

Private Views on Japanese Government Corporations

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Yasushi Kinoshita, Masatsugu Nagato, Hugh Patrick

As part of the Center on Japanese Economy and Business (CJEB)'s 30th anniversary public program series, CJEB invited two prominent speakers to share their views on Japanese government corporations: Masatsugu Nagato, president and CEO of Japan Post Holdings Co., Ltd., and Yasushi Kinoshita, deputy president of the Development Bank of Japan Inc. Hugh Patrick, director of CJEB, introduced the speakers and moderated the discussion. Professor Patrick first noted that the privatization of Japan Post Holdings began in 2005 when Junichiro Koizumi was Prime Minister, and its trajectory continues; however, due to excessive political pressure by local postmasters who rejected this change, it has been a slow process. The Development Bank of Japan (DBJ) was also privatized in 2007 as part of an effort by the first Abe Administration to simplify government; the government has found it useful to have a government-controlled organization that keeps the credit markets liquid for long-term investments. These conversions have been in line with the third arrow of Abenomics: structural reform to create a more productive economy.



Hugh Patrick

Mr. Nagato's remarks, titled "Japan Post Privatization: The Political Intention and the Business Effects," covered the privatization of Japan Post Holdings, which oversees Japan Post Group, which in turn includes postal service, bank and insurance groups. There are 24,000 post offices in Japan, and its bank is the largest financial institution in Japan aside from the central bank.

Mr. Nagato began his remarks by noting that Japan reached \$5 trillion GDP in 1995, but hasn't achieved that level since. Meanwhile, China was "nowhere" in 1990, but now has the 2nd-largest GDP in the world, more than 2.5 times that of Japan. The United States used to have only 150% more nominal GDP than Japan; now, the United States has 400% more nominal GDP than Japan.



Masatsugu Nagato

The Japanese government can be very bureaucratic and inefficient; as such, government officials, looking to boost the economy, looked to privatization to enhance the performance of these public sector institutions by making them profit-oriented. They first privatized the National Railway Company (JNR) in the 1980s. The JNR initially incurred a heavy financial burden on the government, so the government transferred the \$270 billion debt to the special vehicle company. The JNR was broken into pieces, first by region; three of the 11 resulting companies are now listed on the stock exchange.

Japan Post Holdings used to be owned 100% by the government. It has three subsidiaries: Japan Post, Japan Post Bank, and Japan Post Insurance. In 2015, 11% of the shares of Japan Post Bank and Japan Post Insurance were sold to private investors, while 89% still belong to Japan Post Holdings. 100% of the shares of the bank and insurance subsidiaries need to be sold according to the

privatization law. However, this has now been revised, and the current tentative objective is that 50 percent of the shares are supposed to be sold.

The majority of Japan Post Holdings' profits come from the bank and insurance subsidiaries even though, since they are not a traditional bank and insurance company, they are barred from carrying out many types of transactions. Furthermore, Japan Post Bank cannot provide loans, and fee income is less than 5% of total revenue. As such, the revenues from the bank come almost exclusively from investment. They used to invest heavily in Japanese government bonds (JGBs) since the interest rate was favorable; now, however, the rates are negative and the returns aren't enough to pay back depositors, so they have reduced JGBs to less than 40% of their portfolio. Currently, their investments have been diversified into Japanese equity, foreign securities, and municipal bonds.

Japan Post Insurance, which has a market share of 22%, is the largest insurance company in Japan, and operates out of the 24,000 post offices. They also invest mostly in JGBs, but are aiming

to diversify, just like Japan Post Bank. Their revenue from investment is only about 40%; 60% comes from the insurance business.

To conclude his remarks, Mr. Nagato said he is confident that these entities can become sustainable corporations, pointing to the example of Deutsche Post. After going through many mergers and acquisitions, they are now doing very well. Japan Post Holdings differs in scope, but in forming alliances with corporations along with mergers and acquisitions, it will eventually increase its revenue and become a full-fledged private corporation.

Mr. Kinoshita then began his remarks, “Blending Finance to Grow: The Public-Private Partnership in Developed Economies,” describing his experience at the DBJ. He first noted that Japan’s household assets have traditionally been kept in banks; a significant amount of these funds do not flow to the corporate sector. More than half of Japan’s household assets are held as banking deposits, whereas in the United States, only 25% of household assets are held as deposits. Furthermore, the proportion of household funds held as stocks in Japan is 15% compared to 50% in the United States. Companies save their cash; capital investments are kept within the limits of international cash flows. Against this background, the Japanese government has taken a number of measures to promote private funds in both household and corporate sectors.



Yasushi Kinoshita

The DBJ is a unique institution. Established in 1951, it was created to support Japanese industry rehabilitation after World War II. By supplying long-term fixed loans to major industries, it played a significant role in ushering a period of high economic growth in Japan. Toyota and Sony are examples of the beneficiaries of DBJ long-term credit. In 2008, the DBJ underwent a series of



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regulatory reforms: first, the Japanese government converted it into a joint stock company in which they are the sole shareholder. In order to shift to a more profitable asset portfolio, it was privatized and entered into high-risk debt products. Although the intention of the



Masatsugu Nagato



Yasushi Kinoshita

government's plans for privatizing the DBJ were to make it more efficient and profitable, attention was brought to the DBJ's importance as a policy tool. Its workforce has a deep knowledge of industry and a keen risk-taking judgment.

What truly exemplified the DBJ's unique use as a policy tool was its participation in crisis operations – for example, the start of the 2008 global financial crisis, and then in 2011, the earthquake, tsunami and nuclear crisis. In the wake of these events, the DBJ provided special financing for emergencies when capital markets and private banks were not functioning correctly. Long-term public funds were seen as essential after multiple crises. By March 31, 2016, the DBJ had extended more than \$50 billion in loans and crisis finance benefiting more than 1,000 projects, including an emergency loan to Japan Airlines. After 2011, the DBJ provided crisis financing to electric power companies, such as Tepco, affected by the earthquake and tsunami. The government continues to hold one-third of DBJ shares even as privatization moves forward. The DBJ has also been involved in what is called “special investment operations.” In 2012, with the Liberal Democratic Party (LDP) back in power and the announcement of Abenomics, the DBJ found itself with the expectation that it supply funds to increase national growth. As such, the DBJ funded nine projects worth \$2.2 billion. This was in addition to private sector financing of \$4.5 billion. Based on these results, in 2015, the DBJ's functions were amended to include special investment operations.

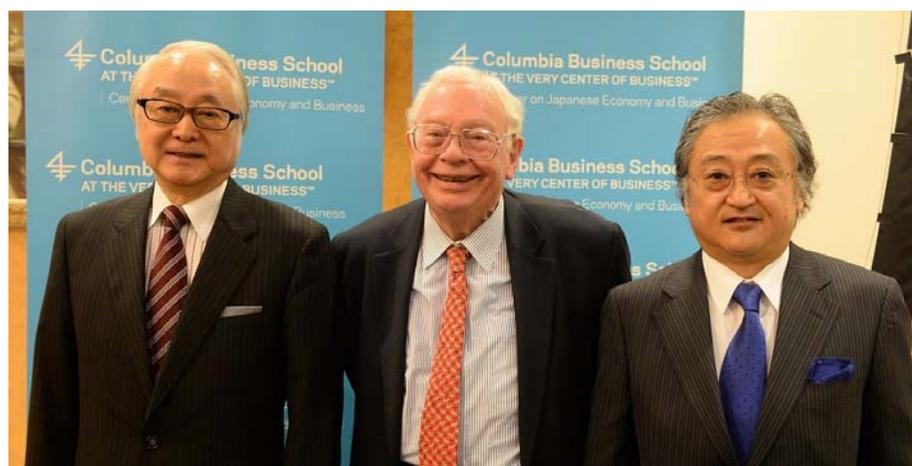


The term “blended finance” typically means environment and social initiative/governance (ESG) investment loans. Public funds are used to strategically encourage private investors to avert risk while investing in special projects. Blended finance dramatically increases the scale of development impact in developing countries where risk is high. The DBJ’s operations cover more than ESG fields; they stimulate private funding across all fields where risk management is essential.

Japan has a traditional financial system. Banks provide firms with long-term capital, also known as “quasi-equity.” After the Japanese bubble collapsed in the 1990s, 180 deposit-taking institutions went bankrupt. The banking system provided long-term fixed loans, thus causing a swift decline in supply. The strengthening of banking regulation further limited the supply of funds and made it hard for banks to take on risk. Additionally, the private equity industry in Japan is small-scale; many Japanese firms view private equity funds with strong caution. The DBJ has the potential to mitigate all these limitations.

It is expected that the DBJ’s special investment operations program will reach \$5 billion in the 5 years leading up to fiscal year 2020. In the program’s initial year ending in March 2016, 19 projects were approved amounting to \$1 billion. In carrying out these special investment operations, the DBJ has to take certain measures so they do not crowd out private investment first. The DBJ cannot use government credit to offer terms that would be advantageous, so they have set up a special monitoring board.

Mr. Kinoshita provided five examples of projects carried out by the DBJ. These included the first public issuance of long-term subordinated debt by a Japanese-owned insurance company, as well as supporting Seiko’s semiconductor subsidiary carve out a niche market. These examples illustrate that the DBJ is bridging the gap between public good, social benefit, and economic value. It will need to develop and foster relationships with non-traditional sources of credit, such as private equity. It will also have to diversify its financial tools to include aircraft financing, infrastructure bonds, methods to help the flow of funds, and to connect businesses with regional institutions and other sources of long-term capital. Overall, the DBJ is trying to increase financing for growth by taking higher risks, allowing the private sector to bear less of the risk burden.



Masatsugu Nagato, Hugh Patrick, Yasushi Kinoshita