and Matsushita Electric or Panasonic returned to this ¥100 Billion ($91 million, ¥110/$1) Current Profit Club. Sharp is a new member.

A host of corporations and manufacturers have launched a comeback or have continued to thrive despite recession and deflation. Let's see about some of them and find out what makes them tick:

C. Itoh's Comeback

Japan, as an island nation, relies on exports and imports, and international trading companies play a vital role in the Japanese economy.

C. Itoh & Co., better known in Japanese as "Itochu," is a respected international trading house — one of the top five in Japan. Itochu mainly handles textiles, machinery, plants, chemicals, even condominiums, as well as IT such as satellite communications, telecommunication, and China trade. In 2003, its annual turnover bounced back to ¥10 trillion ($83.3 billion) and maintained about the same level in the succeeding years.

C. Itoh suffered a huge decline in its performance in the 1990s. At the end of 1997, its share value dropped to ¥182 (approx.$1.80), about one-tenth of its level in the late 80's. This downslide was due chiefly to bad assets, estimated to be some ¥450 billion (approx. $4.5 billion) and generated by excessive investments in real estate (as many trading companies and other corporations did in the late 80's). About that time, I remember reading articles in weekly magazines and journals wondering if C. Itoh and other trading firms would ever survive.

In 1997, C. Itoh formulated and announced a reconstruction plan of its financial structure, but that move did little to boost the market value of its stock. Then Uichiro Niwa was elected its president.

Given a free hand in restructuring the company, Niwa took drastic measures to dispose of bad assets to the tune of some ¥250 billion ($2.5 billion). Slashing executive salaries and reducing manpower, he got rid of over 300 deficit-operating affiliates and subsidiaries. By the end of March 1998, the 45 directors on the company board had been whittled down to 22. President Niwa

36. June 5, 2004, *Nihon Keizai Shimbun.*

(now chairman) even returned his salary to the company. Other measures included making efforts to get to know the employees and helping them change their thinking, building morale by exchanging email and attending employee gatherings on days off.

Sony vs. Panasonic

I was watching TV in September, 2002, and a program came on featuring Matsushita Electric's new president Kunio Nakamura (former president of Matsushita Electric U.S.A.) who talked of restructuring the world's No. 1 appliance/TV manufacturer, domestically employing some 123,500 workers. This measure was prompted after a loss of some ¥431 billion or about $3.69 billion in the period ending March 31, 2002. By the way, he took over as president in June, 2000.

President Nakamura is as tough as any samurai. You don't want to mess with him. When someone rubbed his fur the wrong way in an unconscionable manner, immediately something unprecedented would happen in retribution. A little incident which clearly reflects President Nakamura's sense of determination occurred in 2002.

One national daily has a magazine which deals with topics not covered by the daily in detail. The magazine's editor called Panasonic's recovery a "lie" because of Panasonic's failure to meet its rebound goal, and that rubbed in too much, especially since Nakamura was hitting on all cylinders to get the mammoth company back on track. The daily, resting on its laurels as an established paper, had never expected from Matsushita any adverse reaction regarding what one of its magazines wrote, even though the word got out that President Nakamura had hit the roof when he read the piece which branded Matsushita Electric's V-shape upturn of its business performance a lie.

"You can't get away with that," Nakamura said to himself and quietly served notice that any and all advertising would be suspended for that daily with a nationwide circulation. A one-page advertisement in that newspaper would cost a little under $500,000.

Panasonic is one of the major advertisers in Japan with an advertising outlay of several hundred millions of yen or several hundred million dollars per year. The daily was shocked by the suspension, because this was unheard of. Suspending advertising? No other companies dared. But, Matsushita Electric continued to advertise in other newspapers.

The daily realized that President Nakamura meant business and offered up apologies. President Nakamura is not a spiteful person, but actually a charming man. Apparently he "let bygones be bygones," and he accepted the apologies.

Panasonic ads soon resumed...much to the relief of that national daily. I learned later that the editor responsible for that remark was transferred to some remote outpost. The daily lost some $1.5 million dollars' worth of advertising during the one month Panasonic stopped advertising in that daily, while Panasonic increased its advertising in other newspapers.

But this little incident shows that you don't mess with President Nakamura. He is the kind of person used to taking immediate action, not the type of person you often see among the many top management personnel. Most of them would dilly-dally around and let somebody else clean up the mess.

This kind of quick action, backed by sharp business acumen and persuasiveness, is what's responsible for building up the Panasonic brand image in the United States. Working as chairman of Matsushita Electric Corporation of America, Nakamura took only a few years to establish Panasonic TV in the United States, a market dominated by Sony; it captured a 10% share of the market there, touting itself as the quality TV.

This reminded me of two things. One is a little piece of information on Sony I received when I visited the Matsushita TV plant in 1964 in Kadoma of Osaka. A huge chart hung on the corridor wall with the names of other appliance/TV manufacturers. Sony was near the bottom of the chart with Hitachi, Toshiba occupying prominent positions next to Matsushita. To my question of "How's Sony?" came back a reply: "It's small. A lot of Americans usually ask about the size of Sony's operation. We usually tell them it's as small as what you see on this graph."

In those days, of some 70,000 TV/appliances stores in Japan, around 50,000 of them sold Matsushita products — 27,000 sold nothing but Matsushita products, and some 23,000 shops sold Matsushita products together with other makes. Sony, on the other hand, had 3,000 retail outlets selling only Sony products plus nearly 20,000 shops that handled Sony along with other makes. Matsushita Electric was truly the giant.

At that time in the 1960s, Sony products included transistor radios, tape recorders, Trinitron Color TVs, and portable TVs. Then, Sony developed a host of innovative products such as the Walkman, CD player, 8mm video, Play Station 1 and 2, and even a canine robot. Much to the chagrin of that giant Matsushita Electric, Sony grew and grew to become a world enterprise of consumer electronics and entertainment. In retrospect, I believe that particularly in the 60's, there was a sense of envy among traditional companies and manufacturers about the way Sony was chugging along in the world markets with their fresh image and innovative products.

Now, it is one of the world's best-known brand names, the global leader in audio and video equipment, to speak nothing of its other diverse activities in movies, insurance, e-banking, and game machines. There's even a Maxim's restaurant run by Sony in the Sony Building in Tokyo's Ginza, a tie-in with Maxim's of Paris.

Sony's outstanding achievements extend into entertainment and moviemaking including the hugely successful film Charlie's Angels. The Japanese premier of Charlie's Angeles was held in Tokyo in November, 2000, attended by

Drew Barrymore, Lucy Liu, and other stars of the movie, along with Sony Chairman N. Idei. Spiderman, another worldwide hit, also contributed to Sony's coffers. Its success in move-making marks a sharp contrast to that of Matsushita Electric. Matsushita's 1990 purchase of MCA, operating Universal Studios in Florida and California, didn't turn out so well — so much so that 80% of Matsushita's holdings were sold over to Seagram in 1996.

The other thing that comes to my mind is the story of developing a videotape recorder involving Sony's Betamax and Matsushita/Victor's VHS in 1976. This is a well-known story in the appliance/TV industry. In 1975, Sony introduced its first home VCR format known as Betamax, using 1/2" tape cassettes. The company then disclosed the Betamax product and technology to Matsushita Electric and JVC (Japan Victor Co.), whose major shareholder is Matsushita Electric, for the sole purpose of promoting uniform standards. However, no response from Matsushita Electric/JVC came for about a year. In reality, JVC had begun work on developing its own version, VHS, in 1973, while Sony was still developing the Betamax. (The story of JVC's development was later made into a novel and a movie.)

Sanyo, Toshiba, Aiwa and General all indicated they would adopt Sony's Betamax technology, and Sony's Chairman Akio Morita announced the "First Year of Video." Furthermore, the MITI, the Ministry of International Trade and Industry, was all for it.

Then, in September, 1976, JVC unveiled its own format VHS, to compete with Sony's Betamax. Their product featured a two-hour recording time to boot — twice as long as Betamax — and even suggested to Sony that it adopt the VHS format. Naturally, Sony did a thorough study of VHS format and were shocked to find that the Beta technology and know-how they, themselves, had disclosed were fully incorporated in creating the new VHS format.

VHS is by no means a copy of Beta. But for Matsushita Electric, Betamax had cleared the path; they'd charted the course for whatever technical problems would lie ahead to make a viable videotape recorder and for what the future of video recording and playback would hold. The rest is history. VHS became the standard for home and industry. As a result of this loss of Betamax in its contest with VHS, Sony's profit-picture sagged considerably, for awhile.

However, Sony engineers plugged away at developing a new portable camcorder CCD-TR 55, weighing only 1 lb. 13 ounces (790g). On May 31, 1989, they introduced to the market a passport-size camcorder named the "Handy Cam." Promoted through a superb TV commercial campaign, it proved to be an instant success — 50,000 units were sold in three days.

If anyone mentioned in the 1980s any possibility of Sony's working with Matsushita, people would have taken it as a bad joke. But now, after a decade of deflation, anything can happen. Well, the unthinkable did happen in 2002, as Matsushita Electric and Sony announced plans for joint development of an operating system for the next generation of digital home appliances. The joint venture will involve improving Linux, a PC OS interchangeable with UNIX created by Linus B. Torvalds and used for networking equipment. This system will be modified to provide faster operating speed for home appliances. For example, if installed on TVs or DVD recorders, it will provide network connection function. Most people in the industry consider this a wise decision, one to counter Microsoft's entry into the home appliance field with its own OS.

When this new OS is developed, it will be provided free to the members of the standards association, including Hitachi, NEC Electronics, Sharp, IBM, Phillips, and Samson. Matsushita Electric has already developed its own software while Sony has also created its own software in digital home appliances. Networking home appliances necessitates the development of common software, and this is their answer.

Another area of joint work of Sony and Panasonic is the next generation Blue-ray Disk (BD) with the participation of Disney Production, while the other HD (High Definition) DVD is being developed by Hitachi, NEC, Toshiba and other manufacturers with the participation of Warner Brothers, Universal Pictures and two others.

In October, 2005, it appeared that Paramount Pictures, Warner Brothers, and even Universal Pictures were very likely to sell BD software as well. This means that the BD player alone can play the majority of Hollywood movie software.

The talk of the town in the second half of 2003 was a change in the gloomy state of the economy to a slightly brighter picture. Dawn was appearing, suggesting that the Japanese economy was perhaps on the rebound. More buzz around town involved the recovery of the electric/electronics industry as a whole due to digitalization — brisk sales of Liquid Crystal Display TVs, DVD video recorders, plasma flat screen TVs, digital cameras, and other digital home appliances. NEC, Sanyo, Sharp, and even Panasonic racked up gains due to digitalization

Panasonic's financial condition greatly improved, and on January 6, 2005, the *Nihon Keizai Shimbun* reports that Panasonic's net financial assets are expected to reach the ¥1 trillion ($9.5 billion¥105/$1) level in the middle of 2005 for the first time in 15 years. Panasonic's funds on hand as of September 30, 2004, was some ¥1 trillion 652 billion ($15.73 billion). Liabilities on hand then were ¥965.3 billion ($9.19 billion). Net financial assets are obtained by subtracting this ¥965.3 billion from ¥1 trillion 652 billion. Accordingly, the current net financial assets are ¥686.7 billion or $6.54 billion.

Osaka is Japan's No. 2 city suffering poor business with a 7.2% jobless rate. Roughly, one-third to half of Osaka business is related to Panasonic. Therefore, Panasonic's return to prosperity will gradually affect Osaka business to the better.

In October, 2002, Chairman Idei explained Sony's venture in computer entertainment. It took Sony 10 years to incorporate its movie and music ventures into its core business of electronics. Now that China is emerging as the world's manufacturing plant, Japan's manufacturing industry should shift gears and move toward the "knowledge" industry with a fusion of information technology. Another factor Idei notes is that although Japanese animation and comics are very popular abroad, the manufacturing industry holds the mainstream of Japan's business and industry. Top management and government officials continue setting traditional stores by the manufacturing industry, disregarding a whole new sector of industry consisting of information contents.

What Idei is driving at is that you must take a different attitude towards a whole new world — a world marked by the burgeoning sector of the entertainment industry with its mixture of information, networking, music, video, animation, and the like. Since Sony remains deeply committed to further development, patience is the key, for a few more years, until Sony regains its excellent financial position. In this sense, Chairman Nobuyuki Idei is a new type of business leader.

Yet, many investors want to see profits soon. What happened to Sony? This is often heard as Sony has been behind in sales recently. Chairman Idei explains Sony's strategy for the near future in the January 18, 2005, issue of the Zaikai (meaning "Business World), a well-known business biweekly.

Idei is a rare businessman in Japan — bilingual in English and French as he studied in Europe after he joined Sony in 1960. He also has a China experience. His 2002 best-selling essay, ON and OFF, I thought, proved that he was in no way a typical cut-and-dry business leader only interested in the sales and profits of his group. Being a Tokyo-born "Edokko," Tokyoite (a Japanese version of a New Yorker or a Londoner), he has the Tokyoite's "iki" or sophistication no Osaka-born business leaders can match.

While Panasonic is restructuring to perk up the giant organization, Sony is currently proceeding with a project called TR60 or Transformation 60 aimed at reforming its management structure by the target year 2006. It is made up of Structural Reform, Fusion Strategy, and Integration Strategy.

Idei is very much aware that electronic products are fast becoming borderless, reflecting ever-changing aspects of technology. Semiconductors and other key components are being used for consumer products, so that there is no sharp distinction between the personal computers and consumer electronic products.

Sony's prime concern has been to provide both hardware and software for consumers in the living room where they can pursue their individual tastes. This Idei calls the "Living Room" and "Personalization" — interactive multimedia. Sony's community is where the consumer can see programs on TV and can interact by searching to find what he or she like. At the ATM of a bank, the machine asks and performs as per your instructions. In the same way, TV asks questions. Sony has introduced electronic money, Felica. This is a contact-less card. You just show it to a sensor, and payment is made or your identification is established. It is in the mobile phone, so that you can transfer money from your credit card to the mobile phone. Then your mobile phone itself becomes a purse.

On March 13, 2004, I was watching satellite TV, and an interesting program entitled "Seeking New Employees in Asia" came on. Although the program said only that "one electronics manufacturer" was scouting, it was apparent that Sony was that manufacturer.

As part of its drive to beef up its R and D activities, Sony started a search for Chinese and Korean engineers in 2003. A first screening was held in Shanghai for over 1,200 applicants who were students of Tsin Hwa University, China's leading institution of higher learning. Many of them held PhD and MS degrees. After a series of written exams, the company selected over 200.

An interview was then held in Shanghai for each applicant. There was a panel of Sony examiners representing each department — communications, cell phones, flat panel TVs, DVD recorders, PCs, and so forth — interested in attracting new blood to revitalize Sony's R and D. Using a blackboard, an applicant would explain, in English, the kind of work he or she was doing. Then examiners in his/her field would shoot detailed technical questions to determine if that applicant had enough knowledge to work on the cutting edge of research; these engineers wanted self-starters who could begin right away in the first week of employment.

After each interview session, the examiners then would get together to evaluate and indicate their interest in hiring that applicant. Sometimes, three or four examiners would raise their hands to hire the same person. Then, negotiations began. "Fast-track" hiring is not the usual style of a Japanese company where traditionally, they might take the records of these applicants to their sections and departments, discuss whom to employ, and report the consensus back to the department in charge of employment. That would take weeks.

But, this is Sony — a company known for quick action. The negotiations lasted a few minutes, and the decision was made on the spot and reported to the general manager in charge of employment.

Altogether, some 30-odd applicants passed the final test, and a notification was made in Sony's Shanghai Office in December, 2004. Also hired were four Korean engineers. The salary is $35,000 per year plus inexpensive company housing. One Chinese graduate student was heard saying, "Heck, we could get $50,000 a year in the United States." He probably didn't know that an experience of working for Sony would go a long way towards promoting his succeeding career.

Is Sony Taking a Step to Beef up Its Software Library?

The answer is Yes. Sony already bought Columbia Pictures in 1989 by spending $3.4 billion, and Sony Pictures Entertainment (SPE) is in charge. In 2004, Sony tried to acquire Hollywood film studio MGM known for "Gone with the Wind" and "The Wizard of Oz", because the combined Columbia-MGM film library would be the world's largest with some 8,000 titles, a decisive advantage in winning the upper hand in the rapidly booming DVD market.

However, Time Warner Inc., the giant media and entertainment group, felt the same way and a legal battle ensued. Sony revised its position to split the acquisition risk. Arrangements were worked out with a leading US cable TV operator with the same yen for the film library.

This proved a success, and a group headed by Sony Corp. of America will expend $2.85 billion in cash to purchase the MGM studio. The studio's debt of some $2 billion will naturally be taken care of by the group.

Sony's policy of "hardware hand in hand with software" is evident in the Sony's determination to win, so that Sony will be the winner in the coming contest over the next generation DVD formats. Sony's Blue-ray Disk (BD) will be backed by abundant titles such as the James Bond movies and the Rockies series. 20th Century Fox indicated participation in the BD association which promotes Blue-ray, and if this share is included, the Sony group will occupy nearly a 30% market share of the US box-office profits.

This box-office receipts share leads to the market of DVD, video rental and sales, whose size is more than double the box-office receipts. While the box-office receipts in 2002 and 2003 were respectively about $9.27 billion and $9.16 billion, the sales of the market of DVD, video rental and sales increased from $20.6 billion to $22.5 billion. When it comes to DVD sales alone, it surpassed $11.6 billion in 2003, more than the box office receipts. This is what Chairman Idei is focusing on in the Sony's overall strategy for the near future.

Sony's business performance in 2003 was a disappointment to many investors, and that may be the reason Sony joined the restructuring bandwagon by announcing in October, 2003, its plan to fire 40,000 employees worldwide in the coming four years.

What happened in Matsushita, Hitachi, Toshiba, NEC and other manufacturers in 2000 and 2001 has just now caught up with Sony and its disappointing figures of late: its operating profit at the mid-term closing of accounts in September, 2003 was $49.8 billion ($415 million, ¥120 to the dollar), a some 50% drop from the previous year. In April 27, 2005, Sony released its consolidated balance sheet at the March 2005 term. Its after-tax profit was ¥163.8 billion ($1.63 billion, ¥105/$1), 85.1% up from prior year, but its sales showed a 4.5% drop of ¥7 trillion 159.6 billion ($68.19 billion).

Chairman N. Idei stepped down as announced on March 7, 2005 and Howard Stringer, CEO of Sony Corporation America, officially took over in June, 2005. After all, 79% of Sony's business is overseas, and R. Chubachi is the next president in charge of electronics to beef up its sagging business on electronic hardware in Japanese market.

In the new intermediate management plan announced on September 22, 2005, Stringer indicated to abolish the company system per division in view of many complaints from young engineers about the difficulty of moving around in a rigid system that prevailed.

Something unexpected always happens in business. Sony's television business shot up with the great success of its LC TV BRAVIA. This contributed to Sony's improved performance at the 3rd quarter of FY2005, up 10% over the same period the prior year with a net profit of ¥168.9 billion ($1.468 billion), up 18%. The sagging electronics division came out with sales of ¥1 trillion 595.8 billion ($13.87 billion) and an operating profit of ¥7.89 billion ($686 million) This was a big gain. The brisk sales of LC TV alone mostly accounted for a gain of ¥25 billion ($217.4 million).

The current recession is the longest postwar recession, triggering structural changes in a broad spectrum of Japanese business and industry. Consumer markets, industries, as well as a great number of companies and manufacturers, big and small alike, have undergone drastic reforms at break-neck speed. A host of firms went under, while major corporations either retreated from unprofitable operations or resorted to mergers. Panasonic is a good example and how they achieved restructuring successfully is introduced next.

Panasonic's President Kunio Nakamura

Matsushita Electric (Panasonic) made an astonishing recovery from its huge deficit two years ago, with 2003 mid-term sales of ¥3,939.7 billion ($32.83 billion) up 1%, operating profit of ¥79.6 billion ($663 million) up 59% and net profit of ¥23.1 billion ($192,5 million) up 32%. This was accomplished by President Kunio Nakamura, the man in charge of restructuring and rebuilding the world's largest TV/appliance manufacturer with a worldwide workforce of some 300,000.

The firing of 13,000 domestic employees, coupled with the step of persuading every employee to change his or her way of thinking, did the trick to revitalize the mammoth corporation. Unless you are on your toes and contribute in some tangible way to help rebuild the company, you could wind up in some remote post, demoted or, worse still, fired.

Matsushita rhymes with Maneshita which means "We Copied." One critic said years ago, "Sony is a guinea pig, while Matsushita is a copycat." To some extent, this is akin to a saying, "Canon is a guinea pig, while Nikon is a copycat." This has been true, because whatever Sony developed, be it transistor radio, tape recorder, Walkman, or CD, Matsushita followed up with mass production of these products, then sold them through their extensive distribution channels, and, most importantly, made money.

One thing they did not copy was Sony's enormously popular Play Station 1 and 2, each selling more than 60 million units the world over. As President Nakamura said in an interview[37], "there shall be no more copycatting." And that restructuring policy has proven to be the prime-mover in the resurgence of Panasonic.

President Nakamura believes that the mass production and mass sales system are no longer applicable for today's marketplace. Taking an aggressive stand in the new century, Matsushita's choice is ""technology-orientation." (This sounds like Sony, which has touted this line since its founding.) In keeping with this policy, Matsushita beefed up the number of engineers on R & D to nearly 40,000, in an attempt to shorten lead time from development to marketable, finished product. As a result, some 92 products such as DVD recorders, plasma display panel TVs, and even new, energy-saving air-conditioners are now hot sellers.

Panasonic's large-capacity DVD recorder named DIGA is a good example. The model E200H has a hard disk of 160 GB that can record 36 to 212 hours, depending on picture quality — this is equal to 35 two-hour tapes in conventional recording. DIGA carries a high price tag, but the Japanese consumer has up to 36 months to pay on installment, so this product is selling like hotcakes — racking up a 50% share of the world DVD market. Here was one field Sony did not develop first, since Play Station 1 and 2 both have only DVD playback functions.

President Nakamura also talked about a strategy called "Dismantle and Create." He implemented a number of changes. For instance, some 1,500 personnel were engaged in administration between the front-line workers and the president. He promptly halved the head office staff. Departments and sections were either combined or abolished, and groups were formed. This belt-tightening is called the "Flat and Web" organization.

And another thing, President Nakamura spent ¥140 billion ($1.4 billion) for beefing up IT. Also, to rejuvenate the huge organization that is Matsushita Electric, at a joint training seminar of junior executives, he made it plain that candidates for future executive positions would be selected from those in their 40s. Under Nakamura's leadership, Matsushita's famous divisional company system was abolished and a domain system set up. In the domain system, there is one company for one business, and no two companies make products in the same line.

In addition to bashing and eliminating the division system, the belt conveyor line was replaced with a cell production system where one worker builds up one assembly. In his/her spare time he/she thinks about how to save a step or two or how to achieve accuracy in making each product. Boring work on the conveyor line was converted to an exciting job. As a result, productivity shot up 2.5 times, with an additional savings of a warehouse space for storing products — since each product is shipped as soon as it is completed. This is similar to Toyota's method of minimizing inventory.

37. December 5, 2003, *Shukan Post.*

New product development is made cumbersome under the divisional company system full of self-imposed restrictions. For example, developing a digital TV in 1997 (Sony researchers at work) was extremely difficult at Panasonic at a time when analog TV was having a field day. This is a familiar problem facing any top management — when and how to retire hot sellers and replace them with much better products. Somehow or other, Panasonic overcame their own built-in barriers and successfully developed a digital TV that cornered a 50% share of the Japanese market.

President Nakamura abolished most of the divisions and built the domain system similar to a federation of states. Each company, the state, runs its own business, whereas the Head Office, like a federal government, undertakes diplomatic affairs, marketing and advertising.

Speed is essential in today's business, as we all know. In this topsy-turvy business environment, a No. 1 company can easily lose its dominant market position in a matter of days if a new, more attractive product emerges (for example, the digital camera).

The existing system in most Japanese companies is based on a Ringi-Sho procedure. This means the person in charge of the proposing department shows a draft to all executives involved in the process, and all have to approve the plan. When a given Ringi-Sho has received the "seal of approval" of all the parties concerned, the CEO stamps it "approved."

This takes time. And here is why: The secretary of the person in charge has to make the round to all the parties concerned, that is, all department heads concerned, to get their seals. First she goes to the office of the Sales Manager and leaves the Ringi-Sho there. When the Sales Manager approves it, it is stamped with his seal; eventually the secretary gets a call to come and pick up the Ringi-Sho. This is repeated for each department head. If one department head happens to be out of the office, the Ringi-Sho stays in that office until that person returns. In this way, the whole process takes a few days to complete.

Under the system introduced by President Nakamura, this Ringi-Sho procedure is now stream-lined so that a decision is made at a semi-weekly, consolidated decision-making meeting attended by the president, executives in charge of planning, personnel, accounting, and legal affairs. When they all give it the okay, the buck stops there.

The Ringi-Sho is numbered. Each number, then, is used by the Accounting Department to check out expenses for a given project. In other words, if a project has no number, it receives no funding. In that sense, the Ringi-Sho is a critical in-house document for Japanese corporations and manufacturers.

In October, 2002, President Nakamura took the step of incorporating five major Matsushita companies, including Matsushita Communication Industrial Co. and its subsidiaries, and the Matsushita Group was reorganized into 14 domains.

To top it off, in December, 2003, Matsushita Electric Works, a brother company to Matsushita Electric, was incorporated as a subsidiary. Matsushita Electric Works is well-known in Japan as "Matsushita Denko" mostly specializing in home lighting equipment and building supplies. It is Japan's No. 1 manufacturer and distributor in that line. Also, they manufacture parts and components for electronic materials such as sealants for PDPs, as well as control systems for IT terminals and automobile-mounted electrical parts.

Backed by a very good sales force, this manufacturer boasts annual sales in excess of ¥1 trillion ($9.1 billion) with a current profit of ¥42 billion ($381 million), a result of successful restructuring, by dismissing 1,000 workers and cutting back costs.

In 2003, the stock prices of Matsushita Electric Works were low, and it was time for Matsushita Electric to make a takeover bid. This was a friendly acquisition, and Matsushita Electric Works endorsed it at its board of directors meeting on Dec. 19, 2003. The sum of ¥146 billion ($1.33 billion, ¥110 /$1) was spent by Matsushita Electric to raise its share from 31.8% to 51% (¥1,010 or about $9.18 per share).

By adding Matsushita Electric Works, Matsushita Electric Group gained consolidated sales of over ¥8 trillion ($73 billion) which places it as truly the electric group of the world's largest class as shown in the table below.

This move also places Matsushita Electric ahead of Sony in sales and current aggregate value. I have a feeling that, regardless of reasons for the takeover bid, the ulterior motive could very well be for Panasonic to stay ahead of Sony in financial statements, because, as most everybody around here knows, President Nakamura cannot stand taking a back seat to Sony.

Matsushita Electric's data in this table includes that of Matsushita Electric Works:

Table 12-12 Performance forecast of Panasonic, Sony and Hitachi in FY2003
(Unit: ¥100 million, 110/$1)

	Matsushita Electric	Sony	Hitachi
Sales	¥8.5 trillion ($77.3 billion)	¥7.4 trillion ($67.3 billion)	¥8.35 trillion ($76 billion)
Net Profit	34 billion ($309 million)	50 billion ($455 million)	10 billion ($91 million)
Current Aggregate Value	3.6256 trillion ($32.96 billion)	3.4391 trillion ($31.26 billion)	2.1353 trillion ($19.41 billion)

Source: Dec. 20, 2003, Nihon Keizai Shimbun, p, 3
Note: Forecast for period ending March, 2004, consolidated base

Matsushita Electric stopped using its brand name "National" abroad, and this posed a problem for Matsushita Electric Works. But the new system of working under the Panasonic brand name solves it.

In May, 2004, Panasonic announced plans to spend ¥90 to 95 billion ($818 to $863 million, 110/$1) to build the biggest plasma panel plant in the world. This move reflects Panasonic's determination to keep their 50% share of the flat panel display market.

At the March 2005 term Panasonic reported sales of ¥8.7 trillion ($79 billion) with an operating profit if ¥308.4 billion ($2.8 billion). This is quite an achievement by comparison to the huge deficit of ¥431 billion ($3.59 billion) in FY2001. Now that the task of rebuilding Panasonic is mostly finished, President Nakamura indicated in February 2006 to step out to become Panasonicís chairman. Fumio Ohtsubo, senior managing director, will take over as president in June, 2006.

FANUC, World's No. 1 Manufacturer of Factory Automation and Robots

FANUC stands for Fujitsu Automated Numerical Control. I never heard of FANUC until I rode my motorcycle in 1987 through a village, Oshino-mura, located on a high plateau at the foot of Mt. Fuji. There were a number of yellow-painted two or three-storied buildings spread among pine trees, and they did not look like factories, so I asked a filling station attendant about them. "Oh, didn't you know that? That's FANUC. They are making good money, exporting the world over, so taxes here are less than in neighboring towns and cities."

I learned that they were a pioneer, the world's largest manufacturer of factory automation and industrial robots. That's what has been sweeping the auto industry in Japan, using a lot of interlinked numerically controlled equipment.

Today, FANUC makes at least 1,000 industrial robots per month. So far a total of 120,000 units have been produced. Its products performing spot welding, painting, arc welding, assembly, and alignment are distributed and serviced worldwide, with the 50% global share of market and the 70% domestic share.

At the heart of factory automation is numerical control, and the heart of numerical control is a servomechanism. And the heart of a servomechanism is a servomotor. The servomotor receives power from the amplifier element and drives the load or work piece with a linear or rotary motion. Since the quality of the servomotor makes or breaks factory automation, FANUC manufactures its own servomotors.

These servomotors are sold to many machine tool makers all over the world. Despite high prices, the users are happy because they are very durable and reliable providing precision work. One advantage of the FANUC servomotor is that it is equipped with a regenerator so that any power saved in the servo amplifier may be sold back to the electric power company.

FANUC's founder, Seiemon Inaba was an engineer working on pulse motors at Fujitsu. Inaba is wary of borrowing funds from any source, so when he set up the company in 1972, he obtained Fujitsu's backing. FANUC has been prospering ever since then, with its stock prices hovering around ¥5,000 to ¥7,000 level per share ($42 to $58, ¥120/$1), with no debts, that is, no liabilities with interest, while Fujitsu, one of the major electric/electronic/computer manufacturers which was hard hit by the information technology recession, sold its shares in several batches and today, Fujitsu owns less than 25% of the FANUC shares. This now makes Fujitsu ineligible to include FANUC in its consolidated balance sheet.

In 2005, FANUC enjoyed good sales, in fact, so brisk that every employee received a ¥250,000 ($2,273, ¥110/$1) extra bonus in June, in addition to the usual summer bonus.

Seiko-Epson

In October, 2005, I was visiting Los Angeles and had a lunch with a businessman I had known over 30 years. He is a freight forwarder handling cargo between the United States and Asia. Our conversation turned to office equipment, printers, to be precise. He said he was using an Epson and explained that only they had a model that could produce one original and four copies at a time. In the 1980s, I too had bought an Epson, the LP1500 black and white laser printer, at Tokyo's famed discount district, Akihabara. It lasted for some 15 years with no breakdown.

Epson is synonymous with technological prowess. Its sales and operating profit doubled over the past 10 years. Epson went public in June 2003, and revised its corporate name to Seiko Epson. With ¥100 billion ($854.7 million, ¥117/$1) procured from the stock market, it is beefing up its capital investment for the image and picture division as well as R & D. Way back in 1965, it was known as Suwa Seikosha Co., Ltd. It was a subsidiary of that giant watchmaker, Seiko, which means precision or precision engineering. In 2005, Seiko-Epson racked up sales of ¥1.6 trillion ($14.5 billion, ¥110/$1) through a work force of some 11,000. It recorded the highest net profit of ¥56.69 billion ($515.4 million) at the March 2005 term.

Epson surprised many in Japan's business and industry for taking a drastic action in the early 1990s to scrap certain products from production and sales simply because they were not the world's No. 1 products.

The current prosperity is based on such drastic measures implemented under the farsighted policy set up by Hideaki Yasukawa (former Chairman), after he became President in 1991. In those days, Epson's product line included products which could be made by any other company, such as the floppy disk drive, hard disk drive, and even personal computers. He reasoned that Epson should focus on making the kind of product that could place Epson as No. 1 in the field. Accordingly, Seiko Epson pulled out of floppy disk drives, where Epson was No. 2. It was just a peripheral piece of equipment to the computer with no high added value. For similar reasons, Seiko Epson pulled out of the personal computer line, even though 20,000 to 30,000 units were made per month from 1987 to 1994.

Seiko Epson, like Panasonic, once had a system by which each division operated as an independent company to pursue efficiency. But there appeared the same drawback Panasonic suffered — no intervention in other division's business. Since this doctrine was detrimental when a company-wide effort was needed for a given project, the division system was abolished.

Yasukawa was also known for stressing speedy action and speedy decision-making. No dilly-dallying. This thinking led to abolishing a hierarchical relationship between divisions and headquarters. In many cases, planning, production, and sales proceed simultaneously, for he believed that original technology remains to be original only when it is made commercially available ahead of competitors. This calls for speed.

Seiko-Epson's fame dates back to the Olympics when Seiko became the official time piece. After the Olympics, an economic slump set in, but not for as long as people had feared. On the other hand, the Seiko brand acquired a reputation as the world's timepiece. Then, in 1968, Seiko brought the EP-101 miniprinter to the market, followed by the quartz watch in 1969, which surprised Swiss watchmakers. Both were world firsts.

The 1970s saw Seiko sweeping across the world markets with quartz watches and Sony was doing the same for transistor radios. The quartz watch also paved the way for Seiko-Epson's electronic devices business. Research, development, and production of the main components of the quartz gave birth to a much broader business of precision-engineered products including semiconductors, liquid crystal displays, and quartz devices.

Today, Seiko-Epson has cornered about 20% of the world market of inkjet printer dominated by Hewlett-Packard (which has a 40% share of the world market). Seiko-Epson's products and devices occupying the No. 1 share of market in Japan or in the world include the inkjet printer, color laser printer, color image scanner, liquid crystal projector, and LCD module for mobile phone.

There is a tough price war raging throughout Japan by printer competitors involving Canon, Hewlett Packard, Fuji Xerox, and Ricoh. A strict risk factor should be included within a predictable range, and this consideration must have been reflected in Seiko Epson's forecast — the FY2007 projected sales of ¥1 trillion 660 billion ($15.1 billion, ¥110/$1).

In 2001, Saburo Kusama took over as President (current Chairman). When Seiko Epson went public in February 2003, he declared a goal to build up Seiko Epson as a digital imaging company, somewhat akin to Sony, save information contents and game machines.

As he explained in a magazine interview[38], Seiko Epson's strategy of freeing itself from personal computer means bypassing the use of personal computers. The conventional method has been for the printer, DVD, and other peripheral equipment to function through the personal computer. But, direct transmission of data and information is now carried out from a camera to a printer and a DVD or from DVD to a color TV. In other words, Seiko Epson has three facets of technology — picture processing techniques through color

38. Sep. 6, 2003, the *Shukan Gendai*,.

printers which reproduce pictures of photographic quality, image processing techniques through projectors, and display techniques through liquid crystal panels. By combining these unique techniques, Seiko Epson carries out networking without going through personal computers.

While the PC market is dominated by Microsoft and Intel, the peripheral equipment is mostly made in Japan. In this sense, President Kusama thinks that this will be Japan's century.

In the fall of 2002, this concept entitled "Digital Photo-Link Concept" was announced at Photo-kina, a camera show in Germany, and it was warmly received by Europeans.

Electronic products such as circuit substrates can be easily pirated and copied. However, when it comes to ultra-fine machining in units of one hundred thousandth of a millimeter, other countries including Taiwan, China, and South Korea cannot duplicate it.

Epson Headquarters is located on Lake Suwa, about two hours' ride from Tokyo. Lake Suwa is often compared to Lac Leman of Switzerland, and many engineers want to live and work in that beautiful environment surrounded by a host of hot springs.

That is not all. Seiko Epson has introduced its thin-type TV.

They are also helped by the policy of the Japanese government to begin digitalization of communications including TV broadcasting in 2006, to be completed by 2011. In other words, analog broadcasting will be completely switched to digital broadcasting by 2011. The time is right for Seiko Epson to push its strength in precision technology. On January 7, 2005, Seiko Epson announced its full-scale entry into the home TV market with a large screen, liquid crystal TV based on rear projection. Called Livingstation, it was first sold in the US market.

Then, in June 2005, Seiko Epson made announcement of the direct sale of Livingstation in the Japanese market. Because of direct sales, its retail prices are held much lower than plasma or liquid crystal TV which are in the range of ¥500,000 or $5,000 for a screen of 50" or more. Seiko Epson's rear projection TV I saw in July at a satellite station in Tokyo's Aoyama was priced at ¥298,000 ($2,700, ¥110/$1) for a 47" model and ¥398,000 ($3,618, ¥110/$1) for a 57" model. Naturally, a printer can be hooked up for printing images.

There are three small liquid crystal panels for Red, Blue, and Green, each 0.7 inch square. Use of these three LC panels is called the 3LCD system. Light emanating from a tiny projection bulb first runs through a mirror for color separation into three colors of Red, Green, and Blue. Then, each of the three panels generates a high-precision image of each color. Next, each of the three R, G, B colors is synthesized in the prism which functions to reproduces a sharp image in full color. The image thus generated goes through a projection lens made up of a number of lenses for enlargement in a very short distance. And this enlarged image is reflected on a large screen from behind.

This use of projection is conducive to giving off images which are sharp but soft on the eye. Incorporated is the optical know-how and expertise acquired from Epson's liquid crystal projector.

I was surprised at a few of the small component parts. This should be easy to maintain. One light bulb will last 5 to 6 years, but the unit has a spare bulb included. The bulb itself is available at a retail price of ¥16,000 or $150 or so. On top of all that, its power consumption is a low 190 watts. How thin is it? Only 36.5 cm or about 14.5 inches deep for a 47" model.

Canon

Canon and Epson meet head-to-head in one area — printers. Epson uses its own patented inkjet head, while Canon has developed its own inkjet techniques from its bubble jet. The two produce scanners and digital cameras, as well. Like Epson, Canon pulled out of making personal computers, because Canon PCs were no match for No. 1 NEC PCs or No. 2 Fujitsu PCs in terms of sales and marketing coverage.

Then Sony came out with VAIO which, in no time, captured a 10% share of the PC market. In 2005 Dell, with its low cost, moved in, replaced VAIO and took the No. 3 position. Hewlett Packard is also following Dell. Then, Sony introduced a cheaper priced version of VAIO. This is, indeed, a highly competitive field.

Canon started out as a camera manufacturer. Today, it has expanded to be a manufacturer of office automation equipment, its sales ratio being over 70% office automation equipment, 20% camera, and 8% optical equipment. (By the way, Canon's overseas sales ratio is 75%.) Canon's stepper is as famous as its camera. Used for VLSI manufacturing, this product is a type of semiconductor manufacturing equipment that prints an IC pattern on a silicon wafer.

The company has enjoyed very good sales performance through the 1990s up to now. The first half of the 1990s was a trying period for any business, but Canon managed to come out with a consolidated net profit averaging ¥38.8 billion ($388 million) per year. Their average net profit per year tripled during the second half of the 1990s — ¥105.4 billion ($958 million, $110/$1).

Canon's President Fujio Mitarai set a goal of ¥4 trillion ($38.1 billion, ¥105/$1) for consolidated sales in FY2005 in Phase 2 of the company's Global Excellent Corporate Group Concept that began in 2001. Now, let's see if that goal has been met.

Canon's consolidated sales in FY2000 were ¥2,781 billion ($23 billion, ¥120/$1), up 6.1% over the prior year, with a net profit of ¥134 billion ($1.12 billion) which nearly doubled the prior year record. FY2005 sales have fallen just a little short of the goal but racked up ¥3.74 trillion ($37.4 billion, ¥100/$1) with a net profit of ¥357 billion ($3.57 billion).

In the 1970s, Canon came out with a drum-type copier in the same way as Xerox began. The trouble with the Canon copiers then was that when you copied many pages, say 200 at one time, the drum got too hot and you had to wait an hour or so for the drum to cool down. (Xerox had a similar problem, in the early days.)

In the 1980s, Ricoh was producing copiers based on a sublicense from Australian Xerox. Then in 2002 or 2003, Canon developed a plain paper copier based on a principle different from the Xerox concept. The key is that Xerox used Se (selenium) for its photosensitive material while Canon used something they were very familiar with — CdS (cadmium sulfide). CdS is known to camera manufacturers as the light-receiving element for the camera's exposure meter. Its electric resistance diminishes when hit by rays of light.

First, let's take a look at the Xerox process as partly explained by G. Marushima of Canon, the Patent Department Director who was involved in patent negotiations with Xerox and who retired as Senior Managing Director in 1999. In his book[39], Marushima explains that the Xerox process employs a photosensitive material, Se. This Se is charged in a dark chamber to get a positive charge and subjected to exposure of an image in the dark space. Then, charges escape from the area hit by rays of light, so that a charge-latent image is formed. As the exposure agent is sprayed on this image, it adheres to where the charges remain. This is transferred to paper (called imprinting) so that the toner coated on the paper through imprinting is melted by heat and fused. Subsequently, to re-use the drum, cleaning is applied to its surface.

Canon engineers realized that Xerox's basic patent consisted of charging the photosensitive material in the dark space, exposing it, and making the image. Accordingly, then, if someone could devise a new process that did not require making a latent image by means of charging and exposure, Xerox's basic patent could be bypassed. Canon's researchers placed an insulation sheet over the photosensitive material so that even if charging and exposure are carried out in the dark space, since light is shut off by the insulation sheet, no latent image can be formed. This concept marked Canon's decisive difference from Xerox.

Because of the use of the insulation layer, Canon invented a new method called "blade cleaning" to clean the surface of the drum. This cleaning process was as simple as scraping the surface with a rubber blade, like the windshield wiper of a car. The blade became a point of contention with the Japanese patent examiner who quibbled about its being too simple. This technique was patented in Japan and many other countries, and it is still used by a number of copier manufacturers.

To make a long story short, Canon built up over 1500 patents regarding its NP system. Xerox offered cross-licensing arrangements, and in March, 1978, both parties signed a cross-licensing agreement. Canon's researchers did not stop there. In 1982, Canon developed a toner cartridge which integrated the photosensitive drum and the toner (ink powder) container for the first time in the

39. Marushima, Giichi, *Canon Patent Group* (Canon Tokkyo Butai), Tokyo: Kobunsha, 2002.

world. Today, toner cartridges are widely used because they are so easy to replace. Toner cartridge development soon led to the birth of small personal-use copiers. I remember buying one of these in the 1980s because it was handy and inexpensive. I still use it today.

Today, Canon holds nearly 2,000 US patents, next to No. 1 IBM.

Canon has long been known as an "Excellent Company." This is due mostly to President Fujio Mitarai's persistent efforts to restructure the company. He personally visited every plant to explain the details of cost-cutting measures so that every worker understood. Japan's Prime Minister Koizumi is known to holler, whenever he gets the chance: "Where there is no restructuring, there is no growth." This philosophy exactly characterizes Mitarai's policy. As a result, cost-cutting to the tune of ¥80 billion ($762 million) has been accomplished, greatly contributing to Canon's superb profit picture.

Unlike some companies, Canon did not fire employees to cut costs. President Mitarai mentions on many occasions that Canon holds to traditional forms of life-time employment but avoids seniority-based wages. Good employees stayed on, and some employees were transferred to Canon's affiliates or subsidiaries. Accordingly, labor productivity zoomed up.

In 1988, Canon's employees totaled about 16,000 and its sales amounted to ¥374.5 billion ($3.745 billion). In 1995, Fujio Mitarai took over as Canon's president. The first thing he did was restructure the company. He closed seven unprofitable divisions. This caused the company to lose $73 billion (approx. $730 million) but the deficit decreased. In 1998, 10 years later, while Japan suffered from depression, with deflation creeping up, Canon hired 4,000 more workers. That pushed Canon's total employee-count to a little over 20,000, and the company racked up sales of ¥805.7 billion ($8.057 billion) — 2.5 times the 1988 record. The upward momentum continued strong in 2004 when sales of Canon alone (not consolidated) registered ¥2.23 trillion (¥21.38 billion, ¥105/$1), up 2.76 times over the 1998 record. Remarkably, they achieved this figure with only 18,800 employees — some 2,000 fewer workers than those of 1998.

In other words, Canon's sales-per-employee was ¥23.4 million ($234,000) in 1988, ¥40.3 million ($403,000) in 1998, and a whopping ¥118.62 million ($1.13 million) in 2004. It is no wonder that Canon's stock has always held in the price range of ¥5,000 (a little under $50) despite the past sagging decade. The ratio of foreign shareholders crossed the 50% mark. And Canon has constantly been spending 12 to 13% of its sales — that would be some $2 billion — for R & D, to boot. On top of all that, Canon now has cash bank deposits of ¥1 trillion ($9.1 billion, ¥110/$1).

Rome was not built in a day. It took years for President Mitarai to streamline the structure. He was the nephew of Founder and President Takeshi Mitarai (a former obstetrician), but he never thought he would become the CEO of the company. The Founder's son, Hajime Mitarai, with a PhD in electronics from Stanford, no less, was in line as the obvious choice to take the helm. But, two years after he became President, Hajime Mitarai passed away. That was

1995. Fujio Mitarai remained the only one left who was related to the Mitarai family.

Mitarai graduated from the Law Department of Chuo University, probably the best private law school in Japan. He joined Canon Camera in 1961, and in 1966, went to Canon U.S.A., Inc. He rose to assume its Presidency in 1979. Then, in 1989, he was called back to Tokyo, the reason being that President R. Kaku, himself not an engineer, was due to become the board chairman; and Kaku wanted another person on the board who was not an engineer.

This board diversity is the same concept that governs Sony. Its former chairman N. Idei is not an engineer but an economist versed in electronics. Interestingly, another of its former chairman Ohga is an opera singer, also versed in electronics.

Mitarai went to the US when he was 30 years old and returned to Japan at age 53. His 23 years of living and working in the United States became an indispensable asset in his guiding the future course of Canon. Running Canon U.S.A., he was general manager and treasurer, so he studied the accounting and financial side of the business, as well. He closely observed the American way of life and doing business. One well-known anecdote taught him a memorable lesson.

In 1966, Canon U.S.A. had its first financial results to declare. The sales were only $3 million and undoubtedly the company was in the red. But Mitarai thought that it would be shameful to report a loss, so he found a way of reporting a profit of $6,000 by arranging for an invoice for promotion and advertising to be turned in later. An IRS official eventually observed that a $6,000 profit for sales of $3 million was too little, and suggested the possibility of tax evasion. He checked around some more and told Mitarai that he would be a fool for trying to squeeze out a profit when there was a very good possibility of a deficit. If that was the kind of game he played, Mitarai should collect all the accounts receivable, get the cash, put it into a fixed deposit, pack up, and go back to Japan. That way, he was sure to earn an interest of “5% or so without working.” Then and there, Mitarai learned a valuable lesson that became part and parcel of his management philosophy: “No matter what you do, you’ve got to make money.”

This has been the guiding principle for Mitarai in his restructuring efforts at Canon. Technological achievements are fine, but that is not enough. New technology must assure income for the company.

One major reform of production engineering is Canon’s switch from the belt-conveyor system to the cell production system — just as FANUC did, or Panasonic, later under President K. Nakamura. Productivity shot up 2.5 times at Panasonic. The ideal cell production system is where one worker assembles one product. At the beginning, under the cell system at Canon’s copy machine manufacturing plant, about 10 workers formed a team to tackle assembly work. Since employees were accustomed to the assembly line, they worked according to belt conveyor speed.

In the cell production system, each worker can work at his/her own pace. In the belt-conveyer system, tools and jigs and equipment were made for the assembly line, whereas this new method meant that workers designed and made the kind of tools and jigs and equipment more suited to cell production. Productivity gradually increased. Manpower saved turned out to be 212 workers in 1998, 280 in 1999, and 728 in 2000. (These workers were reassigned to other workplaces.)

In the assembly line system, even if orders for a given product decrease, the line continues churning out products which are piled up in the warehouse as inventory. In the cell production system, the production output is adjustable by increasing or decreasing the number of cells or the number of workers in a cell. Or, the rate of working in the cell can be changed to accommodate changes in production output.

Canon's Nagahama Plant was where the cell production system began. It took several years, but the system proved successful. President Mitarai was introduced at this stage, and he immediately understood its advantages.

In 1998, Mitarai decided to introduce the cell production system to every plant in the company. It spread to plants manufacturing cameras, chemical products, and inkjet printers. On January 28, 2005, Canon announced its consolidated financial results for the term ending December 31, 2004 — sales of ¥3 trillion 467.9 billion ($33.03 billion, ¥105/$1), up 8.4% over the prior year and an after-tax profit of ¥343.3 billion ($3.27 billion), up 24.5% over the prior year. This represents increased earnings and profits for five consecutive years. Further, at the December 2005 term, Canon reported sales of ¥3.67 trillion ($33.36 billion).

Today, Mitarai is one of the most sought-after guest speakers at conventions, local chamber of commerce conferences, and other business meetings on the arts and science of management.

While Mitarai's next step is to consolidate design, production engineering, and cell production sites (this is done at FANUC), his immediate goal is to introduce, in early 2006, a large-screen, thin type TV display called SED whose joint development with Toshiba took 20 years[40]. SED stands for Surface-conduction Electron-emitter Display.

SED is a next-generation thin type display backed by a consolidation of Canon's original technology of an electronic source and miniaturization techniques and Toshiba's Braun tube manufacturing technology and liquid crystal mass-production techniques. Further, the SED display has a printer which enables you to print out information from the TV.

Mitarai is appointed to be the next Chairman of Keidanren, the Japan Federation of Economic Organizations after the current Chairman T. Okuda (Toyota Motor Chairman) finishes his second term in 2006.

40. Channel 1, July 17, 2005, 8:30 pm to 9:00 pm, NHK, Tokyo.

Seven-Eleven Japan

This is Japan's biggest retailer with FY2005 sales of ¥518 billion ($4.93 billion) from its 10,000 stores including franchisees. As the current Chairman T. Suzuki once remarked, Seven-Eleven Japan is like Panasonic, because they don't own property but get leases. There is no sense in tying up funds in fixed assets such as land and buildings. This is one of the many reasons Seven-Eleven has racked up increased sales and profits for the 24 consecutive year.

Seven-Eleven Japan always reminds me of my favorite food in winter, introduced according to Suzuki's idea. It is also favored by many Japanese for years. Called "oden," it is a hodgepodge of vegetables, sea food, and sea food balls cooked in soy sauce and sea food based sauce. Served hot on a small bowl with mustard, it goes well with beer; with a warm cup of sake. Actually, Seven Eleven Japan features this dish at all of its 10,000 stores in fall and winter.

A square copper pot filled with savory morsels soaked in warm sauce sits by the cash register. Naturally, this is copied and other convenient store chains provide the same service all over Japan. It is one example of Seven-Eleven's emphasis on good food. Fresh food and lunches makes up 30% of Seven-Eleven's sales. If you include processed food and food items such as crackers, the food business occupies over 50% of the sales.

Ito-Yokado is Japan's No. 1 supermarket chain currently chaired by Toshifumi Suzuki who is also Chairman of Seven-Eleven Japan. And Seven-Eleven is a member of the Ito-Yokado Group. Suzuki keeps two computers in his office, one for Seven-Eleven and the other for Ito-Yokado.

In 1991, Ito-Yokado took over Southland Corporation, operator of Seven-Eleven franchise in the United States. This takeover was a friendly one.

President M. Ito said, later, in his autobiography that appeared in the *Nihon Keizai Shimbun*, he was asked by Southland Corp. who respected Ito because he had a solid reputation of being a sincere gentleman who would never go after speculative gains such as investing in land and stocks. They asked if Ito would be interested in the good will of Seven Eleven Japan. Ito obliged and loaned some $400 million to Southland against the security of that good will. It was in 1987. Southland needed more cash, so 57 stores in Hawaii were sold next year to Ito's group for $75 million. Then, there was a takeover bid by another company.

On the other hand, Japan was in the middle of the bubble and Ito said that his company had some funds available, enough to save Southland.

In the end, the IY group spent another $430 million for an outright purchase of the rights to manage Southland. Suzuki was in charge of the negotiations and convinced Masatoshi Ito, the IY group chairman, whose financial conservatism made him hesitant about spending $430 million. Suzuki told Ito that should this go wrong, we ought to take it as a fee for a lesson worth learning.

As he predicted, this didn't go wrong. Today, Seven-Eleven U.S.A. is part of the Ito-Yokado Group and under American management. The same efficient

POS system is used for the American operations as well. For example, when I visited one Seven Eleven shop in Los Angeles, the manager was seen touching a keyboard. Popular items instantly appeared on the display—one particular brand of beer, et cetera, et cetera. Orders for products were placed according to what was in demand, and the store enjoys good sales.

In the early 1970s Ito-Yokado was No. 8 supermarket chain with only 29 stores. President Ito was looking for ways to learn about chain store operations. The fastest way was to tie-in with some American company operating franchise. Their choice fell on Seven-Eleven and Denny's. Arrangements with Denny's to operate its restaurant chain in Japan went without a hitch. But Seven-Eleven successfully operating 4,500 shops in the United States at that time was a tough nut to crack.

It was May, 1971 when Ito-Yokado's representative went to Dallas to propose some kind of arrangement to run Seven-Eleven in Japan. "Not interested" was the answer.

Now, if the representative went back to Japan, reporting "No go," he would be just an errand boy, but he was not. Any negotiation starts after the first refusal. The Dallas Branch of C. Itoh, Japan's leading international trading house, was instrumental in working out a deal, and finally, Southland Corp. agreed to listen to what the Japanese party had to offer.

It was more than a year later in October, 1972 when Southland opened its door to Ito-Yokado. After meetings, in 1973, they sent a mission consisting of three retail experts to check Ito-Yokado's stores and operations as well as other supermarkets. Their reaction was a positive one. One major factor was that Ito-Yokado stores were cleaner than other supermarkets.

While T Suzuki was working hard in the 1970s for a supermarket chain called IY or Ito-Yokado, that was still a small operation compared to Daiei, which was forging ahead as Japan's No. 1 supermarket chain. Suzuki realized that there was a need to save those small family-run shops which were being run out of business by the big chain stores. Whenever he attended a grand-opening for a new IY store, he had to face an anti-IY drive staged by local merchants. In 1973, he began working on the Seven Eleven project.

Suzuki had visited the United States several times to negotiate a successful deal with Denny's. At that time, he saw Seven Eleven stores in the United States, but he didn't pay much attention. Upon his return to Japan, he had a chance to read materials on Seven Eleven which was profitably run by Southland Corporation

On the other hand, IY itself was overwhelmingly against Suzuki's idea. "How can you make money running a chain of small stores?" The bigger the better was the prevailing attitude in Japan then. President M. Ito of IY also took a doubtful position.

Suzuki's position was that, even if it is a small shop, it's all a matter of productivity of workers. So long as you systemize the operation to increase productivity, you should be able to make a decent profit. Japanese consumer behavior is definitely in favor of buying a product if it is worth buying and conveniently available for purchase. The trouble was that Southland Corporation, itself, was not interested in working with a Japanese partner to operate in Japan. It took a year and a half before they were able to conclude an agreement, near the end of 1973. As anyone familiar with international deals knows, signing an agreement is just the beginning of loads of work.

First Suzuki tackled the method of operation. When he went to Southland's training center in San Diego with his staff, Suzuki immediately saw that most of the operating methods of US convenience stores could not be copied. Retail business is highly indigenous, so his group had to devise a Japanese system tailored to Japanese consumers. Suzuki retained Southland's accounting system, but other details of merchandising and sales were built from the ground, up.

Suzuki had to start from scratch when he took over as Senior Managing Director of York Seven (later renamed Seven Eleven), which was established in November, 1973, after conclusion of the agreement with Southland Corp. The first franchise shop opened in Tokyo on May 15, 1974, at a former liquor store. It was a small shop with a floor space of 25 tsubo, which is a little under 1,000 sq. ft. The owner paid for remodeling, with shop equipment to be offered by Seven Eleven. The accounting system for both parties was to be the open account system for every interested party to see.

Profit was calculated in gross income or gross sales minus purchasing cost. This is known as "gross profit margin," with 45% going to Seven Eleven and 55% to the franchisee. The relationship between Seven Eleven and the franchisee is equal. Seven Eleven will not meddle with the franchisee's right to operate the shop.

According to *Toshifumi Suzuki: Paradoxical Management* (Suzuki Toshifumi—Gyakusetsuno Keiei), the first shop has been doing good business for 20 years now — with daily sales grossing nearly ¥3 million ($28,000, ¥105/$1), annual sales ¥7 to 800 million ($6.7 million to $7.6 million). It is one of the leading stores. An average Seven Eleven store grosses about ¥700,000 ($6,700) per day.

In the 1970s, to get customers familiar with Seven Eleven, stores were set up in one target area like carpet-bombing. This also helped cut back delivery and advertising/promotion costs. Accordingly, one shop after another opened in the ward where the first Seven Elevens were set up.

Suzuki remembers the first problem of stocking in small lots. His initial policy was to use wholesalers' delivery function instead of buying directly from manufacturers, but many wholesalers were not too enthusiastic about delivering small lots of merchandise to the stores. Even those wholesalers dealing with the IY supermarket chain, Seven Eleven's parent company, refused to do business with Seven Eleven, because delivering small lots of merchandise takes time and work.

The 1970s was the age of mass production and mass sales. Take canned goods, for example. The minimum lot for ordering was 4 dozens or 48 cans.

Based on sales of a few cans per day, it would take a few months for a small store to sell that many cans. Since there were about 3,000 items per store, stocking 48 pieces of each would require a big warehouse, and a wide assortment of goods could not be made available to consumers.

Conversely, Suzuki says, since other bigger stores buy in large lots, they are unable to provide newer goods and a large assortment of merchandise. As far as Seven Eleven was concerned, it would be convenient if the wholesalers could make out small lots of other merchandise and deliver twice a week. Naturally, big wholesalers were not interested, but Suzuki succeeded in persuading small wholesalers to do small-lot operations. Now that convenience stores abound in today's Japan, it is normal for manufacturers to offer small lots.

At the beginning, Seven Eleven tried selling hot dogs, but hot dogs did not quite catch on. So Suzuki decided to experiment with fast food tailored to Japanese tastes, and the choice fell on o-nigiri, or rice balls, as well as lunch boxes with cooked rice and an assortment of fish, meat, and other food. Consider when this choice of food items was made — 1976.

Naturally, many at Seven Eleven were not optimistic about the prospect. Rice is something you cook at home — (this is why Toshiba introduced the world's first electric rice cooker which caught on in Japan, as well as in Asia with a host of the appliance manufacturers copying). Lunch boxes were something wives or mothers made at home for their children and husbands to take to work or school. Back then, nobody bought lunch boxes or rice balls at stores.

At first, rice balls and lunch boxes didn't sell well. It is difficult to cook rice properly, and it is even more difficult to keep cooked rice fluffy. After much trial and error, they discovered that once the rice's temperature falls below 16°C, its taste deteriorates. This is not a problem in spring and summer, but in winter the temperature drops, and because rice is transported by truck, this posed a dilemma. As a result, a special truck that can retain a constant inside temperature at 20°C was developed in tie-in with an automaker, says Suzuki in the August 2, 1997, issue of the Asahi Shinbun (Evening Edition). This truck was put into service beginning in 1988.

He also stressed from the beginning the four basic principles of convenience store business: a wide assortment of merchandise, food freshness control, cleanliness, and friendly service. Cleanliness at Seven Eleven means sweeping the vicinity of the store and keeping it neat and tidy. One time, there was a Seven Eleven store with cigarettes spread around the store front because of an adjacent bus stop. Since the store was not racking up good sales, the Operation Field Counselor (OFC) and the District Manager gave advice on this point to the store owner.

First, the owner's response was poor, but the OFC and the District Manager went to that store every day and had a heart-to-heart talk. Gradually, the owner changed his attitude. As the store became cleaner, sales increased[41]

You realize that all these efforts were for purposes of creating customers and increasing the number of regular customers. This reminds me of what Peter

Drucker, that dean of American management science, defined as the objective of a corporation not in terms of profit but in terms of creating customers as explained in *The Practice of Management* and other works. This is exactly what T. Suzuki has been doing at Seven Eleven Japan and Ito Yokado Supermarket Chain.

It is no wonder, then, that in 2003, Masatoshi Ito, honorary chairman of Ito Yokado Supermarket Chain, the parent company of Seven Eleven, donated $20 million to Graduate Management School of Claremont Graduate University where Peter Drucker teaches. What amazes me is that no one knew this donation until Drucker disclosed it in his Autobiographical Note in the *Nihon Keizai Shimbun*[42].

In 1982, the Point of Sales (POS) system was introduced to find out which items out of 3,000 items at each shop were selling. This was actually a trail blazing action in Japan's distribution trade — to minimize loss of sales opportunity and loss due to discarding unsold food items whose freshness dates expired. There are some 40 perishable items including lunch boxes, rice balls, and sandwiches.

The POS system determines the time and quantity for food items to be sold on an item-by-item basis. According to *SEVEN ELEVEN: What Do We Learn from Toshifumi Suzuki?* in 1985 to build up the POS network on an unprecedented scale in the world.

It was the beginning of "Tanpin Kanri" or Item-by-Item Inventory Control. The minimum inventory naturally contributes to profit. This notion was actually invented by Toyota Motor according to Toyota's Vice President T. Ohno (now retired) in his book, *Toyota Production System* (Toyota Seisan Hoshiki). Toyota's world-famous concept of "Kanban" and "Just in Time" blossomed out in the 1970s to counter the adverse effects of oil crises. This bible of how to attain production efficiency came out in 1978. In three years, it put out 24 impressions.

Suzuki independently conceived his similar ideas and applied them to distribution — to execute and maintain an item-by-item inventory control using cutting-edge technology to such an elaborate extent as to place Seven Eleven's POS system as the finest retailing tool in the world. In 1978, a terminal for issuing orders called "Terminal Seven" was jointly developed by NEC. Since then, Seven Eleven's information system has been revised in stages.

In the third information system, the graphic information analysis computer was introduced to show sales data in graphics. This enables you to understand sales in terms of image. In the current fifth stage, the shop system is designed to make it easy for the shop salesperson to operate. It features a new type of POS register with a large liquid crystal display providing information and messages in moving as well as still pictures.

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41. Suzuki, Toshifumi, *The Starting Point of Business* (Shobai no Genten), Tokyo: Kodansha, 1998. 15—20.
42. February 28, 2005, *Nihon Keizai Shimbun*., 40.

With this visual information and use of the touch panel on the screen, the store salesperson can easily input 3,000 items available in the store as well as other sales information. In addition, each store has a store computer which verifies the information from the register and transmits it to the headquarters.

Providing numerical data is not enough in this age of multi-media. Multimedia are used to add Chinese characters written by hand as well recorded voice messages. What the store must watch out for is running out of stock of popular food items. This is where careful order placement comes in. The whole high-tech system is built around that policy of assuring to minimize loss of sales opportunity due to short stock.

Weather and customers' purchasing patterns are taken into consideration in working out what and how many items are to be ordered for. There are some 200 field counselors called the OFC and all carry a mobile PC, so he or she can check the status of orders placed, store-by-store POS data on each item and give pertinent advice.

Use of images and voice calls for huge volumes of information to be transmitted between nearly 10,000 stores and the headquarters. The ISDN and satellite digital communications are now used to handle these volumes.

At the Seven Eleven store in Subashiri near Gotemba, this is how the system is working. In addition to the cash register with a liquid crystal display linked to the headquarters, the store has another computer through which they place orders of items with the headquarters. Whatever the store orders by 11:00 AM is delivered in the evening of the same day. Issuing orders just before noon, they already know the weather condition, so that more accurate order placement can be made. It is also simple to operate because of the touch screen, and even background music at each store is transmitted from the headquarters. It is no wonder that Suzuki's "Tanpin Kanri" item-by-item inventory control honed to near perfection appears in US business school text books including Harvard.

Suzuki adopted an aggressive pricing policy from the beginning—absolutely no discounts of items on sale. This reflects the original policy of Southland. Since the company sells convenience, there is no sense discounting like supermarkets do. This is why Seven Eleven Japan has racked up profits for 24 consecutive years.

Take, for instance, Cup Noodle, a very popular item in Japan. All that this noodle-in-a-cup calls for is to pour in some hot water and keep the cup covered for three minutes; then the soup noodle is ready. This is sold for ¥100 or so (a little under $1) in supermarkets including IY. But, Seven Eleven Japan sells it for at least ¥150 ($1.40) per cup. (Naturally, hot water is available for free in a thermos jar.)

When I first bought Cup Noodle for ¥150, I thought that the price was stiff. But after a while, I got used to paying the extra, because I realized that I am paying a little more for the sake of convenience.

I usually check out food prices of Ito-Yokado Supermarkets and Seven Eleven stores as well as other supermarkets and convenient stores. What amazes me at both Supermarkets and Seven Eleven stores is their pricing. Food prices are on the threshold of being high and low. They are in the price range high enough to insure profits but low enough to attract consumers. This is the work of first-rate pricing experts who know the delicate arts and science of retail pricing.

Today, this is Japan's biggest retailer with 2003 total sales, from 10,000 stores including franchisees, of ¥2.213 trillion ($18.44 billion) and consolidated operating profit of ¥153.7 billion ($1.28 billion). Its liabilities with interest are a little over ¥10 billion ($9.52 million).

Some 10 million consumers of all ages drop in Seven Eleven stores day in and day out. Why not offer financial services for them? This thinking must have been in Suzuki's mind. In 1999, Suzuki hired two financial experts from the Bank of Japan and Shizuoka Bank as advisors. They naturally racked their brains to work out a viable scheme for opening a bank.

In 2001, IY Bank was established jointly by Seven Eleven and Ito Yokado in 2001 with its 10,000 ATMs in their stores operating 24 hours a day. With a capital of ¥61 billion (approx. $600 million), IY Bank itself is an official member of the Bankers Association handling deposits. Fully backed by Japan's No. 1 bank, Mitsubishi-Tokyo UFJ Bank, it has a roster of shareholders such as Hitachi, NEC, Panasonic, major insurance companies, brokerage firms, international trading companies, and even Kirin Beer. Sony did not join because it has its own e-bank.

IY Bank is doing good business. At the term ended March 31, 2005, a current profit of ¥10.075 billion ($95.95 million, ¥105/$1) is reported with a 3-fold increase over prior year.

Since commercial and regional banks as well as credit card companies are its shareholders, you can use nearly 500 cards at more than 10,000 ATM locations. Its cash dispensing cards can be used at ATMs of banks and post offices. Today, it carries out not only e-banking but also mobile phone and telephone banking services.

Suzuki's farsightedness knows no bounds as we learn that he set up 7Dream.Com in 2001. Seven Eleven's advantage is that when you buy a product on the Internet, you can get it and pay for it at the Seven Eleven store near you without any shipping cost. You can buy CDs, DVDs, PC software, PC game software, toys, game software, watches, accessories, concert tickets, and many other products and services. Sony and Sony Marketing invest in 7Dream.Com because they think highly of its potential in business infrastructure for the networking age. This e-commerce is also enjoying good business.

Another interesting point is that the locations of convenient stores are a leading factor for consumers when they look for rooms to let. Being near the train station was a major factor, but now being near the convenience store is an equally important factor for suburbanites in Tokyo, Osaka, and other major cities.

When you get off the train and walk home, you feel relieved as you see bright lights of the convenience store in your neighborhood. In many ways, it is an oasis for millions of Japanese. For example, many communities designate the convenience store as the shelter for children and girls to run to if they should be in danger of being molested or kidnapped. And that was made possible by none other than Toshifumi Suzuki.

As we learn about Suzuki's many achievements, I think that he should be ranked as a genius. We have a number of geniuses in science and technology. Take Dr. Yoshiro Nakamatsu, Japanese inventor. He invented floppy disk while he was an engineering student at the University of Tokyo. He has numerous high-tech products as well as nearly 300 patents and utility model patents to his credit. Moreover, Japan has Dr. Jun-ichi Nishizawa, Father of Japanese Microelectronics In 1953, he first discovered that light could be used for communication purposes by way of semiconductors, and in 1954, he found the use of fiber optic cable for communications. In 1964, he invented optical fiber. It is no wonder that he received the IEEE (Institute of Electrical and Electronics Engineers) Jack A. Morton Award comparable to the Nobel Prize in electronic engineering.

Toshifumi Suzuki belongs to that class of geniuses not in science and technology but in the arts and science of high-tech distribution.

On August 26, 2005, Seven-Eleven Japan was delisted as the member of the Tokyo Stock Exchange and its shareholders automatically became the shareholders of a new holding company, Seven and I Holdings. On September 1, 2005, this was jointly established by Ito-Yokado, Seven-Eleven Japan, and Denny's Japan as the three companies carried out management integration. This is the biggest distribution group in Japan including 70 companies under its wing, with total sales of ¥6.6 trillion ($60 billion, $110/$1), and some 680,000 employees. Ito-Yokado announced plans to close 30 stores by February, 2009 to improve the profitability of the supermarket operations. Ito-Yokado is not doing well, with its operating profit at the February 2005 term of ¥8.8 billion ($80 million), the lowest since 1975.

Suzuki has more surprises in store. On December 26, 2005, the Mainichi Shimbun and other national dailies reported Seven-Eleven's plan to buy 65% of the shares of Millennium Holding, which has Seibu and Sogo Department Store Chains. This puts Seven-Eleven as the leading distribution group in Japan and one of the major retail groups in the world. The *Asahi Shimbun* reports that Seven-Eleven intends to move into a burgeoning field of home improvement centers in a few years.

Square-Enix, Maker of Family Games

A series of interesting articles appeared every Saturday in December of 1999 in the *Asahi Shimbun*. It was about a unique company called Enix. As a matter of fact, its product is better known in Japan than the company name, Enix (now Square-Enix).

It is the company that produced "Dragon Quest" series for family computers including Sony's Play Station 1 and 2. The first program of the "Dragon Quest" series for family computers introduced in May, 1986 sold 1.5 million copies, and the subsequent series including Dragon Quest II, III and the recent VIII sold 4 million copies.

Enix was set up in 1982 by Yasuhiro Fukushima when he was 35 years old. Before that, he must have been a computer software engineer, or an electronic engineer? No; he was educated to be an architect. But upon graduation from college, he decided to become an entrepreneur.

Enix is well-known among Japanese investors as a debt-free company listed in the First Section of the Tokyo Stock Exchange — with FY2001 sales of ¥45.2 billion ($376.6 million,¥120/$1) and a current profit of ¥20.4 billion ($170 million). Its per-share earning was ¥153.1($1.27).

In the early 1980s, there was a four-story commercial building near where Fukushima lived. It was part shopping mall and part office building — shops, restaurants, offices all mixed up in a disorderly way. So he thought that he could work out a free publicity booklet featuring a guide map of the place to help consumers get to any of the tenants easily. The shops and restaurants had an association whose president approved the idea and would foot the publication cost.

While he was working on the booklet, the association president found out that his operation was not officially registered as a company. When it was pointed out by the president to Fukushima, he did not understand the meaning of it. He had thought that companies could be set up freely. He realized that he had made a mistake, explained the situation to the president, and decided to give up the idea.

Another decision he made was getting married, and he looked around for a new apartment. When a young couple due to be married looks for a place to live, they usually look for a suitable apartment in public housing projects operated by prefectural or national public housing corporations. Then, after they save enough for down payment to buy a new house in 10 to 20 years, they may move out. Fukushima realized that unless he read some daily every day looking for announcement ads on the details of accepting applications for these public housing projects, he would not be able get into anyone of them. Besides, because most of these housing units are so popular, they select the tenants or buyers by lot.

The public housing situation being what it is, Fukushima had a hunch that there was a chance of making money by collecting and publishing the gist of accepting applications for public housing. In 1975, he incorporated what he started out previous year as an individual operation and registered it as Eidansha Boshu Center (Public Housing Application Service Center).

His hunch was right. A monthly tabloid called the New Information on Housing priced at ¥300 (approx. $1.50) per copy began selling and reached a circulation of 30,000 copies in a few years. The Company grew to gross about ¥300 million (approx. $1.5 million) with an operating profit of some ¥70 million (approx. $350,000) per year.

While he was making enough money to make ends meet, he was not contented with this business, so he sponsored a meeting called the "Conference on the Future." His employees, friends, and associates got together at the meeting room nearly every night and discussed potential fields that might develop in the future.

One idea that came up at one of the meetings was a chain of take-home sushi shops. With a goal of setting up 490 shops in five years, Fukushima opened a first shop. But running the sushi shop is no job for amateurs. He gave it up in three months.

Another idea was making personal computer software. First, he became a sales agent for Toshiba's office computers; this gave him an opportunity to investigate what would be promising software. In the early 80's, when personal computers were still in infancy, the mainstream software was game software.

With the initial capital of ¥5 million (a little over $30,000), Enix was founded in August 1982 to develop game software. Note that Fukushima and his staff had no computer knowledge to develop game software. He just saw an opportunity to make money in this promising field. Enix is taken from two words: ENIAC, the world's first full-scale computer, and Phoenix, a mythical bird that never dies as it burns itself to ashes every five hundred years and is then born again.

The new Company needed talented TV game software engineers. Usually an entrepreneur going into the game software would first run classified ads looking for game software engineers. Fukushima did not. Instead, he decided to run a contest as a means of scouting.

"Why don't you become a game software star?" — featuring this headline, an ad appeared in magazines for the First Game Hobby Program Contest with a ¥1 million ($5,000) award for the top prize. This award was several times more than the awards of contests of other software makers.

Despite the offer of this big money, only a handful of software came in after a month. This was because Enix was a unknown company, and people got suspicious of the big award, wondering if this might be a ploy to get participants with an announcement of "No Awardable Software" at the end of the campaign. He realized at that time the importance of "brand recognition."

To get more participants, his sales staff went canvassing by calling TV and appliance stores, magazines, visiting hobby clubs such as "I Like PC" in various parts of Japan and promising them that "We will give the top award without fail." As a result, about 300 entries of PC games were received by the end of the contest. Yuuji Horii who later produced the best-selling "Dragon Quest" game was among the 13 winners. The winning games were then polished up by professional game creators and put on sale in February, 1983.

To Fukushima's surprise, these games sold like hot cakes, capturing the first, second, third, fifth, and seventh places in the top 10 best-selling game programs. With a host of additional orders, the initial year racked up a profit of over ¥300 million ($1.5 million, ¥200=$1). The contest was a resounding success.

While the PC game business was in full swing 1984, he happened to read a newspaper article reporting that Nintendo's Family Computer sold more than one million units. My Goodness, computers for families! This is a far bigger market than personal computers, thought Fukushima. And he quickly concluded an agreement with Nintendo.

Enix's initial work for creating game software consisted of reprogramming PC games for family computers. For example, "Portopia Serial Murder Case" was a game of unraveling the mystery puzzle. Y. Horii created the PC game, which Koichi Nakamura reprogrammed for family computers. These two creators worked together for this project, which sold 700,000 copies, and got along so well that they decided to work on a new game.

Horii acted as the game designer and worked out the plot and architecture of the game, while programming was undertaken by Nakamura's company. The character designs were conceived and drawn by a well-known cartoonist, and music was composed by one of the top ranking composers.

After a period of four months for development, in May, 1986, the first of the "Dragon Quest" series was introduced to the market for sale. The title of the "Dragon Quest" means a quest for the Dragon who stands in the way at the end of the adventure. This was on top of the best sellers list and its sales crossed the one million mark in six months, and all in total, 1.5 million copies were sold.

Fukushima believes that there were two factors to the enormous success of the first "Dragon Quest": it was the trail-blazing work in the field of role playing game, in which the hero grows up step by step. The main stream of the family computer games in those days comprised games where the operator shot down the enemy using his or her reflex. Y. Horii who took charge of the scenario and architecture was infatuated with the American role playing game for PC called "Wizardly," and challenged the new field so as to let other game lovers to have fun by allowing the hero to grow up.

Another factor was that "Dragon Quest" itself was in tune with the sense and feelings of ordinary people who play with family computers. Creator Horii paid good attention to make sure that the game was not designed to meet the fancy of some game maniacs. "Wizardly" at the time was merely a cave adventure game with not much story, so that it would be hard to attract the grade school and junior high school pupils which formed the main core of family computer users. Consequently, "Dragon Quest" is based on a theme filled with dreams where the hero saves Princess Laura while adventuring in towns and grasslands and beating the Dragon King at the end. Through this process, the hero gradually grows up.

When "Dragon Quest III" was put on sale in February, 1988, it was a nationwide social event at the Enix sales outlets which captured the attention of many people from every age bracket. A day before the day of sales, there were long queues of buyers, mostly teenagers, at the stores authorized to sell. The first day alone registered sales of 1 million copies, while some 400 grade school and junior high school pupils who had played hooky to get in the line were taken into protective custody by the police. Further, some pupils with "Dragon Quest III" were threatened by some teenage intimidators and their prized possessions were hijacked in broad daylight. Some shops were cunning enough to sell "Dragon Quest III" on condition that they bought other unpopular games.

Later, Enix was asked by the police to make such sales arrangements that the teenagers could buy without playing hooky. As a result, the shops were asked to cooperate by distributing advance reservation tickets on Sundays. Moreover, when Dragon Quest IV was put on sale in February, 1990, a holiday was selected as the sales day.

Fukushima's position on copyright is that the game software should be treated as a book just like a movie in which the creator's thinking is incorporated. Accordingly, when he first began selling a PC game, he employed a royalty payment to ensure that the creator could be compensated commensurate with the sales. By the same token, the creator's picture and resume were inserted on the back cover of the package.

This is responsible for filing several copyright actions. One suit involved a shop renting PC games, and Enix filed a complaint to ban the shop from rental business, and obtained an out-of-court settlement which stipulated that the shop would not be engaged in renting game software without prior consent of the game maker.

Another action involves the sales of used game software. In August 1999, Enix asked a game software sales firm to stop selling used game software, whereas, the company filed a suit in October of the same year to seek verification that the game manufacturer had no right to ban the sales of used products.

In May, 1999, the Tokyo District Court gave a decision contrary to many precedents which had treated games as books in the same way as movies, and accepted the claim of the sales firm "because the game maker is merely providing raw materials out of which the user makes a story, a distinction that makes game software different from movies."

Immediately, Enix filed an appeal with the Tokyo High Court. In March, 2001, the Tokyo High Court gave a decision in favor of the sales company on certain points not covered in the lower court decision, and the case is being reviewed at the Supreme Court of Japan.

Beginning with game software put on sale in March, 1999, Enix has granted sales of any used game nine months after its initial sales for the benefit of users and retail shops, provided that 7% of the desired retail price be paid as copyright authorization fee.

The period of nine months is based on a survey of games: it is an average of the periods which reached half of the total number of games sold as used. Other manufacturers are operating along this line on the condition of authorization. In 2005, many video tape/DVD rental shops are handling used game software.

Founder and CEO Fukushima says in the Dec. 26, 1999 issue of the *Asahi Shimbun* that despite his success and his love of doing business, he does not like making money for the sake of money-making. To him, doing business is an undertaking that can continue for a long time. By money-making, he means a job that may turn out a profit of several million dollars but only once. He says that he must have a steady nature. In playing mah-jong, a favorite pastime of many Japanese businessmen, he does not look for high stakes but try not to discard a tile that would make a winning hand for one of the other players.

As a result, Enix has been operating since its founding — with absolutely no debts whatsoever, and has never suffered tight cash positions. He realizes that good cash positions alone were not sufficient, because Enix did not carry a corporate image befitting its cash positions in the eye of parents whose sons and daughters were interested in working for Enix. This is why Enix had its stock listed in the First Section of the Tokyo Stock Exchange in August, 1999. Any gain in corporate image, brand recognition, and resultant respectability due to listing will be of help in recruiting talented individuals.

The kind of person Fukushima is looking for is not the person who excels in designing and programming game software. He should be the one who can think by himself and take action accordingly.

At Enix, 20 to 50 people form a project team to create one game software, and only one or two of them are Enix employees, the rest being people outside the Company invited to participate in the project. Game software is a collection of the merging of each participant's separate and diverse talent. A better piece of work is produced by hiring talented people for each game software from outside the Company instead of employees working to fulfill quota. It follows then that what is required of an employee is the ability to conceive an original idea and ability to coordinate the work of the diverse minds that make up the project team.

In addition to the software division, Enix runs two other successful divisions — publishing and toy. The cornerstone of the publishing division is a cartoon magazine, *Gekkan Shonen Gan Gan* (Monthly Boys Gan Gan), 200,000 copies of which are issued every month, racking up annual sales of over ¥6 billion ($46.2 million, ¥1=$130) . This division has published over 1200 items.

Despite the stagnant economy, Enix is doing fine. Chairman Yasuhiro Fukushima was placed 56th in the list of the top 100 taxpayers of Japan in 2001 — for paying ¥358.9 million or about $2.76 million (¥130 to the dollar). This is the amount of income tax he paid. Calculating from this, his total income could have been in the neighborhood of ¥1 billion or $7.7 million in 2001.

With a payment of income tax of ¥637.57 million or about $4.9 million and an estimated income of ¥1.765 billion or $13.58 million, T. Furukawa, Japanese vice president of Microsoft U.S.A., made more money than Fukushima. Nonetheless, Fukushima made more money than H. Fukino, Dell Computer

Japan's chairman, who paid ¥310 million or $2.38 million for income tax with an estimated income of ¥858.3 million or $6.6 million in 2001. Dell is doing well in Japan, judging from its sales performance — its share of the PC market in Japan grew from No. 8 to No. 6 (6.1%) in 2001 and crossed the 10% market share to place it No. 3 in Japan in 2004. (By the way, K. Kitashiro, IBM Japan's chairman, made more than Fukushima — ¥362.54 or $3.79 million for income tax with an estimated income of ¥1.003 billion or $7.7 million.)

The annual income of ¥1 billion ($7.7 million) is not bad for Fukushima, who started out with nothing over 20 years ago.

Square is known for its world-famous product, "Final Fantasy" series. Enix is famous for its "Dragon Quest" series. So, in this highly competitive environment, it is natural for the two game software makers to merge. The merger took place in April, 2003, producing remarkable increases in sales and profits.

The President of the merged company is Yoichi Wada and Y. Fukushima is the chairman. (Now, Fukushima is the honorary chairman and Wada is the chairman.) It is interesting to note that Fukushima holds 40.4% .of the stock, his wife, 2.1%, and his company called Fukushima Kikaku, 16.6% — a total of 59.1% of the stock of the merged company held by the Fukushima's side.

The stock price used to be around ¥2,000 to ¥3,000 ($18.2 to $27.3 , ¥110/ $1) per share, now crossing the ¥3000 mark in 2005. Since 109.9 million shares are issued, 59.1% of that is 64.95 million which is worth about ¥129 billion (about $1.38 billion) — all in a matter of 20 years. Fukushima is not content with a sweet smell of success. Together with President Wada, he is working hard on new projects to forge ahead.

It is time to look for a tie-in with a game machine manufacturer, and in August, 2005, Square-Enix announced a take over bid of one of the major commercial game machine manufacturers, Taito. Also engaged in direct operation of large scale amusement facilities, Taito has bee doing poorly. Its major stockholder, Kyocera, is in favor of the take over bid.

In 2005, Square-Enix has a staff of little over 1,600, posting the consolidated sales of ¥73.864 million ($671.5 million, ¥110/$1) with an operating profit of ¥26.438 billion ($240.3 million). Most importantly, Square-Enix remains debt-free.

Part 3. Epilogue

The Japanese Economy Continues Its Upswing

The current outlook for financial conditions is bright indeed. As BOJ Governor Fukui stated in the *Yomiuri Shimbun* on May 24, 2005, appropriate action has been successfully taken to cope with the worsening state of the economy and a risk of deflationary spiral, so that business is gradually picking up and financial institutions are procuring funds on their own without depending on the BOJ's financial adjustments. There is even talk of doing away with the Quantitative Relaxation or "easy money" sometime in 2006. The Governor naturally added that even if the easy money policy is suspended, this does not mean a switch to tight money. Money will be made abundantly available at slightly less than the current level. He is optimistic that the Consumer Price Index (perishables excluded) may turn to a positive growth sometime in 2006 (98.1% as of September, 2005).

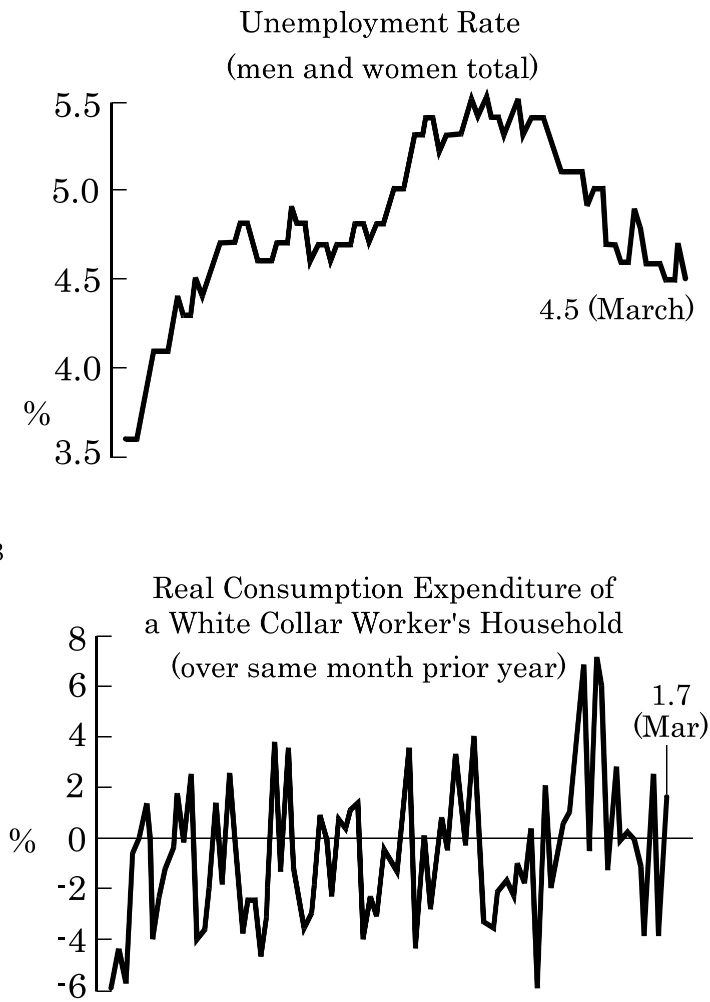
Demand for funds is expanding as the balance of loans extended by the banks is rising. Take, for example, the total balance of loans extended by the 128 mega and regional banks. As of October, 2005, this registered ¥400.417 trillion ($3.64 trillion, ¥110/$1), a 0.2% increase over the same month prior year — the first increase in six years, seven months. Funds are needed for real estate funds and other funds investing in real estate. Housing loans are bouncing upward, and so is the spending for construction as a whole as you can see in the chart below. Loans for small and medium-sized businesses are growing as well.

The stock market continues to rally. The Nikkei Stock Average (225), after crossing the ¥12,000 level, continued its ascent. On September 21, the Tokyo Stock Exchange (1st Section) reported a record trading volume of 3.69 billion shares exceeding the bubble period by many times, a record Nikkei Stock Average of ¥13,196.57, and a TOPIX of 1,357.71, also this year's record. The Nikkei Stock Average crossed the ¥14,000 mark on November 4, 2005. The Nikkei crossed the ¥17.000 mark on March 30, 2006, for the first in 5 years and 7 months, while the TOPIX also registered a high 1,726.68 for the first time in 6 years. Many analysts believe that the Nikkei is very likely to reach the ¥20,000 mark by the end of 2006.

Figure 13-1 FY2004 Economic Indicators

A

B



C

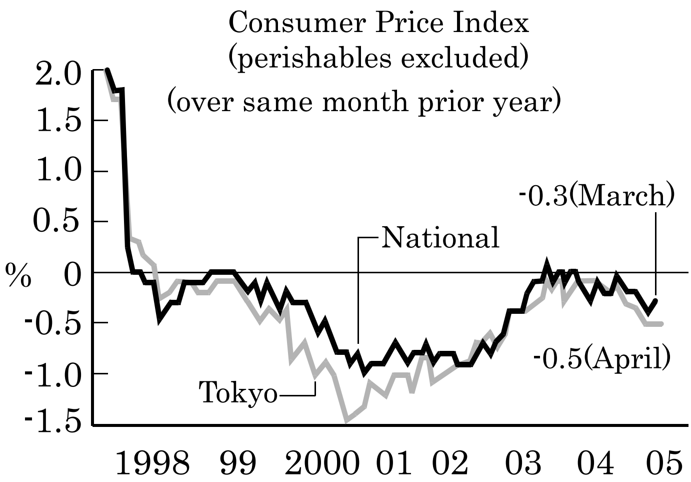


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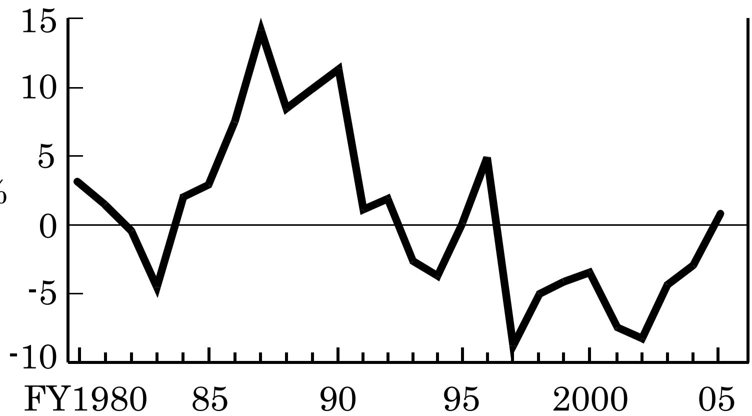
Figure 13-2 Increase in Nominal Construction Investment



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There was another record set on November 8, 2005: the volume of trading at the Tokyo Stock Exchange (first section) shot up to a record-high 4.5 billion shares, up 23% over previous day. This represents nearly five times the highest volume of trading of 1 billion shares in the peak bubble period in the late 1980s, exceeding the volume of trading of some 3.2 billion shares in the US stock market.

The TOPIX, known for indicating the overall price movement of the stock market, registered 1,428.13, up by 26.66 on October 29, 2005. The Tokyo Stock Exchange First Section reports that the amount of buying and selling from the beginning of 2005 up to October 28 reached the record cumulative total of ¥328 trillion ($2.852 trillion, ¥115/$1) per year. This is already surpassing in 10 months the 1989 record of ¥325 trillion, in yen terms. You will recall that this figure fell short of ¥100 trillion during the sagging 1990s.

Other reassuring factors account for such increases in stock prices. Land prices in urban Tokyo increased by a few percentage points, for the first time in many years. Of the nine Bank of Japan regional branches, six branches revised their estimates of the business conditions to reflect an upturn. Investments from abroad are rapidly increasing. Take buying on balance by foreign investors. In the fourth week of October this amounted to some ¥374.5 billion ($2.39 billion, ¥115/¥1) for 20 consecutive weeks.

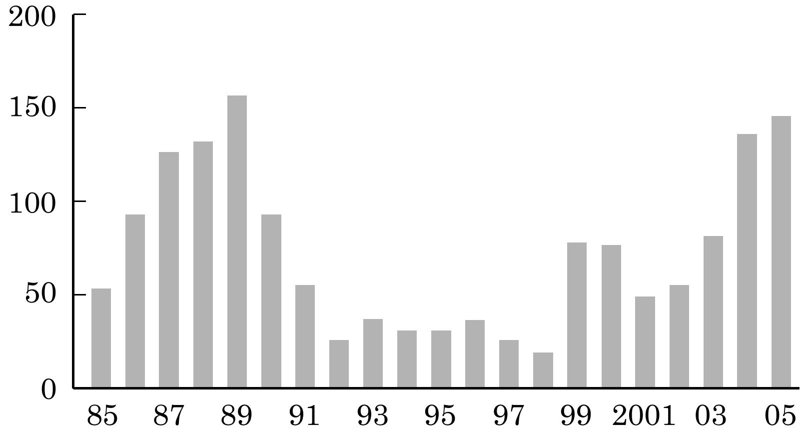
Such heavy investments from abroad are fueling domestic investors' confidence in Japanese stocks, and individual Internet traders are actively engaged in buying and selling. Further, the current profits of the 289 corporations listed in the stock market in their September 2005 interim settlement showed an 11.0% increase over prior term.

Individual investors continue to invest as evidenced by the ever-rising profits of the five major Internet stock brokers. For example, the No. 1 broker Matsui Securities reports ¥14.7 billion ($133,6 million, ¥110/$1) as their brokerage commission for the interim settlement of accounts in September, 2005, up 11.6% over prior term. The total payments for stock transactions of these five brokers from April to September amounted to ¥65.7558 trillion ($597.78 billion), an all-time record high. Some industry watchers indicate concern about this "mini-bubble."

Moreover, the unemployment rate was 4.5% in January 2006. In February, this came down to 4.1%, the biggest drop in over 7 years. In that month, the unemployed numbered 2.77 million, down by 310,000 over the same month the prior year, while the effective ratio of job opening-to-job applicant was 1.04.

Banks are repaying their loans to the public funds. On October 1, 2005, two mega financial groups, Tokyo-Mitsubishi Bank and UFJ merged to form the Mitsubishi UFJ Financial Group (MUFG), and on October 4, the Group announced repaying ¥323.6 billion ($2.94 billion, ¥110/$1) to the Japanese government, the remainder of the public funds to be repaid being ¥1.764 trillion ($16.04 billion). Prior to the merger, UFJ Holdings, which was taken over by the new Group, owed ¥1.4 trillion to the public funds.

Figure 13-3 Amounts Paid by Individual Investors for Buying and Selling in trillions of yen



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With total assets at about ¥190 trillion ($1.65 trillion, ¥115/$1), MUFG has taken its place as the world's largest financial group; its balance of outstanding loans is also the world's largest.

There are two other mega financial groups of the Mizuho Financial Group with a balance of the public funds in the amount of ¥850 billion ($7.727 billion) and the Sumitomo-Mitsui Financial Group with a balance of the public funds in the amount of ¥1.1 trillion ($10 billion).

The mid-term consolidated financial results (half year) as of September, 2005 at six mega banking and financial groups (MUFG, Mizuho, Sumitomo-Mitsui, Resona, Sumitomo Trust, and Mitsui Trust) reported nothing but dramatic gains on November 24, 2005. The group's after-tax profit jumped by 22 times over the same period prior year — ¥1.7293 trillion ($15.037 billion, ¥115/$1) and the total loss due to bad loan disposal came to zero. MUFG's after-tax profit reached ¥711.7 billion ($6.19 billion), surpassing the ¥570.5 billion ($4.96 billion) of Toyota Motor. That makes MUFG the top earning company in Japan.

The principal cause of these stunning results is that the reserves they had put up in preparation for insolvencies of their client corporations became unnecessary because of recovery of business performance. For example, in the half-year accounts of prior year, the six groups earmarked ¥1.1008 trillion or some $10 billion for loss due to bad loan disposal. This projected loss decreased considerably, and ¥195.8 billion of that or $1.7 billion was not needed.

This means a profit due to return or special profit.[43] Bad credit disposal profit and loss consequently became a plus. At the March 2002 term, this loss crossed ¥7 trillion ($58.3 billion, ¥120/$1) but diminished to about ¥2 trillion ($19 billion, ¥105/$1) in March, 2005.

The forecast of profit for the current term ending March, 2006 is in the neighborhood of ¥2.6 trillion ($21.67 billion, ¥120/$1), surpassing the record profit of ¥1.76656 trillion ($17.67 billion, ¥100/$1) of FY1988 by a big margin.[44]

Table 13-4 September 2005 Mid-Term Results of Six Mega Banking Groups (in billion yen) (¥110/$1)

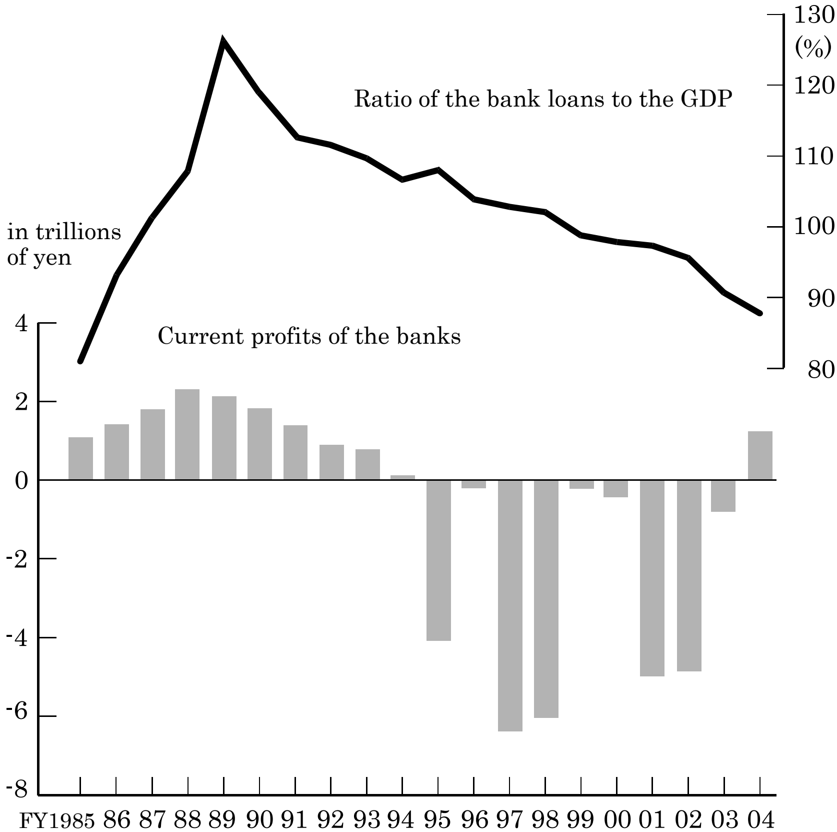
	Net Profit	Mid-Term Profit & Loss	Current Term Estimate of Profit & Loss[3]	Bad Loan Disposal Cost	Bad Loan Ratio (%)	Ratio of Equity Capital to Total Assets (%)[4]
MUFG	341.5[1] ($3.10 bn)	300.6 ($2.73 bn)	930 ($8.45 bn)	◊63.0[5] ($572.4 mil)	2.21	12.01
	323.8[2] ($2.94 bn)	411.0 ($3.74 bn)		◊315.4 ($286.7 mil)	3.32	11.67
Mizuho	564.6 ($5.13 bn)	338.5 ($3.08 bn)	630 ($5.73 bn)	14.6 ($132.7 mil)	1.85	10.73
Sumitomo-Mitsui	474.2 ($4.31 bn)	392.3 ($3.57 bn)	550 ($5 bn)	129.7 ($1,173 bn)	2.49	11.00
Resona	179.0 $1.63 bn)	174.3 ($1.58 bn)	270 ($2.45 bn)	11.8 ($107.3 mil)	3.02	10.20
Mitsui Trust	80.0 ($727.3 mil)	58.6 ($532.7 mil)	120 ($1.09 bn)	22.9 ($208.3 mil)	2.23	11.01
Sumitomo Trust & Banking	88.0 ($800 mil)	53.7 ($488.2 mil)	95 ($863.6 mil)	3.4 ($30.9 mil)	1.18	11.16

Source: Compiled from data released by the six groups..
Note: 1. This row refers to the Mitsubishi Tokyo data.
2. This row refers to the UFJ data.
3. This shows projections of the profit and loss of the current term ending March 31, 2006.
4. The BIS requirement is 8%.
5. ‡ means the amount returned.

Many surveys including the one carried out by the *Nihon Keizai Shimbun* indicate that some 90 percent of top management is of the opinion that the economy is bound for recovery. Because of brisk equipment investment and consumption, 13 of the 15 private research organizations revised their May estimates of this fiscal year's GDP upward to an average of 1.9%. What about the financial ratio of major corporations? Are they making any profit? Their ratio of break-even point to sales dropped to 85% in 2005 from the 100% level that typifies the 1990s. This is good news because they have 15% to work with in their financial management.

43. November 25, 2005, *Yomiuri Shimbun*, 1.
44. November 25, 2005, *Asahi Shimbun*, 1.

Figure 13-5 The Ups and Downs of Japan's Financial World in 15 Years



Source: October 2, 2005, Asahi Shimbun
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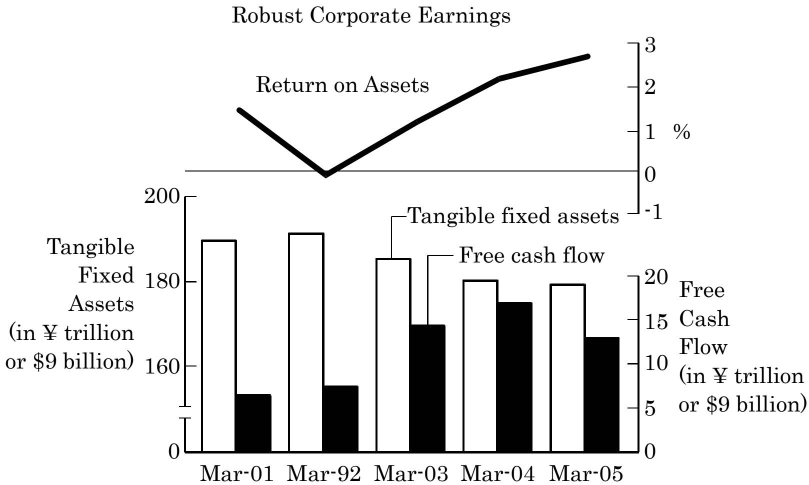
Thanks to restructuring efforts, major corporations now have excellent cash flow. Excess cash flow obtained by subtracting the spending for new plant and equipment from sales cash flow rose to about ¥20 trillion ($174 billion, ¥115/$1) or some 4% of the Japan's nominal GDP of ¥500 trillion ($4.348 trillion). Chief Economist N. Iizuka of the Dai-Ichi Life Insurance Institute of Economic Research calculates a growth rate of 6% by adding this 4% to the current 2% economic growth rate.

Figure 13-6 Robust Corporate Earnings



Source: June 2, 2005, Nihon Keizai Shimbun. Re-printed with permission.
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Corporations with excess funds are now investing. According to the survey of equipment investment by the Ministry of Economy, Trade and Industry, the 2005 corporate plans for equipment spending are up 21.3% over the prior year in manufacturing, up 8.5% in non-manufacturing. 21.3% is a considerable increase. All steelmakers are reporting gains as steel demand continues to grow. The booming steel industry is actively spending for equipment as well as for setting up research facilities — a luxury they were unable to afford during the lean years. Tokyo Steel Mfg. Company, Japan's largest electric furnace steelmaker, is well-known as a major H-beam maker. This steelmaker also supplies steel sheets to automobile parts makers. The Company is planning to build a new steel mill in Aichi Prefecture, where Toyota is located. This marks a first in 14 years in Japan's steel industry.

The auto industry is no exception. For example, Toyota's consolidated sales at the March term, 2006 is forecast to be close to ¥20 trillion ($230 billion, ¥115/$1), with a net profit of ¥1.19 trillion ($10.3 billion). Toyota began introducing Lexus to the domestic market in August 2005, and in the second half of 2006, US production of its hybrid cars is scheduled to begin.

Another area for spending for new plant and equipment is that of digitalization materials. Dai-Nippon Printing is spending some ¥55 billion ($500 million, ¥110/$1) for facilities to increase production of filters for the sixth-generation liquid crystal panel. Mass production in Japan and South Korea of new Polaroid plates for giant liquid crystal TVs is what Sumitomo Chemical is spending ¥30 billion ($273 million) for. Sharp is shelling out a total of ¥150 billion ($1.28 billion, ¥117/$1) for construction of another plant for production of liquid crystal TVs.

Even department store chains are considering spending for revamping their stores. H. Suzuki, president of Takashimaya Department Store Chain, Japan's biggest department store chain, is aware of the need to cope with ever-changing tastes of consumers and has allocated a 7-year budget totaling ¥300 billion ($2.56 billion) to refurbish its Shinjuku Store and other expansion plans. Mitsukoshi, the No. 2 department store chain, which reduced its work force by 1,000 through its early retirement program, is planning to increase its sales floor in its Ginza store.

Now, Daiei under the new management — including the super auto sales lady who headed the BMW Tokyo Office as well as the former president of Hewlett Packard Japan — is planning, despite closing many of its stores, to spend ¥60 billion ($513 million) to refurbish its existing locations. This is the former No. 1 retailer now being revived under the support of the Industrial Revitalization Corporation, its loss reported to be ¥511.1 billion ($4.37 billion, ¥117/$1) at the February 2005 term.

The business upturn is limited to some sectors of Japan's economy. Among the not-so-successful companies is Japan Airlines. This flagship carrier of Japan is reported to be posting a loss of ¥45 billion ($385 million, ¥117/$1) for the March 2006 term due to rising fuel costs, fare hikes, and a diminishing number of passengers. Sanyo Electric is also running red with heavy losses.

Nonetheless, a thriving sector naturally produces beneficial effects on employment, and the jobless rate is down from over the 5% level of previous years to 4.2% in September, 2005; that's a 1.1% effective ratio of job opening-to-job applicant. The number of employees in Japan was 64.37 million, up 68,000 over the same month of the prior year. In terms of age groups, the number of 15- to 24-year-olds who were unemployed dropped from 10.1% in 2003 to 7.8% in January 2006; and the jobless rate for 25- to 34-year-olds dropped from 6.4% in 2002 to 5.2% as of January 2006.

Japan is also entering a new era of mergers and acquisitions. For example, one of the major non-banking institutions, Orix announced on October 31, 2005, its plan to buy a major US investment banking firm: Houlihan Lockey Howard & Zukin (HLHZ) for $500 million. HLHZ's expertise covers business and securities valuation and has provided financial opinions for their 5,000 clients over the past 25 years. Orix will set up a new company in the United States to take over the entire business of HLHZ. At the same time, their expertise will be utilized in Japan for M & A. In March 2006, the mobile phone company Softbank, a giant in the Internet business profitably operating Yahoo Japan as well as high-speed data transmission service, announced that agreement had been reached with Vodafone Japan to purchase it at ¥1 trillion 750 billion ($14.95 billion, ¥117/$1) through leveraged buyout using borrowed funds. This is the biggest acquisition in Japanese corporate history.

M & A seemed to be something alien to Japanese corporate culture until recently when Live Door, a supposedly rich IT company, wrangled over $300 million from Fuji TV of the Fuji Sankei Group. Live Door and its subsidiary first bought 35% of the stock of Nippon Broadcasting, a radio station of the Fuji Sankei Group. When this came to light on February 8, 2005, the Fuji TV top management was nonplussed. It was something they had never anticipated.

Live Door quietly bought these shares online from 8.20 am to 9 am every day, before the stock market opened. 35% was all that was needed because a shareholder having over 33.4% of the stock is legally entitled to reject any special resolution of the general meeting of shareholders of a corporation.

There was a strange capital relationship between Fuji TV and Nippon Broadcasting. Fuji TV is a far bigger company than Nippon Broadcasting with the current aggregate value of the stock about three times more than Nippon Broadcasting. On the other hand, Nippon Broadcasting is the majority shareholder of Fuji TV because it owns 22.5% of the issued shares of the Fuji TV stock. In other words, having a controlling interest of Nippon Broadcasting is tantamount to having enough power to influence the giant Fuji TV.

A lot of talk and negotiations went on, while Live Door kept buying the Nippon Broadcasting stock. This lasted more than two months, and on May 18, Fuji TV agreed to buy back the Nippon Broadcasting stock held by Live Door through payment of ¥147.4 billion ($1.34 billion, ¥110/$1). Since Live Door had spent ¥111 billion (a little over $1 billion) to get the Nippon Broadcasting stock, this means a simple gain of ¥36.4 billion or $330.1 million. Actually, it was found out that Fuji TV acquired Live Door's stock by paying ¥44 billion ($400 million). However, Live Door is under investigation and its top management personnel were arrested for violation of the Securities Transaction Law and falsification of accounting data.

There is yet another on-going attempt by another Internet company: Rakuten, which runs a huge Internet shopping mall, in addition to its professional baseball team. This time, the target was a major TV key station Tokyo Broadcasting System, commonly called TBS. Rakuten spent ¥88 billion ($800 million) to own over 19% of the TBS stock and suggested to TBS to consolidate its management with Rakuten. TBS finds it difficult to go along with this offer, and negotiations will probably continue. Meanwhile, some TBS employees are selling their own TBS shares.

Then, on September 26, the Murakami Investment Fund, run by a former MITI official Y. Murakami, announced its possession of 19% of the Hanshin Railway stock. This is a well-known private railway between Osaka, the second largest city in Japan, and the neighboring port city of Kobe. The Railway happens to have choice property in front of Osaka Station worth well over $1 billion. A month or so later, the Murakami Fund got hold of 39.77% of the stock, enough to exercise 1/3 voting power.

Y. Murakami, the Murakami Fund manager, proposed to Hanshin Railway to have the Hanshin Tigers listed in the stock exchange. The answer was negative. The Hanshin Tigers is one of the leading professional baseball team in Osaka and Japan. It is like the New York Yankees in New York. This will probably take time for resolution.

The Murakami Investment Fund also owns over 7% of the TBS stock, so TBS has another major shareholder to be concerned about.

Lower House Election

Prime Minister Koizumi, after the bad loan problem was on its way to resolution, appointed Minister Takenaka as the State Minister for Privatization of Postal Services. Some 20 years ago, Koizumi was the Minister of Postal Services, and he was fully convinced then that something must be done to completely restructure that huge organization called Postal Service.

Accordingly, a bill for privatization of postal services was sent to the Lower House. It was endorsed there despite some dissent from his own LDP. Then, the bill went to the Upper House, but the dissenters won, and it was rejected on August 8 — only 17 votes shy of victory.

Koizumi had publicly said again and again that he would dissolve the Diet should the bill be rejected, because postal reform had been his No. 1 project over the past 20 years. It is also the key to other structural reform. Immediately after the Upper House's rejection, the Prime Minister, true to his word, used his prerogative, dissolved the Lower House, and called a Lower House Election on September 11, 2005.

Until the Election Day, Koizumi frequently appeared on TV commercials as if talking to each and every one us. Many of us still remember him giving one simple message: "The postal workers number 270,000. This is more than our police force and the self-defense army. Privatization is a must." I believe that the general public was convinced of the necessity of privatization. You must also take into consideration his success in coping with the bad loan problem. Although the mainstream mass media took this for granted without mentioning it, everyone was aware of his record of clearing out much of the uncollectible loan fiasco by forcing the banks to put their house in order. "You can count on Koizumi" was the general consensus.

Would Koizumi prevail? The outcome of this election was something no political experts could predict. What is amazing was that on such short notice, the LDP made a thorough preparation. As LDP's Secretary General T. Takebe recalls in an interview that appeared in the politically savvy *Mainichi Shimbun* on October 21, 2005, it was like "taking an exploration rocket on a trip to Mars and back...I don't know how we managed to come back alive." He added, "This is the Koizumi Revolution!"

He put up attractive female candidates in the electoral districts of the anti-privatization LDP candidates, much like sending in an assassin or hit-man, and successfully backed them to the hilt. These and other candidates were secretly selected by Takebe himself, LDP General Affairs Bureau Chief T. Nikai, and the Prime Minister's Secretary I. Iijima at Akasaka Prince Hotel. This caught the fancy of the mass media and turned into a big media festival.

The result was a huge victory for the LDP, which racked up 296 seats. Together with the Komeito, or the Fairness Party, the coalition ruling party got more than two-thirds (320 seats) of the 480 seats of the Lower House. It is interesting to note that the LDP candidates won in urban districts, a traditional haven for the socialists or anti-establishment voters. On October 31, Koizumi reshuffled the cabinet to ensure continuation of the restructuring endeavor.

The stock market likes this political result, for it promises stability of the financial policy. There is a glut of overseas funds including the oil dollar. Now that the Japanese economy has nearly divested itself of deflation, overseas funds operators realize that, from a long-range standpoint, the Japanese economy is on the road to economic expansion. Furthermore, profitability of Japanese companies is hitting a high note as a result of rigorous belt-tightening necessitated by deflation. There is, indeed, big room for growth.

The market also likes the new cabinet members after the reshuffle, because it all points to one thing: restructuring. According to Chief Economist Jasper Koll of Merrill Lynch Japan Securities, Japanese stock prices are in the process of spiraling upward from a middle and long-term perspective. In addition, individual investors joined the bandwagon as the number of Internet trading accounts increased by 1.12 million in six months to 6.94 million, as of March 31, 2005.

Japan's major concern is who will take the financial helm in this new government. Sadakazu Tanigaki continues as the Finance Minister. The next day after the reshuffle on November 1, on a TBS morning talk show, he said: "The name of the game is to balance the budget. Less spending and more revenue. Right now, Japan's tax revenue is about ¥44 trillion ($382.6 billion, ¥115/$1), while budgeted expenditures call for ¥82.2 trillion ($714.78 billion). Anyone can see that we must cut and cut.... Tax increases are what we cannot avoid."

Tanigaki is a graduate of the famed University of Tokyo Department of Law. The story goes that he liked mountain climbing so much, it took him eight years to graduate. He also likes to go bicycling. But he was smart enough to pass the bar examination known to be the toughest national examination, back in his day. Tanigaki intends to do something about what the past Finance Ministers have avoided — including raising taxes.

Prime Minister Koizumi is due to step down in September, 2006 as his term expires. He declared, again and again, that he would not seek re-election as the president of LDP. He is well aware that the absolute power corrupts. Accordingly, the members of his new cabinet are those who will pursue the restructuring policy.

The Japanese economy in 2006 and thereafter appears very promising if we look at some of the new data released. First, the supply and demand gap turned positive. In the Oct–Dec quarter of FY2005, it showed 0.7% for the first time in 8 years and 9 months since the Jan–Mar 1997 period. This means that as a result of steady growth of personal consumption, the supply and demand situation has switched from one of excessive supply to a shortage of supply. This is a step forward out of deflation.

Reflecting this positive change, the consumer price index has been on a steady upward course. January 2006 figures indicate 0.5% up over the same month last year. This is one of the factors that caused the BOJ to lift the 5-year-old Quantitative Financial Relaxation Policy on March 9, 2006. It is, in a way, a historic event in that the BOJ put an end to its easy money and will assume the normal role of central banking by regulating the discount rate for financial adjustments. Governor Fukui indicated that the 0% discount rate would be raised if and only if any such increase would be conducive to improving the overall state of the economy, the criterion being a 0% to 2% increase in consumer prices. This will take time, so the hike would probably be made near the end of 2006.As further evidence of Governor Fukui's thinking, the February 2006 consumer price index showed 97.6 (2000 as 100), a 0.5% increase over the same month the prior year.

Meanwhile, according to the BOJ's funds flow statistics, financial assets held by individuals in Japan crossed the 1500 trillion mark ($13 trillion, ¥115/$1) as of the end of 2005. Actually, the balance of financial assets of individuals increased by ¥74.8 trillion in 2005 mostly due to increases in stock prices and gains from investment trusts. Corporate debts have shifted to an increase, indicating that the corporations and manufacturers are adopting an aggressive management strategy to invest in new plant and equipment through borrowing. Sensing an upward business trend, consumers, instead of saving, are spending by buying new cars, thin type TVs, DVD recorders, stylish clothes as well as stocks.

What about spending plans for new plant and equipment? Let me repeat that in FY2005, the plans registered a 21.3% increase over the prior year in manufacturing and an 8.5% increase over the prior year in non-manufacturing. According to the *Nihon Keizai Shimbun*, 99% of the top management personnel surveyed replied, "The domestic economy has recovered." Some 50% indicated to expand equipment investment.

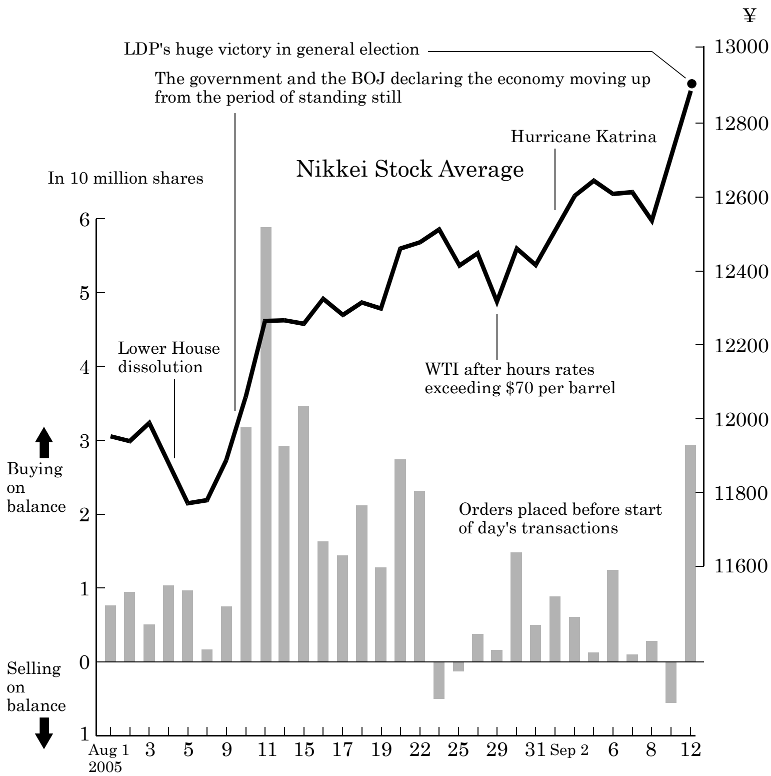
What about exports? The 2005 calendar year figures are ¥65 trillion 656.5 billion ($570.926 billion, ¥115/$1) for exports and ¥56 trillion 949.4 billion ($495.212 billion) — a gain of ¥8 trillion 707.1 billion ($75.713 billion). This uplifting news caused the World Bank to revise its forecast of Japan's GDP in 2006 from 1.8% to 2.8% on March 29, 2006.

One thing is for certain. As a result of the privatization of postal services in October 2007, Japan's largest corporate group, Japan Postal Services will make a debut. Its annual turnover will be as big as that of Toyota Motor — ¥20 trillion ($164 billion, ¥115/$1) with a current profit of ¥1.9 trillion ($16.5 billion). This is bound to affect Japan's distribution and financial retailing through its more than 25,000 post offices.

Furthermore, the privatization will bring into the open some ¥340 trillion (approx. $3 trillion) currently held as postal savings and postal life insurance.

This will be used to produce profits in every way they know how in non-governmental sectors of industry. How will it affect the Japanese economy, as well as the world economy? That is the question.

Figure 13-7 Orders Placed by Foreign Stockbrokers Prior to the Start of Day's Stock Transactions and the Nikkei Stock Average



Source:September 13, 2005, Nihon Keizai Shimbun
Note:Orders placed by foreign stockbrokers prior to the start of day's transactions based on market estimation in terms of 12 brokers.
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