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Japan's Problems and Emerging China: A Japanese Banker's Perspective

September 20, 2007

Masamoto Yashiro

Senior Advisor, Shinsei Bank, Limited

Hugh Patrick, director of the Center on Japanese Economy and Business, Columbia Business School, served as the moderator for this event.

This report highlights the speaker's remarks and the following discussion that took place. The CJEB Distinguished Leader Lecture was cosponsored by Columbia Business School's Asian Business Association, Greater China Society, and Japan Business Association.

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SYMPOSIUM SUMMARY

Mr. Yashiro drew on his experience as a senior executive in the oil and banking industries in the United States, Japan, and China, to compare economic prospects and corporate cultures in Japan and China. Mr. Yashiro began by outlining some of the key reasons behind Japan's post-bubble economic malaise. With American industry in decline in the late 1970s and early 1980s, excessive hubris among Japanese corporate leadership combined with a strengthened yen following the Plaza accords to help create a domestic economic bubble. The result has been stagnant growth and loss of competitive edge for Japan since the bubble burst in the early 1990s.

Mr. Yashiro went on to explain lessons that Japan should learn from the bubble experience. Lack of international perspective, English skills, scarcity of foreigners among senior corporate leadership, the seniority-based promotion system, and risk-averse behavior continue to hinder Japanese corporations' global competitiveness and the expansion of Japan's economy. Moreover, lack of clear national goals, exemplified by former Prime Minister Abe's stated goal of a "beautiful Japan," is the most significant roadblock to renewed economic and political strength.

Reflecting upon his recent experience working to reform Chinese state-owned banks, Mr. Yashiro outlined several key challenges on the path of continued growth. Chinese financial institutions, which recently had bad asset problems similar to those experienced by Japan, have largely taken care of them by transferring them to asset management companies. Moving forward, China must maintain its high rates of economic growth to avoid further nonperforming loan problems. Chinese banks must continue to develop a strong credit culture and risk management skills, prevent irregularities, and improve profitability through services other than loans and deposits.

In contrast to the Japanese corporations, Mr. Yashiro described the eagerness of Chinese banks to tap into the skill and experience of foreigners. Already benefiting from infusions of Western capital, by absorbing foreign expertise Chinese financial institutions will soon be among the leading banks in the world, according to Mr. Yashiro. In Tokyo, on the other hand, it is rare to see foreigners among senior banking executives, and without fresh ideas and perspectives, Japan will struggle to compete globally.



HUGH PATRICK

Director, Center on Japanese Economy and Business, Columbia Business School

It is my pleasure, as well as my honor, to introduce our distinguished lecturer today, Masamoto Yashiro.

I have known Mr. Yashiro for some years and count him as a good friend. He is a person and a business leader I admire and respect deeply, and you will see why once you hear what he has to say.

During the course of the year, the Program on Alternative Investments of the Center on Japanese Economy and Business brings you distinguished lecturers in finance, holds symposia, and, under Alicia's leadership, has inaugurated an annual conference series in late May in Tokyo.

You have a brief of biography of Mr. Yashiro in the program booklet, and I will not repeat that, but let me tell you a few other things about his career. He was the first Japanese that I know of to work for a major American multinational firm in a major position in the United States, not in Japan. He ran operations for Exxon in Houston, and there, among other things, he learned the central importance of detailed monthly performance measures, as he has mentioned to me from time to time.

John Reed of Citicorp brought Mr. Yashiro out of retirement from Exxon to head Citicorp's Japan operations and to be a part of a core team, the senior management,

for Citicorp. Then Mr. Yashiro retired again. Then Ripplewood brought him out of retirement to head Shinsei Bank, which was another brilliant move, I think, on Shinsei's part.

In both institutions, Citicorp and Shinsei Bank, he installed and instilled the management disciplines he learned at Exxon. Almost exactly three years ago, he gave a talk here on what he was accomplishing at Shinsei Bank. In 2006, Mr. Yashiro was named Best Banker of the Year by *The Asian Banker* publication. I think by then he was in Hong Kong, working to help reform and develop Chinese banks while serving as chairman of Shinsei Bank after having completed his term as its president.

And he is now devoting his efforts to his fourth career—his previous three being Exxon, Citicorp, and Shinsei—improving the Chinese banking system. Accordingly, he moved to Beijing late last year and is studying the Chinese language assiduously. I guess he is a proponent of lifetime learning.

I could go on and tell you much more about him, but you did not come here to hear me talk about him. Rather, you want to hear what he has to say, and his talk is titled in a very general way that allows him to say anything he wants: "Japan's Problems and Emerging China: A Japanese Banker's Perspective."



MASAMOTO YASHIRO

Senior Advisor, Shinsei Bank, Limited

Thank you very much, Hugh. I would like to start by talking about Japan's problems, and then I will go on to discuss what I think of the Chinese banking system and its future. This evening, rather than discussing specific banking problems, I want to deal with much larger and broader subjects, that is, why Japan, including the banking industry, has suffered from stagnant growth for the past ten years and has lost the competitive edge in many areas of global activities. And then I will touch on China.

It should be noted that China's current rapid economic expansion reminds us of Japan's fast growth during the 1960s. There are certain similarities. Among them, Japan's decade of the 1960s was characterized by about 10 percent per year GDP growth, heavy and chemical industries playing the central role in the growth, and consumption—particularly petroleum—growing at double digits. And, furthermore, the natural environment was severely damaged by rapid industrial growth.

However, there are important differences between the two countries' experiences. In the case of China, its growth began from an even lower level compared to Japan's. Furthermore, everything in China is much larger in scale and is happening much faster than we saw in Japan. For example, foreign exchange reserves as of the end of July were \$1.4 trillion dollars, and

energy demand is increasing even more rapidly.

Even after the extremely rapid economic growth during the 1960s, Japan maintained a somewhat slower, but healthy, growth during 1970s and first half of the 1980s. I believe there are a couple of reasons why Japan was able to do so. In the early 1970s, we experienced the first energy crisis, which eventually collected some of the excesses of the 1960s. The world realized that there are finite limits to global resources that can be exploited and developed in a short period of time.

During the 1960s, the global consumption of petroleum increased by about 4 percent per year, which meant that the global economy needed to add, every year, a productive capacity equivalent to that of Kuwait: two million barrels per day. Building such a large capacity every year was getting to be physically impossible or at least very difficult. The energy crisis in the early 1970s caused the world to look for ways and means to save energy and improve energy efficiency.

Japan also launched a serious effort to protect the environment. The government mandated the use of lead-free gasoline for automobiles and required power generating plants to burn only low-sulfur fuel or natural gas. Furthermore, the industrial structure also began to shift away from the heavy and chemical industries, such as steel shipbuilding and aluminum, toward automobiles and electronic consumer goods. As a result of a somewhat fortuitous but serious reaction to the impact of an energy crisis, Japan was able to achieve measurable improvement in air quality. Japan's economy has achieved the best unit of energy input per unit of GDP output ratio in the world.

I believe the root of Japan's economic problems began to surface in the early 1980s, when Japanese business management was widely regarded as the model for the rest of the world. The United States started to suffer from the effects of inflation and lost competitiveness in the world market; in particular, the U.S. auto industry began to lose its dominant position to Japanese competitors.

Seeing these unexpected but advantageous developments, Japanese corporate managers became very impressed with themselves and began to say, "We now have nothing to learn from anybody, including the United States." To make matters worse, the September 1985 Plaza Accord caused a sudden and very large revaluation of Japanese yen per U.S. dollar: from 240 yen to 150 yen by January 1987.

The Japanese government, among others, decided to provide the market with an almost unlimited supply of low-interest-rate credit in order to support export industries. This freely available supply of cheap money caused not only individuals but also corporations to do what was called *zaiteku*, financial engineering, which simply meant putting money into domestic stocks, as well as real estate properties in Japan and abroad. The Nikkei 225, which hovered around 12,000 yen in 1985, climbed to 39,000 yen by the end of 1989, and the property market in most of the major cities went through the roof.

Since many people know about the bursting of the bubble and its aftermath, I will not dwell on the matter. Rather, I wish to discuss what and how this experience must change us so that we do what is necessary to restore the Japanese economy's strength and competitiveness in the next several years, before it is too late.

First, Japanese corporate management lacks a truly global orientation. Only a handful of companies have non-Japanese individuals as members of their board. Sony and Nissan seem to be the only large Japanese companies who have, or have had, non-Japanese individuals as their chief executive officers, but even that was a result of poor earlier management problems. Government deliberative councils on education spent an inordinate amount of time discussing whether or not Japanese grade schools should teach English as a second language and have finally decided against it. They felt that teaching a foreign language to young children could divert the children's attention from learning proper Japanese, which is very bad reasoning.

In sharp contrast with such a decision, in China English is now taught beginning in the first grade. As you know, most Japanese in leadership positions, either in politics, government, or business, do not have the ability to communicate directly in English with their counterparts in other countries. Communication through interpreters, no matter how good the interpreters are, is not as effective as direct communication.

Perhaps one of the most serious problems is that Japan no longer has well-defined national goals. The Abe government's defeat in the recent election of the House of Councilors can be attributed, significantly, to the fact that his announced government objectives, such as a "beautiful Japan" and revision of the constitution, were either too abstract or did not address any of the important issues of public concern.

Now that Mr. Abe is gone, his successor [Prime Minister Fukuda] should direct people's interest to something concrete that we

Japanese would like to aspire to achieve. For instance, grow the Japanese economy by 3 percent per year for the next five years. How can we achieve that? Or make Tokyo University, which probably is considered the best educational institution in Japan, one of the top five in the world, rather than its current 20th ranking. Or improve the profitability of Japanese companies by getting corporate managers interested in improving efficiency of capital use.

The Japanese government must develop much closer political and economic relationships with our own neighbors. With more than 50 years of strong U.S. influence in politics, government, business, and even our daily life, Japan has tended to follow, almost blindly, the lead of the United States. Now that Asia has become a very important region of power in world affairs, we must reinforce our effort to establish closer contacts with our neighbors, in particular China and South Korea. A peaceful and stable Asia, without conflicts between Japan and China, would be a very desirable condition for the global economy and prosperity. In particular, it would be very beneficial for the prosperity of Japan and China.

The overseas presence of Japanese banks is rather insignificant, as they tend to work only with Japanese corporate customers operating overseas, rather than becoming an integral part of the local economy. For their overseas operations, Japanese banks must change the management structure to place locally hired, qualified individuals in key positions. I believe the sooner Japanese banks let local people run the local operations, the faster they can develop corporate and individual businesses closely related to the local economy.

Japanese corporate management lacks a truly global orientation.

One of the legacy problems in the post-bubble years is that the current corporate managers at Japanese banks are in their 50s and early 60s, so that they have spent the last 15 years dealing with the aftermath of the bubble bursting, mainly fighting bad asset problems. As a result, they have become excessively conservative and generally risk averse. Almost any business, including the banking business, has some elements of risk. Taking acceptable risks is a precondition for business success.

Lastly, I believe we must invite qualified non-Japanese into Japanese corporate management. The fact that practically every Japanese company's management consists of only Japanese individuals causes the management to hold on to a traditional approach and reject nonconventional ideas or approaches as heresies. Since the world is changing very quickly, and since many innovative concepts and approaches are being introduced, an attitude of isolation will become a deterrent to Japan's progress.

Now, turning to China, over the last several years, Chinese banks were faced with bad asset problems similar to those that Japanese banks experienced from the mid-1990s. The Japanese banking industry took nearly ten years to clean up the balance sheet problems and restore capital ratio to acceptable levels.

The Chinese government transferred much of the nonperforming loans (NPLs) from the state-owned banks into separate, newly created asset management companies, then injected large amounts of U.S. dollars from the government foreign exchange fund to shore up the banks' impaired capital base. I believe the government injected \$60 billion into three banks. I think the Bank of China and China Construction Bank each

received \$22.5 billion and that \$15 billion went to the Industrial and Commercial Bank of China.

During the past three years or so, large Chinese banks, particularly some of the state-owned ones, have begun to pursue the strategy of developing a strong credit culture and risk management skills. They are working hard to prevent the recurrence of irregularities within their own institutions. At the same time, in order to improve their profitability, they are developing capabilities to offer fee-generating products and services other than deposits and loans.

Needless to say, the future success of these large Chinese banks depends on several critical factors. Among them is whether the Chinese economy can maintain the high growth rates of the past. When the economy continues to grow, bad loan problems generally do not surface because growth provides businesses with the necessary cash flow. If the economy stops growing at a high rate, however, loan assets, which otherwise would remain normal, could turn into bad assets.

Therefore, above all, the Chinese government must avoid the bubble and manage a high enough growth rate, but not so high a rate that it could cause bubbles in the economy. This is not easy. However, I believe the Chinese government and the People's Bank of China will be capable of avoiding the occurrence of bubble-related banking problems. Furthermore, a sudden and very large renminbi revaluation, as we saw for the Japanese yen in 1985-1986, will not happen. The Chinese government will let the renminbi exchange rate adjust its only gradually, in a measured way.

I am on the advisory board of the China Banking Regulatory Commission. There are seven

people on that commission, and they are all foreigners. The Japanese Financial Services Agency (FSA) does not have any foreigners in such a position, despite the fact that foreign advisors play a very important role. In fact, this past June our advisory board met in Beijing with the premier of China, Wen Jiaobao, and spent one hour discussing Chinese banking problems.

I believe that practically all of the Chinese banks must work harder to create a sound credit culture, to evaluate customers' credit worthiness, and apply proper pricing to their base loan interest that is appropriate for each risk category of borrowers. They tend to charge most borrowers the same interest rate, which is a problem. For a goal as important as credit management, they must develop a management process that enables their internal decision makers to know exactly, on a real-time basis, what transactions are being conducted between the banks and their customers, and what the products and services are. This is not only about what machines the bank buys. I have seen that Chinese banks are buying very expensive hardware from U.S. companies, which they do not use as well as they should. There is a tendency for large companies to think they have a good control system just because they spent several hundred million dollars on technology.

As long as most of the transactions at local branches are recorded manually, there is a high degree of possibility that errors and fraud can take place without being detected on a real-time basis. Indisputably, the machine does not lie and follows faithfully what it is programmed to do by humans. You know the phrase "garbage in, garbage out." Human

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beings are liable to make errors and even engage intentionally in fraud. In other words, I believe a good internal control system can be achieved only if a bank has a well-developed machine-based management process.

I was an independent director of China Construction Bank from September 2004 until June of this year. I retired, but I am now an advisor to China Construction Bank. From the limited but invaluable experience I have gained from the past couple of years, I would like to make the following observations.

First, as you know, all of the state banks are exceedingly large and they need not be any larger. They are already too large. China Construction Bank has a \$500 billion balance sheet, 300,000 employees, and 14,000 branches, and it makes about \$5 billion after taxes per year. Its NPL ratio was 3.2 percent as of the end of 2006.

The most critical question is whether a bank will be able to contain NPL problems in the future, both in terms of the amount and the ratio. This is not an easy task. As we all know, many of the past NPLs were caused by loans extended to state-owned enterprises. It is very difficult to collect loans from state-owned enterprises, even if they are poor credit customers. The bank must be firm in rejecting problematic loans, not only to private businesses, but also to the state-owned enterprises, even when the borrowers have political backing.

I have watched how they manage and collect NPLs. I think that before the government sorted out and took bad assets into asset management companies, all of these state-owned banks had about 20 percent to 25 percent in NPLs. That is significant. But after taking the bad assets into asset management companies, most

problem NPL ratios of large, state-owned banks came down to around 10 percent. It is down to 3 or 4 percent today. The Banking Regulatory Commission gave tough targets, the bank hired young professionals, and management listened to independent directors.

In fact, in the case of China Construction Bank, Bank of America, which became a strategic investor, has about 50 people working side by side with the Chinese staff. They spend a great deal of time with them, even taking Chinese trainees into Bank of America's operating units in the United States. I think they are really doing their best to improve those areas I mentioned.

Concerning China Construction Bank's board, it now usually meets quarterly, but during the first two years, it met probably every other month. In three years' time, I attended 35 board meetings. Each board meeting lasts one full day. Prior to the board meeting, you go to the committee meetings, which, again, last one full day. So for two full days per each board meeting, I had to be in different cities in China where the meetings took place. All together, I think I spent at least 300 to 400 hours per year as a member of the board and independent director. This illustrates the extent to which the board members know what is going on.

Are the financial statements published by Chinese banks believable? That is the usual question I get from my Japanese friends, and I am sure that my American friends also have the same question. My view is that Chinese banks are rapidly moving toward international standards, both in accounting and in auditing. One of the critical questions in this area is whether the current NPL ratio being

reported by large state-owned banks can be trusted. In my view, so long as auditing is done by one of the four internationally recognized accounting/auditing firms, the financial statements are as good as you would expect any place in the world. In fact, before listing in Hong Kong, China Construction Bank paid KPMG a great deal of money.

The large American companies, in my experience, spend about \$20–25 million per year on auditing. This is true for Exxon, IBM, and other such companies. Chinese banks spend an equal amount. Auditors identify discrepancies between what they find and what management is reporting. Generally, the discrepancy is insignificant, and the effect on the bottom line is less than 1 percent. Even if the adjustment is 5 percent on net income, it is not as significant as some people claim.

One of the questions I raised about the future of Chinese banks was where these state-owned banks are headed. We know that some foreign strategic investors have acquired substantial equity interest, and these banks have had initial public offerings. And, as you know, the three state-owned banks rank among the ten largest banks in the world, in terms of market cap. They are Industrial and Commercial Bank of China, Bank of China, and China Construction Bank. Some people say this is because their stocks are inflated, but that is something we can talk about during the discussion period.

Another question is whether or not these banks are moving toward what you call "privatization." I raised that question with some of the Chinese leaders and the middle management staff as well. They do not think they are moving toward privatization, but the answer I get is interesting. I am sure that you

My view is that Chinese banks are rapidly moving toward international standards, both in accounting and in auditing.

know the word “marketization.” I looked in the 1993 *Oxford English Dictionary* and did not find the word, so apparently it is something new. I think the Chinese are maintaining socialism philosophically and politically, but in terms of economic activities, they have gone for large-scale capitalism even more than Japan has. Japan is maybe one of the last remaining socialist countries, in the sense that everybody is equal.

My view is that privatization of the kind that replaces much of government ownership is not likely to happen in China. The purpose of inviting foreign strategic investors was primarily to acquire knowledge and skills from them to build well-managed and profitable banks in the future.

I saw many foreign investors going to China during 2005 and 2006. In 2007, I do not see as many. I think the Chinese time frame is probably five to ten times faster than Japan’s. Japan has spent about 20 years wondering whether or not we should invite foreign investors, how to treat them, what to do with them if they want to merge, etc. The Chinese probably learned what needed to be done in two years. They decided initially that they needed foreign investors to demonstrate that China is a good place for foreigners to invest in and also to receive some capital contributions by foreign investors.

But having seen so many foreign investors carrying bags of money into China, they do not need any more money. The Chinese want to learn the skills and gain experience. Accordingly, they have decided to invest in Barclays. I think they have probably sent one or two people to be on the board of Barclays so that they can learn its strategic view and more.

The Chinese are much more interested than the Japanese in

learning skills and gaining from foreigners’ experiences. The only reason they invited me to be one of the seven members on the advisory committee of the Banking Regulatory Commission is because they wanted to learn why the Japanese banking system went sour and why we could not solve the problem for ten years. I think those are the only reasons. I did not speak Chinese at all, and I did not know anything about China, but they wanted to learn from me about Japan’s problems.

Having spent three years with China Construction Bank, and also the Chinese Banking Regulatory Commission, I am called the most optimistic Japanese with regard to the Chinese banking system. I think in ten years’ time, one or two of the large Chinese banks will be as good as Citigroup, Bank of America, or any European bank. We will see one or two Chinese global financial institutions. That is my bottom line, because they are very serious in their desire to learn as fast as they can.

Every institution has to have objectives. “Beautiful Japan” cannot be an objective. It is somebody’s perception of how things are in Japan. You have to have elements that make people feel Japan is a good place to do business in or to go to. That is my bottom line with respect to Japan. Thank you very much.

DISCUSSION

HUGH PATRICK

Let me ask one question to start. You began by talking about Japan, and basically you said in order to compete globally, Japanese companies have to have a global outlook, which means they also have to take on senior staff who are not Japanese. You seemed rather pessimistic about the

chance of this happening, and maybe we will come back to that, but are Chinese institutions prepared to accept foreigners as senior members who will then play an important role? Or do they just want to hire outside experts and listen to their advice, and then after several years, send them home, similar to the Meiji approach to the way Japan did it?

MASAMOTO YASHIRO

My answer is very simple. It depends on the individual. Particularly, if the individual speaks Chinese, they will keep them. If the individual does not speak Chinese, it is difficult, because they have to deal with so many Chinese staff that may not have other language facilities. It is desirable to have a foreigner speaking Chinese.

In fact, at China Construction Bank, when I was the chairman of the Nomination and Compensation Committee, we were trying to hire a chief credit officer. I suggested we hire headhunters and give them some of the specifications of what we were looking for. Instead, it was decided to take out a full-page advertisement in the *Financial Times*. I said, “No. You will receive many applications, but you will not find the right person.”

They did receive many applications, but many were from academics, Chinese academics studying or teaching in U.S. universities who had good training backgrounds but no practical experience running credit management in any banking institutions. They also received applications from foreigners, but some of the foreigners asked for very large annual compensation.

Finally, they decided to use their own human resources. Chinese public institutions have many qualified individuals coming back to China rather than staying

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overseas. I have asked some of those young people why they come back to get paid one-third or one-fourth of what they could earn in the United States. They said that they come back because they want to make their own contribution to the success of the Chinese institutions.

Actually, I think large Chinese institutions, even state-owned ones, are paying very well today. When I started helping China Construction Bank as an independent director, the number one person, the chairman of the board, was earning about 700,000 renminbi a year, including a performance bonus. Fifty-five percent is merit, 45 percent is base. That is the nearly 50/50 split, which you do not generally find in Japan. The problem is they do not differentiate performance pay among people as widely as they should. I tried to raise the chairman's pay as fast as I could.

If you work as top middle management at a state-owned bank, you earn about \$50,000 per year. Now the top people at Chinese banks earn about \$100,000 per year. Again, this pay differential is too compressed, and it needs widening, but I think such important changes have to be approved by the state council or a similar organization. You cannot make a decision and implement it right away.

Privately owned Chinese banks can pay three times as much as state-owned ones for top people. So the Chinese are paying quite well. If you ask Chinese people today which foreign large private institutions they would like to work for, their order of preference is Chinese, American, European, and then Japanese. Below that are South Korean and Taiwanese institutions.

The Japanese companies' problems are not only pay related, but foreigners lack ample promotional opportunities. I think this is a

very bad situation. If you want to run multinational corporations, you do not look at nationality, skin color, or religion. You have to really look at individuals' capabilities and contributions.

As a chairman of the Compensation Committee, I have tried to develop incentive plans. I was amazed how often I met with the staff of human resources and the board during the first six months. We came up with three plans. The first is an employee stock ownership plan. Employees can buy at a 19 percent discount from the market price. Depending on their annual salary, there is a limit to how much each person can buy. The second is a performance bonus in terms of stock equivalents. If your performance is very good, then the bank can give a cash equivalent to stock. The third is the management incentive program. This is a stock appreciation right, which allows a manager to receive a cash equivalent to the stock appreciation over a specified period.

I do not think any Japanese company I know of has three different incentive programs of this kind or has developed them within six months. Currently, only one of these programs has been approved by the Chinese government, and two are still pending, though I think it is only a matter of time before they are approved.

It is interesting to note that one of the independent directors, a Chinese university finance professor, argued very strongly against the introduction of a stock ownership plan. I think he remembered too well the freezing cold stock market of 2005 and worried that if we encouraged the employees to buy stock and the stock went down, then it would be bad for the employees. He is still very much a socialist-oriented thinker in this way. Really, it is up to the employ-

ees whether they buy stock or not. I think he wanted to protect the employees. So far, stock prices have increased significantly in two years' time, and I wish that we had introduced the plan more quickly and that the Chinese government was faster to approve the stock ownership plan.

AUDIENCE

When you left Tokyo University in 1958, you decided to join the Japan branch of Standard Vacuum Oil Company, which was an American company at the time. What were your thoughts with respect to joining an American company instead of a Japanese one or the government?

MASAMOTO YASHIRO

Well, to tell you the truth, I never wanted to be a businessman. I wanted to teach like Professor Hugh Patrick, but when I was a graduate student at Tokyo University, I was led to believe that since I did my undergraduate studies at Kyoto University, not Tokyo University, I would never be able to get a job at a top school like Tokyo University.

In the meantime, while at a cocktail party with my wife, I met a man who worked for an oil company. Eventually, after we spoke several times, he convinced me to work for Standard Vacuum, which is the predecessor of Exxon Mobil Corporation in Japan. I begin at its head office. I only took the job because my wife wanted me to. She said, "We are getting hungry."

So I had my first job. I was running the Exxon Japanese affiliate, which probably makes about \$150 million a year net income. The group as a whole used to make about \$300 million out of equity interests in Japan. And I had at least 2,000 people working for me.

I think large Chinese institutions, even state-owned ones, are paying very well today.

I have never liked conventional things, and I thought working for an American company was going to be very interesting.

AUDIENCE

I would like to hear your assessment of the opening of China's financial sector, related to its World Trade Organization obligations.

MASAMOTO YASHIRO

I think Liu Mingkang, chairman of China Banking Regulatory Commission, says there are three different reactions from foreign banks operating in China. One is that of very happy people working as strategic investors with Chinese counterparts. Then there are some people who are always complaining about problems with the Chinese partner. The third reaction is uncertainty about what to think.

I think that Bank of America's strategy is a very interesting and correct one. First of all, Chinese law permits equity ownership by foreigners up to 25 percent, but one foreign investor can own only 19.9 percent. In the case of China Construction Bank, 19.9 percent is owned by Bank of America, and 5.1 percent by Temasek, a Singapore investment entity. That makes up 25 percent.

Bank of America has made it known that it is not interested in maintaining its own operation in China. It is going to do everything through China Construction Bank. That is one of the main reasons why China Construction Bank selected Bank of America as its partner.

AUDIENCE

You spoke about international expansion of both Japanese and Chinese banks. Looking five years ahead, do you believe that any of the major Chinese banks will make an acquisition to control a

first- or second-tier international bank, both to take advantage of its international network and to assimilate its management and credit systems? And, similarly, could you see a Japanese bank making a comparable move in that same time frame?

MASAMOTO YASHIRO

I think that Chinese banks will be more likely to acquire second-tier non-Chinese banks overseas. When Chinese banks do acquire second-tier banks, they will probably not replace management and will depend instead on the existing management to run it. They will probably send middle management to work side by side with the local people and to learn from them. This is what I think will happen.

I think the Japanese model is the exact opposite with respect to acquiring a foreign bank. They will run it with Japanese people at the top, and the local people will not get the top jobs, even in the local market. Moreover, I do not think the Japanese banks have the appetite to acquire foreign banks today, because this was done during the 1970s and 1980s, and most of them failed.

I think the important matter is who runs the foreign bank that is acquired. The Chinese are too smart to satisfy their egos by sending their own people and consequently messing up the whole situation. I think they would exercise management control in only two ways: deciding who runs the local operation and how much money they will spend. The secret of good management, I think, is not to bother with the day-to-day business.

AUDIENCE

I am interested in your expectation that there will be one or two of the big Chinese banks that will join

the ranks of the mega global banks in ten or so years. I am wondering if that expectation assumes that China will avoid any kind of significant economic bump, say from 12 percent growth to 4 percent. I understand there are many potentially latent bad loans in the system that do not show up when growth is great. Can the Chinese system and these one or two big banks survive a shock?

MASAMOTO YASHIRO

I do not know how the Chinese GDP could go down to 4 percent growth. If you go back to Japan's experience, remember that Prime Minister Ikeda announced a national income doubling plan at the beginning of the 1960s. That meant 7.2 percent growth for ten years, but actually GDP growth was more than 10 percent during the 1960s. I think China is in some trouble if the economy slows down to 6-7 percent. However, in some ways, I think that if China's economy has a brief bump that causes adjustments, like Japan had with the energy crisis, it would be very good, because it would cool all heads a bit.

Now, why I am optimistic about the Chinese banking system with regard to NPLs is because I give a lot of credit to the Banking Regulatory Commission. It has done a very good job. In the first half of 2006, for instance, China Construction Bank's loan balance increased 26 percent relative to the previous year. During the second half of the year it slowed down significantly and annual growth was only 15 percent. In this case the Banking Regulatory Commission sent a lot of instructions to China Construction Bank and talked to senior management, the board, and so on. I think the Banking Regulatory Commission always takes very timely actions in this

I do not think the Japanese banks have the appetite to acquire foreign banks today.

manner. If China Construction Bank is likely to have any NPL problems, I think the government of China, through the Banking Regulatory Commission or even the State Council, would do something about it. I did not see this happen in my own country. When the bubble started in Japan in the second half of the 1980s, very little was done to stop it, and all of a sudden it collapsed in the early 1990s.

AUDIENCE

Do you feel there is a crisis or major problems looming ahead for China?

MASAMOTO YASHIRO

Well, I think that you should read Greenspan's book, as he devotes about 15 pages to China. He is quite concerned about agriculture, the farming communities' income disparity, and so on. I am aware of some of the problems, but I tend to be more optimistic than he is.

The problem with the banking system in China is that you do not know what is happening sometimes because you often have around 14,000 branches across the country. This is why there is a lot of emphasis on IT renovation, and it started with the China Banking Regulatory Commission. I believe that by the end of this year, 90 percent of operations will be automated at China Construction Bank. So long as you have people who prepared and programmed computerization properly, you know exactly what is happening in real time.

Generally speaking, most of the top managers in most countries show little interest in learning what IT can do, but I have taken a perhaps inordinate amount of interest and spent a large amount of time talking to IT guys from India.

We had an Indian fellow who was very well known in the IT field. I learned enough to ask good questions, but, more importantly, he expected me to tell him what I wanted as the CEO of the bank. I told him that I wanted to know, on a monthly basis, exactly what products or services generated what revenue, and what cost was incurred by that business, by customer, and by product group. This request was delivered quickly.

HUGH PATRICK

How did you, as an outsider in China, deal with the reality that there was tremendous political pressure from the highest levels to lend to certain individuals or institutions that were not necessarily the most economically efficient?

MASAMOTO YASHIRO

I will give the credit to the chairman of the Banking Regulatory Commission. Within my first year as independent director, I and the other independent directors were invited to meet with him. He mentioned specific state enterprises by name that were probably very risky. He told us we should not let the bank make loans to them.

I do not think there is any pressure today from State Council to keep making loans to badly run state enterprises. I think if you ask the chairmen of the large Chinese banks, they would agree.

There is some corruption. The first chairman I met after September 2004 was a very nice person. I think within six months he found himself in jail. One of his predecessors was also jailed. The chairman I first met had allegedly received a bribe, and I think he is serving a ten-year sentence. Can you imagine receiving a bribe from a Hong Kong-based IT company in the amount of US\$600,000.00,

according to the Chinese newspaper, and being jailed for ten years? His predecessor is also serving 15 years in jail. The government is very serious about punishing those people who violate the law. The other problem, however, is again in the area of compliance, and, shall we say, breaking the law. Oftentimes, it is impossible to know what is going on at countryside branches. The branches used to have authority to make loans. Today, any loan of a particular size and above has to come to the head office.

I think many people who like to think that China is going to have a problem take the "glass is half empty" perspective. I like to think that the glass is half full, because it takes time to correct all the problems, and China is moving fast to do this. I think the future looks quite good.

AUDIENCE

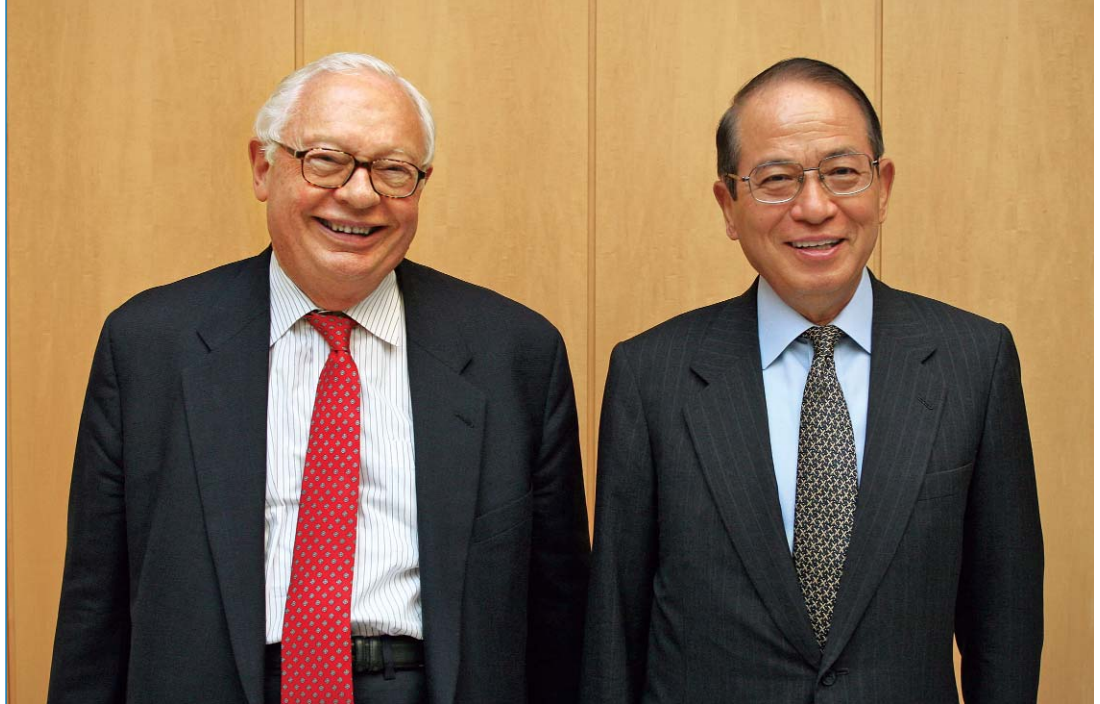
Do you think there is hope that Japanese banks will make the changes necessary to become competitive again in the international business field, or should they get out of international business and focus on domestic business?

MASAMOTO YASHIRO

I think the management structure must be changed to allow younger people to move into senior positions faster, rather than only promoting by seniority. If you replace the current management with people who have Japanese banking experience and are completely bilingual because they studied abroad, and then also hire foreign individuals who have special skills, then there is hope.

The Japanese have not yet developed highly value added products and services where they can use non-Japanese experience by hiring people from outside. If you

The problem with the banking system in China is that you do not know what is happening sometimes because you often have around 14,000 branches across the country.



Japanese management is very protective of its jobs, and foreign and young people are a threat to them.

go to the Marunouchi district of Tokyo, 99.9 percent of the people have black hair, no hair, or white hair. There is no blonde or red hair, and that is a very bad thing. I think if you hire non-Japanese, that means you are bringing somebody else's experience into your own organization. That is why I think that if the management of Japanese corporations decides, "We really have to learn from somebody else," that could cause some important changes. Unfortunately, Japanese management is very protective of its jobs, and foreign and young people are a threat to them.

Sometimes people think I am crazy when I say this, but if you fire everybody over 55 years old from the management and replace them with people 45 years or younger, you will have a great institution. I really think that we have to change. Somebody said to me the other day, "It is not the age; it is the mentality." Some older people can be young in spirit, but I am not entirely

convinced. I think Japanese should have more curiosity about what the rest of the world is doing.

CLOSING REMARKS

HUGH PATRICK

You are very young in spirit, and I think that has been demonstrated tonight. Just about three years ago, you were talking here at Columbia Business School about your work at Shinsei Bank, and you spoke of how you were trying to use that experience as a model for how Japanese banks should change and become, themselves, more profit oriented, more efficiency oriented, more global, more utilizing of foreign expertise. I think that that was not a happy message for many traditional Japanese bankers.

I suppose that was frustrating for you, but now you have found a wonderful, huge country that really needs your services, and I think the

Chinese are very fortunate to have you as committed as you are to helping solve the massive issues of how to handle finance within a rapidly developing economy.

We are indebted to you. Thank you so very much.

日本の諸問題及び新興する中国—日本人銀行家の考察

株式会社 新生銀行 シニア・アドバイザー
八城政基

2007年9月20日、コロンビア大学ビジネス・スクール日本経済経営研究所（以下、CJEB）は八城政基氏を招いて、「日本の諸問題及び新興する中国—日本人銀行家の考察」と題した講演を行った。八城氏は、米国、日本、そして中国の石油・銀行業界において上級管理職を務めた経験を基に、今後の日本と中国の経済観測と企業文化比較について述べた。講演では、CJEBの所長であるヒュー・パトリック教授がモデレーターを務めた。以下は本講演の要約。

まず八城氏は、ポスト・バブル期における日本経済の沈滞の主な原因について説明。1970年代後半から1980年代初頭にかけてのアメリカ産業の減退を受けて、日本企業の指導者達が過度の自信を持ち、プラザ合意によって強化された円と相まって、国内のバブル経済を作り出す要因になった。その結果が、1990年代初頭のバブル崩壊から続く日本経済の停滞と国際競争力の喪失である。

続けて八城氏はバブル期の失敗から日本が学ぶべき教訓について述べた。国際的視野の欠如、英語力の問題、企業内の外国人上級管理職者数の不足、年功序列の昇進制度、リスク回避行動などが、引き続き日本企業の世界的競争力強化と日本経済の拡大の妨げになる。さらに、安倍前首相が掲げた政権構想「美しい国、日本」が例示するように、明確な国家戦略の欠如が、日本が新たに政治・経済力強化をしていくのに最も重大な障害になるだろう。

中国の国有銀行改革に携わった最近の経験を振り返りながら、八城氏は、中国の継続的成長の道程において要となるいくつかの課題について説明した。日本が経験したものと類似した不良債権問題を近年抱えていた中国の金融機関は、それらを資産管理会社に譲渡することによって問題を解決してきた。前進していくために、またさらなる不良債権問題を避けるためには、中国は今後も高い経済成長率を維持していかなければならない。中国の銀行は、強い信用文化と危機管理スキルの発達、不正行為の阻止、ローンや預金以外のサービスを通して収益性の向上をそれぞれ継続していかなければならない。

日本企業と対比して、中国の銀行は外国人からスキルや経験を学び、活用しようとする熱意があると、八城氏は述べる。中国の金融機関はすでに欧米の資本注入による利益を享受しており、海外のノウハウを吸収することによって、すぐに世界でも有数の銀行になるであろう。一方、東京の銀行では外国人の上級管理職は稀であり、新鮮なアイデアと視野を持たなくては、日本は世界経済の中で競争していけないであろう。

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