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Industry finds it difficult to regain confidence

With no end in sight for sluggish growth, the migration of financial institutions overseas has only just begun, writes *Michiyo Nakamoto*

Reflections: it cannot be denied that much of the past 20 years has been an era of mild but relentless decline AP

Japan enjoyed a few days in the global spotlight this month when regulators, financiers and pundits from around the world arrived in Tokyo for this year's International Monetary Fund and World Bank annual meetings.

The last time Japan hosted the meetings, in 1964, the country was on the cusp of rapid economic growth that would see it rise from the devastation of the second world war to become the world's second-largest economy after the US.

But nearly half a century later, the optimism and dynamism that characterised Japan back then has been replaced by a sense of drift and uncertainty.

To be sure, during the IMF and World Bank meetings, which brought an estimated 15,000 visitors to Japan, Tokyo was able to present its face as a gleaming, modern metropolis and the Japanese government proudly pointed to the progress made in rebuilding areas devastated by the earthquake and tsunami on March 11 last year.

Yet it cannot be denied that the bulk of the past 20 years has been an era of mild but relentless decline, including in the banking and financial sector. The benchmark Nikkei average, hovering at about 9,000, is now less than one-quarter of its all-time peak of 38,915 on December 29, 1989, and has not recovered the level it was at before the Lehman shock, of just over 12,000. "Japan as a whole has lost confidence and that is reflected in the capital markets," says Koji Nagai, chief executive of Nomura.

Weak market activity is by no means restricted to Japan, but the Tokyo market's decline has been more prolonged, while a shrinking population makes it difficult to be optimistic about the future.

Net operating revenues of the securities industry fell more than 20 per cent from an average of Y2.25tn between fiscal 2002 and 2009 to Y1.78tn in the year to March 2012.

"I'm not wildly optimistic about the equity market in the short term. The market is fundamentally cheap, but it lacks some kind of catalyst to unlock that value," says the head of one western investment bank.

Not surprisingly, western investment banks have been shrinking their operations in Tokyo. Goldman Sachs is moving its hedge fund conference, which had been held every year in Tokyo, to Singapore this year.

But foreign banks are hardly alone in finding it difficult to grow in Japan. The financial industry overall has struggled to find ways to encourage savers to shift some of their bank deposits to more profitable investments.

Even as household assets have grown by Y500tn over the past 20 years to Y1,518tn in 2011, about half of that is still held in cash and deposits, according to the Bank of Japan.

Nomura and Daiwa, the country's leading investment banks, sought to counter diminishing prospects by expanding overseas. But as Nomura's recent scaling back of its global operations shows, the global environment is now significantly worse than it was a few years ago.

Still, it is not all doom and gloom. Savvy investors in Japanese stocks have been able to generate strong returns by identifying hidden gems, such as Anritsu, which sells communications test and measurement solutions and has enjoyed a 263 per cent rise in its share price from Y282, the Friday before Lehman Brothers collapsed in 2008, to Y1,025 on October 19 this year.

Twenty-three stocks on the Topix have more than doubled this year and the real estate investment trust sector is up more than a quarter, supported by Y110bn of purchases by the central bank as part of its monetary easing programme.

> It is not all gloom. Savvy investors have been able to generate strong returns by identifying hidden gems

And Japan's large banks, which still rely for the bulk of their profits on the home market, are highly profitable again. Mitsubishi UFJ Financial Group made net profits of Y981.3bn in the year to March, 2012. That is nearly twice the second largest profit earner on the TSE – NTT, at Y467.7bn.

However, the large banks generate the bulk of their profits by trading in government bonds (JGBs) and less than 70 per cent of deposits at Japanese banks go towards lending to

Continued on Page 2

Inside »

Property
Signs of a perkier market are beginning to emerge
Page 2

Retail corporate bonds
Sales by solid companies are back in favour
Page 2

Project finance
Banks are seeking and winning many contracts overseas
Page 3

Mitsubishi/ Morgan Stanley
Hurried marriage in which partners have switched roles
Page 3

The salaryman
Gone are the days of lavish lunches and drinks dates with friends
Page 3

All parts of corporate sector come to the regulator's attention

Oversight

Companies are being scrutinised without fear or favour, says *Paul J Davies*

Banks in Japan have been keeping the local regulator busy in the past couple of years.

The fallout from the financial crisis of 2008 in the US, Europe and beyond has taken many of the headlines globally, but Japan has been having a torrid time of it too.

There have been scandals large and small in stock markets, interest rate markets and consumer markets. But, because people from all parts of the industry – and both domestic and foreign firms – have been involved, the burden of the regulatory response is also being borne more or less equally.

Most recent were the insider trading scandals in which some securities houses were leaking to favoured clients news of equity issues from public companies ahead of their announcements. Foreign and domestic groups were involved in various ways, but it was Nomura, a Japanese bank, that saw the most abuses.

There were also the charges that some banks were manipulating Tibor, a rate at which banks lend to each other, to give an advantage again to favoured clients. This scandal echoed the Libor abuses in the west, where investigations are continuing and further penalties are expected. This time in Japan it was Citigroup and UBS at the centre of things.

Citigroup also has suffered a string of run-ins with the regulator over its retail business in the country. At the end of last year it was handed a temporary business suspension after it was accused of violations, including inappropriate solicitation of customers and sales of investment products.

Citi, which is now the only foreign bank to maintain retail, commercial and investment banking businesses in Japan, has been in trouble with the regulator five times since 2004.

In spite of all this, foreign banks in Japan today face an environment that has not suffered particularly compared with domestic groups either in the eyes of client companies or regulators, according to bankers and lawyers in Japan.

According to Ed Cole, a partner at Freshfields in Tokyo, things have actually got better for foreign banks over recent years.

"The regulatory environment has greatly improved," he says. "A couple of years ago, there was a policy change to make the regime much more principles based and the senior regulatory guys are now very comfortable working that way."

This improvement, however, may be partly because foreign banks are not asking for much in terms of market liberalisation, he adds.

One senior Japanese banker says everyone is now focused on restoring trust. "Since the insider trading scandals, the industry needs to regain investor trust," says Katsunori Sago, deputy president of Goldman Sachs Japan and head of its securities division. "That's exactly what regulators have been focusing on in order to increase trading volumes and enhance the presence of the Tokyo market."

> There have been scandals in stock markets, interest rate markets and consumer markets

In competitive terms, the fact that scandals have fallen on both domestic and foreign groups means that local companies do not necessarily hold any group more culpable than another.

Nomura lost some capital markets work in Japan this year as the latest revelations on its role in leaking deals was uncovered but companies nevertheless still need to find the right banks for the work they need doing.

Japanese and foreign banks exist quite symbiotically, says Mr Cole. None of the foreigners really wants to go fully into the domestic market, but more to be a conduit for offshore deals.

Goldman's Mr Sago says that local companies have stopped seeing banks as domestic and foreign, but more as global or not global.

"Japanese companies are increasingly looking overseas for growth opportunities and so they need to talk to securities firms with strong global networks," he says. "The kind of clients we work with look for more global investment banking services."

There is no doubt that local banks are trying to break more into the kind of high paying investment banking work that the likes of Goldman and others have pursued successfully in Japan.

Nomura, for example, is seen more as a global bank than a local one since its takeover of the international business of Lehman Brothers.

But, for the most part, Japanese banks still lack the experience and the ideas of their foreign rivals, the rivals say.

"Frankly, the local banks are not becoming more sophisticated," says a senior Japanese banker in Tokyo.

"They are doing more investment banking and advisory work but, at the moment, they are mainly presenting commercial bankers who have little content [what bankers call ideas for how to structure a trade or what businesses would make good targets]," says the banker.

"Their execution services are poor compared with the foreign banks as well."

Bowing out: Nomura CEO (right) quits over insider trading

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Gentle recovery in property after four years in the dumps

Real estate Analysts have called the bottom of the market, writes *Jonathan Soble*

For most Japanese, the biggest news in real estate this year has been the completion of Tokyo Skytree, a 634-metre latticed silver needle that is the world's tallest broadcast tower and second-tallest structure after the Burj Khalifa skyscraper in Dubai.

Built in a relatively poor and otherwise low-rise district in eastern Tokyo, Skytree is a tourist attraction and – city planners hope – a spur to economic development.

More financially inclined property-watchers have been celebrating another, less visible development: a pickup in deal volumes and rents that may herald a recovery after more than four years in the dumps.

The Japanese capital was the most active city in Asia for real estate investment in the second quarter of 2012, says Jones Lang LaSalle, the property consultancy, with $3.7bn of transactions. It moved from 26th in the world in the same period last year to fourth, behind only London, Paris and New York.

The Tokyo Stock Exchange's index of real estate investment trusts (Reits) is meanwhile up by one-quarter since the start of the year, compared with about 5 per cent for the Nikkei share average.

Commercial property prices are still about 40 per cent below their pre financial crisis peak, but analysts are calling the bottom of the market.

"There is a buying opportunity," says Kayoko Hirao, head of Japan research at the consultancy DTZ. "Japanese banks are in good shape compared with European ones, so financing is readily available. It won't be a sharp V-shaped rebound, but we do see a gentle recovery ahead."

Japan's property market is known mainly for the long, relentless tumble that began in the early 1990s. Prices picked up a bit in the mid-2000s, only to be flattened again in the global financial collapse. Last year's earthquake, tsunami and nuclear accident added an extra obstacle to recovery.

Yet the generally weak state of affairs has not stopped developers from building, at least in Tokyo, where the past decade has seen several areas transformed by new office and retail projects.

Roppongi, a neighbourhood known mainly as a somewhat seedy nightspot, is now filled with bankers and lawyers during daylight hours too, thanks to two large mixed-use projects – Roppongi Hills, completed by the privately owned Mori Building Company in 2003, and Mitsui Fudosan's Tokyo Midtown, opened in 2007.

An extensive redevelopment of the Marunouchi area, just southeast of the central Imperial Palace, is meanwhile continuing under its dominant landowner, Mitsubishi Estate. The neighbourhood received a boost this month with the completion of restoration work on Tokyo Station, an elegant 1914 rail terminal that is one of only a few red-brick buildings in the city.

The emergence of new, high-quality space in central locations is drawing tenants from more peripheral areas. In one of the more talked-about moves, Morgan Stanley is taking its Tokyo headquarters from Ebisu, a western district known more for apartments and shops than investment banks, to the financial district of Otemachi in 2014. "Demand is being driven by a sense that there is good value available and by a flight to quality," says Takeshi Akagi, head of research at Jones Lang LaSalle in Japan.

Tokyo Skytree: tourist attraction and, city planners hope, a spur to development

Signs of a perkier market can be seen in rents for top-grade office space, which rose in the second quarter of this year for the first time since 2008, Jones Lang LaSalle calculates.

More tenants moved into new space in the first half than in any comparable period since January-June 2007. Some of the activity is a function of timing: with a contract period of five years being typical, many tenants who moved during the last run-up are again in the market for space.

Investors remain mostly local. Japan has a far lower proportion of foreign buyers than any other top-10 market, at about 7 per cent of the total by value. In a country struggling with deflation where 10-year government bonds yield less than 1 per cent, the 3 or 4 per cent yields available in property can seem like a windfall.

But foreigners are taking more of an interest too as turbulence in Europe and elsewhere heightens Japan's safe-haven appeal. In May, TPG, the private equity group, combined with the property consultancy Savills to take over Joint Corporation, a bankrupt residential real estate developer, for an undisclosed sum. Hong Kong-based Pacific Alliance and Secured Capital recently bought a building in trendy Omotesando, and Goldman Sachs in September launched a Y30bn private Japanese Reit, though its backers are to be mainly Japanese pension funds.

Outside Tokyo, a market rebound looks further off. In Osaka, a stagnant economy has created an ever-widening gap with the capital. Office rents slipped 1.3 per cent in the second quarter compared with a year earlier, and at a little over Y10,800 per tsubo (roughly equal to 3.3sq m) they are 40 per cent of Tokyo's level. Yet Osaka's relative weakness can hide potential opportunities, since lower rents can be more than offset by cheaper purchase prices.

Shrewd buyers might do better in the city than in glitzier Tokyo: the average investment yield on Osaka office properties was 5.2 per cent in the second quarter, says Jones Lang LaSalle, compared with 3.6 per cent in the capital.

More interest paid in a stable return

Retail corporate bonds

Ben McLannahan finds enthusiasm for local companies

Bankers in Tokyo tend to offer three pieces of advice for elderly relatives fielding cold calls from brokers.

"If the salesman is calling after the 20th of the month, don't buy it – he is probably short of his sales target. If he says the product is 'really popular', don't buy it (if so, why is he calling you?)," they say. "And, unless you understand the product completely, don't buy it."

The wariness is understandable.

Japanese households are sitting on more than Y1,500tn of assets, more than half of it pooled in cash deposit accounts, earning almost nothing.

For years, brokers have been trying to steer more of that money into products on which they can earn a commission, and from which asset managers and custodians can earn fees.

Recently, the market regulator has been watching particularly closely over sales of collective investment trusts combining high-yielding assets with high-yielding currencies.

Many have fluctuated wildly in price amid turmoil over Europe, to the surprise and dismay of investors.

That backdrop helps explain why stable bonds sold by Japan's most solid companies are back in favour.

According to Dealogic, the investment banking specialist, total corporate bond issuance to Japanese retail investors runs to Y1.23tn ($15.5bn) so far this year, the highest in dollar terms since 2009, with more deals – 30 – than any year since 2001.

Unlike so-called "double-decker" mutual funds, bonds are simple products, paying a simple annual yield.

They are issued by familiar names and denominated in a currency – the yen – that investors understand.

"Retail investors have got smarter," says Daisaku Fujikawa, co-head of capital markets origination at Citi in Tokyo.

"They now have a deeper understanding of the risks embedded in structured, foreign exchange-related products."

Commitments to corporate bonds do not have to be huge.

While institutional investors typically make a minimum investment of Y100m, the units are as small as Y100,000 to Y2.5m for retail.

And even if the coupon on the bond is low, it is not quite as low as the meagre rates of interest offered by equivalent Japanese government bonds.

One increasingly frequent seller of bonds to retail investors is Orix Corporation, the financial services company, which is well known in Japan through its car rental business and its sponsorship of the Buffaloes, a professional baseball team based in Osaka and Kobe.

Since April this year, Orix has sold three bonds to retail investors worth a combined Y90bn, while offering progressively lower coupons.

The last, a five-year bond issued in August, offered an annual yield of just 0.777 per cent.

While that may seem a barely adequate reward for investing in a company rated single-A by R&I, the largest Japanese credit rating agency, it is almost four times higher than the current five-year JGB.

"There is a wide range of people who want a stable investment in a company quite rooted in Japan," says Greg Melchior, an investor relations manager at Orix. "If the demand is there, there's no reason why we wouldn't tap it."

It is not just Orix.

As Kathy Matsui, chief Japan strategist at Goldman Sachs, notes, the gap between the dividend yield of equities and the average single-A rated corporate bond yield of a company on the Topix index reached a record high in September, at about 1.6 percentage points in favour of stocks.

That "record dividend-credit yield gap suggests the potential to leverage balance sheets", she says.

Asset managers have cottoned on. Since April, they have launched five new yen-denominated corporate bond funds, raising Y48bn ($610m).

Four of those funds are focused on subordinated bonds issued by banks, that are racing to issue such debt by March 2013, the deadline for eligibility under new capital adequacy standards.

> Bonds are issued by familiar names and denominated in yen – a currency investors know

Banks are zeroing in on retail investors because many institutions have had enough of this kind of debt, which ranks lower than other bonds in terms of repayment priority, if the issuer becomes insolvent.

Still, for many retail investors, such bonds are considered "safe assets", says Yusuke Ueda, credit strategist at Bank of America Merrill Lynch in Tokyo.

One final driver of rising retail ownership of corporate bonds, is a general reshuffling of portfolios.

A large number of five-year JGBs targeting individuals, first released in 2006, have matured this year. After redemption, investors have tended to buy corporate bonds instead of reinvesting in much lower-yielding JGBs.

And why not make that trade?

By the (admittedly crude) indicator of credit default swap prices, many of Japan's biggest companies – including Canon, Japan Tobacco and Asahi Breweries – are considered safer bets than the government itself.

"Retail investors are gradually losing trust in JGBs," says Yunosuke Ikeda, chief foreign exchange strategist at Nomura, alluding to the government's failure to pass a deficit-financing bill in the run-up to a general election.

"It is not a dramatic trend, as of now. But if political uncertainty continues, [corporate bonds] might gain in future."

Tough market is happy hunting ground for some

Equities

Ben McLannahan says there are hidden gems if you know where to look

With a 24 per cent share of new listings and a 12 per cent share of trading, it is fair to say that Nomura Holdings has a strong hold on the Japanese equity market.

So when the cheerleader-in-chief takes down its official forecasts for the Nikkei 225 stock average, it can cast a pall.

Spirits sagged a little earlier this month when Nomura did just that, its chief strategist Hiromichi Tamura rattling off a long list of reasons – growing tensions with China, the strong yen, gloom in Europe – why his earlier projections were too high.

With full-year earnings for large companies expected to be flat from last year, rather than up 10 per cent, the Nikkei would be unlikely to see the important threshold of 10,000 again until the first half of 2013, he said.

"Our basic view is now worse than we'd expected," says Mr Tamura. "This is one of the biggest [earnings] slumps we have seen, after Lehman."

As if asset allocators needed any more encouragement to turn away from Japan. Even with stock valuations plumbing new depths, relative to the S&P 500, 38 per cent of global fund managers told Bank of America Merrill Lynch that they were underweight Japanese equities in October. That was the worst reading since the March 2009 survey, up from a net 23 per cent in September.

The outlook is not much better. Twenty-four per cent of investors said Japan was the region they most wanted to underweight. And who can blame them?

The market has failed to ignite so often, that bosses may not tolerate bets that do not pay off. "If you're long and wrong on most markets in the world, you get a second chance," says Jesper Koll, head of research at JPMorgan in Tokyo. "If you're long and wrong on Japan, you get fired."

For some investors, though, Japan has been a happy hunting ground. Years of tough markets have made them skilled at spotting good opportunities. Take Masahiro Koshiba, chief executive of United Managers Japan, a holding company for a small group of fund managers. Since starting his own fund, UMJ Kotoshiro, four years ago, he is up about 21 per cent, against a benchmark down 18 per cent.

One of his strategies is to home in on mid-sized companies that, through a mixture of luck and design, have become consolidators in their industries. They often buy loss-making competitors for next to nothing, then turn quick profits by adding them to efficient operating platforms.

Two such "longs" in recent years have been VT Holdings and Koshidaka Holdings, which have applied that formula to car dealerships and karaoke booths, respectively. "It's simple: I focus on stock selection and keep positions as long as possible," he says. "If it's a good business model, I'm long. If it's not, I'm short."

Others tell stories of unearthing little-known gems. Many smaller-cap stocks, relying mainly on domestic consumption, have raced ahead of benchmarks. Twenty-three stocks on the Topix have more than doubled in 2012.

> Market has failed to ignite so often that bosses may not tolerate bets that do not pay off

Some of these stocks really are hidden. As Nicholas Smith, an analyst at CLSA, notes, 964 companies on the 1,689-strong Topix index are covered by two analysts or fewer – compared with 30 on the S&P 1500.

But even mega-caps can really move. Chiyoda Corp and JGC, the engineering companies, have both gained more than 50 per cent this year, benefiting from the reconstruction of the tsunami-afflicted north-east.

The listed real estate investment trust (Reit) sector has also motored in 2012, up more than a quarter, thanks in large part to about Y110bn of Reit purchases by the Bank of Japan, as part of its monetary easing programme. "Property has offered high dividend yields and significant capital appreciation," says Charles Beazley, chief executive of Nikko Asset Management.

Even macro strategies can do well, if timed nicely. Japan has outperformed other developed markets several times over the past decade, says Audrey Kaplan, head of international equities at Federated Investors, a Pittsburgh-based mutual fund manager.

Her global fund has about one-fifth of its $533m in assets in Japan – more than six percentage points higher than the MSCI benchmark weighting.

"We've been adding in expectation that the future will be better than the past," she says, noting that sentiment has been jolted in particular by Japan's territorial dispute with China. "You never want to invest when everything is rosy and perfect, as that is what gives you downside."

With about two-thirds of the biggest Japanese stocks trading below book value, the potential for further falls appears limited, she says. A few dozen non-financial companies on the Topix have even sunk to negative enterprise value – where the cash on the balance-sheet exceeds the cumulative market value of both debt and equity. That effectively allows investors to get future income streams for free.

"If you think there is any value at all in Japan, now is the opportunity," says Ms Kaplan. "Otherwise you might as well give up."

Industry finds it difficult to regain confidence

Continued from Page 1

businesses. "Corporate Japan is cash rich, and 40 per cent of companies listed on the Tokyo Stock Exchange have net cash," says Brian Waterhouse, banking analyst at CLSA in Tokyo.

Consequently, Japanese banks have been buying JGBs to the extent that for some, the bonds make up 25 per cent of assets, putting them in a dangerous situation should interest rates rise – and lead to a fall in the value of bonds, which carry a fixed yield.

To help reduce their dependence on JGB trading profits amid stagnant loan demand at home, the banks are looking overseas in search of growth.

"Growth in Japan is flat, but, on the other hand, overseas markets can give Japanese banks double-digit growth," says Ken Takamiya, banking analyst at Nomura.

Despite the setback Nomura and Daiwa have faced overseas, many institutions believe their best hope for growth lies beyond Japan's borders, at least for the foreseeable future.

Armed with a strong yen and firm balance sheets, MUFG, Sumitomo Mitsui Financial Group and Mizuho are scouring global markets for assets to acquire from western financial institutions that have retreated from overseas markets due to the financial crisis.

MUFG acquired the asset finance business of Royal Bank of Scotland two years ago for $6.4bn, while SMFG bought RBS's aviation leasing business for $7.3bn this year.

The banks are stepping up project finance business, in particular, which is seen as a promising market where they have an advantage because of their strong balance sheets and long-term approach to lending.

> Groups are all scouring global markets for assets to acquire from western institutions

"There is no question that project finance is a big pillar of our profits. It provides value-added in terms of the fees," generated from arranging the deals, says Yasuhiro Oka, head of the planning and co-ordination team in Mizuho's global structured finance division.

Insurance companies have also been active in targeting overseas assets. Dai-ichi Life, Japan's second largest life insurer, is acquiring a 15-20 per cent stake in Janus Capital Group, a Denver-based money manager.

"In the medium to longer term, non-life insurers, which are lowering the weight of their stockholdings, are likely to reinvest those funds in overseas M&A," says Wataru Otsuka, analyst at Nomura.

With no end in sight for sluggish economic growth at home, the shrinking population and the strong yen, the signs are the migration of Japan's financial institutions overseas has only just begun.

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Focus turns to overseas opportunities

Project finance

Banks want to offset dependence on lending at home, says *Michiyo Nakamoto*

When the Saudi Arabian government decided to privatise Medina Airport, it awarded the contract to build a passenger terminal and operate the airport for 25 years to a consortium led by TAV Airports, the Turkish group.

No Japanese companies were involved in the first ever airport privatisation in Saudi Arabia, but Sumitomo Mitsui Banking Corporation won the contest to become sole financial adviser on the deal – its first sharia compliant deal ever.

The Medina agreement is one of countless project finance deals in overseas markets that Japanese banks are seeking and winning.

"We believe there is huge potential in this market," says Yasuhiro Oka, head of the planning and co-ordination team in Mizuho's global structured finance division.

Mizuho, Sumitomo Mitsui Banking Corporation and Bank of Tokyo Mitsubishi UFJ, Japan's top three banks, are looking to overseas project finance to reduce their dependence on lending at home.

Although Japanese banks have been participating in project finance deals for decades, their focus on the business in overseas markets has grown, as lending at home has stagnated.

> SMBC has expanded its team from fewer than 40 in 1997 to more than 360 globally

SMBC, for example, has expanded its team from fewer than 40 people in 1997 to more than 360 globally today, says Rajeev Kannan, general manager of SMBC's project and export finance department.

The boost to project financing deals is largely due to the pressure on European banks, in particular, to shrink their balance sheets in the wake of the financial crisis.

In contrast to western banks, Japanese banks have large deposits they cannot efficiently employ in their home market, due to a prolonged slump in borrowing demand.

Mitsubishi UFJ Financial Group, which includes BTMU, was the top-ranked global mandated arranger of project finance deals in the first nine months of this year, with Sumitomo Financial Group, the holding company including SMBC, in third place.

Mizuho was in fourth place, according to Thomson Reuters.

At the same time, Japan's proximity to the rest of Asia is an advantage.

"The centre of gravity of this business has moved from the west to Asia, and Japanese banks are the centre of the business," says Mr Kannan.

Project finance deals were down in all regions in the first nine months of this year, with Asia suffering a 27 per cent slump, according to Thomson Reuters.

Nevertheless, Asia, including Japan, maintained the lead in total proceeds, at $55.2bn in that period, compared with $26.2bn in the Americas and $50.7bn for Europe, the Middle East and Africa, Thomson Reuters reports.

Japanese banks are particularly well suited to project financing, says Makoto Kobayashi, global head of structured finance at BTMU. "Project finance depends on stable cash flow over a long period and we prefer deals that provide stable revenues, rather than short-term gains," which have been the focus of western investment banks, Mr Kobayashi says.

What is more, project financing deals lead to other banking businesses, such as deposit accounts and cash settlement services. "We provide interest rate hedging, cash management, transaction banking and other services. So if I put all these together in a basket, the overall return of this business is quite good," says Mr Kannan.

The government is also putting substantial effort into supporting packaged infrastructure exports, including operational support and longer-term maintenance.

This is primarily through financial institutions such as the Japan Bank for International Cooperation and Nippon Export and Investment Insurance, the export credit agency.

The involvement by a government agency can be critical to winning deals, particularly in the Middle East, but is also important to minimise risk, says Tadashi Maeda, global head of JBIC's infrastructure finance group.

"The lenders cannot minimise risk, so the governments need to get involved," he says. "We have to have bank-able deals, so we get involved at an early stage by providing feasibility study grants and that makes it easier for private banks to participate."

Amid all the enthusiasm for project finance, there are signs that competition is already intensifying.

Mizuho, for example, has been investing at an early stage in large projects to ensure it is better placed to participate in the financing.

For example, it has invested equity in Ascendas, a Singaporean company, developing an industrial park and multipurpose site in Chennai, India.

"It will probably take 10 years for the Chennai project to generate returns," says Ko Isaki, manager of the strategic projects department in the Industry Research Division of Mizuho Corporate Bank.

"But we are getting involved at an early stage because, by the time the project gets to the financing stage, there is huge competition and the returns become quite competitive," he says.

'Rebuilding takes more than money'

Reconstruction Financier finds biggest obstacle is the lack of an overall recovery plan, says *Jonathan Soble*

Soon after the tsunami that devastated Japan's north-eastern coast last year, Tomoaki Tsutsumi, a Tokyo-based fund manager, gathered his 10 employees and set out for the disaster zone.

Like thousands of volunteers from around the country, the group from Keystone Partners spent days distributing rice and water to homeless survivors.

"It was a shock to see that people were only getting three hot meals a week," Mr Tsutsumi remembers.

Later, he helped organise a pop concert and used connections at a trading company to source rare Vietnamese dragon fruit to break the monotony of evacuation-shelter rations.

"At first, the focus is on life and death. But, before long, stress and boredom set in."

Before he became a money manager, Mr Tsutsumi was a world-champion yacht racer, and it was not long before his activities in the disaster zone landed his name in a Japanese newspaper.

That, he says, was when local business owners started sending him requests for help – not with tropical fruit or concerts, but for financing for their reeling companies.

"They were dealing with tsunami damage, electricity shortages and scrambled supply chains," he says. Keystone, which was founded in 2009 and manages about Y10bn of assets, has since invested in two businesses in the region, an operator of hotels and ski resorts and a delivery company.

"Ultimately, the question was, what could we contribute as a fund?"

On the whole, money is not scarce in the tsunami zone. Since the waves hit 18 months ago, killing nearly 20,000 people and wiping out towns and villages along a 300km stretch of coast, the government has committed vast financial resources to reconstruction.

About Y5tn is available to businesses, farms and other enterprises in the form of low- or no-interest loans and loan guarantees from state-affiliated banks.

That has left relatively little room for the private financial sector to back rebuilding efforts.

But there are some areas where the industry has found ways to get involved.

In addition to smaller funds such as Keystone, heavyweights such as Nomura Asset Management and Daiwa Asset Management have set up special funds to invest in the region.

Devastation: the government has committed vast resources to reconstruction Gettyi

> Some enterprises suffered indirect damage from the disaster yet do not meet the criteria for state aid

One area where they have found a need is bridging loans.

Despite the wealth of aid available to local businesses, the huge number of applicants means it can take months to process and deliver it.

Even if money has been promised by a state-backed bank, rules forbid recipients using the promise as collateral for private loans, a situation that can lead to potentially business-wrecking funding gaps.

That was the case with the delivery company in which Mr Tsutsumi invested.

Orders had started to pick up as reconstruction efforts accelerated, and it needed operating capital to meet the increase in business.

Government aid was months away, so Keystone agreed to provide a bridging loan of Y1bn, which has since been repaid.

Some enterprises suffered indirect damage from the disaster yet do not meet the criteria for state aid. In the tourism industry, business fell off even in areas where infrastructure remained intact, as travellers were turned off by images of suffering and gloom and concerns about radiation from the Fukushima nuclear site.

The ski and hotel company turned to Keystone for a Y500m loan when it was turned down by public institutions.

Keystone is backed by Japanese banks, pension funds and Mitsubishi Corporation, the trading and investment house, and is planning a second fund that will be open to foreign investors.

Mr Tsutsumi says he is charging market rates on his loans to the two groups in the disaster zone, but allows some flexibility in repayment schedules to account for their strained circumstances.

Other funds have taken a more overtly charitable approach. Music Securities, an innovative micro-lending outfit that raises money for struggling bands and singers, set up a fund for small businesses in the tsunami-hit region.

So far, it has raised Y854m from 24,000 people; half the money is donated, and the other half earns a return if and when the businesses recover.

Investors can choose the companies they want to support. On Music's web site, visitors can browse profiles of sake breweries, fish shops and soy sauce makers, make a donation-cum-investment – in increments of Y10,000 plus a Y500 management fee – and, in some cases, order the companies' products.

Mr Tsutsumi says the biggest obstacle to reconstruction finance, both public and private, is the lack of an overall recovery plan for the region.

The rural area's population was already shrinking and ageing before the disaster, and there is still no consensus about which parts should be restored and how.

"You can't just stick a factory in the middle of a flattened town," Mr Tsutsumi says.

"Some local businesses had only a handful of employees with specialised knowledge, and they've disappeared or moved away. Rebuilding takes more than money."

Hurried marriage confounds most of the sceptics

Case study
Mitsubishi tie-up

Paul J Davies looks at the performance of a joint venture

Marry in haste, repent at leisure.

The phrase could almost have been written for Morgan Stanley and Mitsubishi UFJ in the first few years after the latter's hurried $9bn investment in the former in the depths of the financial crisis of 2008.

But the twin joint ventures created by the two in 2010 finally appear to be achieving something that might be working. The combined businesses are sitting at or near the top of the rankings for equities, debt and mergers and acquisitions work.

Two deals this year in particular demonstrated where the strength of the complicated tie-ups might lie and made rival investment bankers sit up and take notice.

First was the role advising Dentsu, an advertising company, on its $4bn purchase of Aegis, a UK peer.

Dentsu was never a main client of Mitsubishi UFJ, but the combination of the bank's cheap funding and Morgan Stanley's international network of advisers got Dentsu into the fray.

Second was the $8.5bn initial public offering for Japan Airlines. The tie-up makes them among only three institutions that can conduct both the domestic and international parts of share sales.

Most Japanese securities firms or arms of banks can only conduct domestic offerings, while foreign firms can only conduct international ones.

Haruo Nakamura, deputy president and CEO of investment banking at Mitsubishi UFJ Morgan Stanley Securities, or MUMSS, admits there were plenty of doubters when the joint ventures were created.

"There was a negative view of our chances of success among rival companies and in the media," he says. "But, given the recent achievements, we don't think they are sceptical any more."

Others also have positive things to say. Mitsubishi had the local size and scale, but now they also have the distribution internationally – that is very powerful," says Andrew Whan, a partner involved in M&A at Clifford Chance.

Even some rivals have positive things to say – at least in private – but many remain sceptical, in part because of the structure of the tie-up and the big difference between former Morgan Stanley bankers and former Mitsubishi bankers.

The two came together when Morgan Stanley sold Mitsubishi a 21 per cent stake in the group for $9bn in October 2008. It was in effect a bailout by the Japanese when US investment banks were under huge pressure following the collapse of Lehman Brothers and the spiralling crisis in US mortgage markets.

After 18 months of negotiations that followed, the two banks created two linked joint ventures, both 60 per cent owned by the Japanese bank, but one controlled by the US company.

MUMSS, where Mr Nakamura now works, having been seconded like many of his colleagues from Morgan Stanley, is the old MUFJ securities business but with Morgan Stanley's investment bankers grafted on top.

This business, which is controlled by Mitsubishi UFJ, gives Morgan Stanley bankers access to the full list of the Japanese group's corporate clients.

It also holds the sales, trading, research and capital markets staff of MUFJ and operates the domestic end of bond and equity deals.

The other arm of the joint venture is Morgan Stanley Mitsubishi Securities, or MSMS. This has the sales, trading, research and capital markets teams of Morgan Stanley's old securities business in Japan and does the international leg of debt and equity deals.

MUFG securities business

It is still owned 60 per cent by Mitsubishi UFJ, but Morgan Stanley has 51 per cent of the voting rights.

What complicates things is that the investment bankers at MUMSS still sit in the same building as their former colleagues now in MSMS – so while MUMSS is gaining access to Mitsubishi UFJ's clients, it is questionable whether Japanese bankers are receiving any benefit in education or experience from the more international Morgan Stanley bankers they should be working with.

Also questionable is how the business is performing and whether Morgan Stanley is getting any commercial benefit from the joint ventures' move up the league tables.

One Japanese banker says the ventures are going quite well but "they risk destroying the franchise by doing cheaper work and jumping on any deal because they still have too many bankers".

But with financial markets in far better shape than they were four years ago and cross-border M&A volumes increasing out of Japan as the domestic business shrinks, it seems that Mitsubishi UFJ needs Morgan Stanley probably a good deal more than Morgan Stanley any longer needs Mitsubishi UFJ.

Uncertain future shapes lunchtime behaviour as incomes dwindle

The salaryman

Workers are saving, not spending, says *Michiyo Nakamoto*

Kaname Tomite has given up renting DVDs, cut back on socialising with friends and stopped buying the electronic gadgets and programming books he used to buy regularly.

Still, the 34-year-old, who works at a research and development centre for a large high-tech company, is feeling the financial squeeze, despite all his cutting back.

"I used to spend Y50,000 to Y60,000 a month in pocket money to buy digital products like PC peripherals and programming books, and I used to go out drinking with friends and colleagues every week," Mr Tomite says.

"But from around two years ago, ever since my daughter was born, my pocket money has been reduced to Y30,000 a month, with Y20,000 of that going towards lunch and bottled soft drinks," he says.

Mr Tomite is among a growing number of salarymen tightening their belts to cope with dwindling incomes.

The average wage of workers who have been employed for more than a year, including part-timers, has fallen consistently over the past 23 years, hitting Y4.09m last year, according to the National Tax Agency.

That is 12 per cent below the average wage of Y4.67m in 1997 and back to levels last seen in 1989, when the average wage was Y4.02m.

Not surprisingly, households in Japan are feeling financially constrained, according to a study by NLI Research Institute, which found that 61.5 per cent of households surveyed found it difficult to make ends meet.

This ratio has risen each year over the past decade since reaching 53.7 per cent in 2002, the institute notes in a report.

As wages have shrunk, Japan's long-suffering salaried worker has seen disposable income fall back to levels last seen in 1981, according to a survey conducted by Shinsei Bank.

The so-called salaryman was envied for his stable job and benefits in the 1960s and 1970s.

But these days he is more pitied for his lack of pocket money, which is down to an average Y39,756 a month this year, or nearly half the peak of Y77,725 in 1990, according to the survey.

> Many people fear they can no longer rely on their pensions after retiring

The fall in wages and disposable income highlights Japan's economic decline over the past 15 years, during which it lost to China its position as the world's second-largest economy.

But it is not just Japan's lost decades of economic weakness that are behind the phenomenon of falling wages.

Employers have been reducing real wages by not raising them each year as workers age.

This was once the practice, at large corporations in particular, in Japan's seniority-based employment system, says Tomoki Inoue, an analyst in the social improvement and life design research group, at NLI Research Institute.

They are also trying to eliminate overtime and are hiring more part-time workers, says Mr Inoue.

"Things are tough at the company and we don't get any overtime pay," says Mr Tomite.

More salarymen are bringing their own lunch to work, complete with flasks, says Ryujin Nishikawa, a marketer who has studied the lifestyle of salarymen. "The three most important things for a salaryman's lunch are his mobile phone, lunchbox and flask," Mr Nishikawa says.

The fall in pocket money clearly affects people's social lives.

The Shinsei study found that as people spent less money on lunch they also spent less time, cutting their break to 19.6 minutes from 33 minutes. "More people go to lunch on their own and look at their smartphone," says Toru Endo, a manager in Shinsei Bank's consumer finance business division.

What has helped the salaryman cope with his plight has been Japan's persistent deflation, which has reduced the prices of goods ranging from ready-made meals to haircuts.

Mr Tomite has taken to eating in his company's cafeteria where lunch costs Y500. Many salarymen are also tightening their belts not only because wages are being squeezed but also because they feel a strong need to save..

With public debt exceeding 200 per cent of gross domestic product, an ageing population and surging social welfare costs, many people fear they cannot rely on their pensions after retiring.

"There is concern about the future," says Mr Nishikawa. "In the 1980s, there was an expectation that things would get better but now there are fears even big companies could suddenly collapse, they could find themselves restructured out of their jobs or their bonuses could be cut. So people are trying to cut back on their pocket money and, if possible, save that money instead."

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