# BANKING ON BRITAIN?
# THE CHANGING RØLE AND GEOGRAPHY OF JAPANESE BANKS IN BRITAIN

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## The changing role and geography of Japanese banks in Britain

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Working Paper 93/8

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## Introduction

The 1980s was an important period for the United Kingdom. While much of the country's traditional industrial base was being eroded, economic growth appeared to be emerging in new economic sectors and from new sources. Two of the most notable growth areas were foreign direct investment - Britain attracted up to a fifth of foreign investment within Europe in the good years - and the financial services sector, which increased its share of both employment and output by a third during the decade (Court and McDowell, 1993). However, although these developments have attracted widespread comment individually, the effects of the growth of foreign banks in London on the British economy, and the resultant geography, have received little attention. Japanese involvement in the British financial system has been one of the more significant trends to develop over the past ten years or so. At the last count, Japanese banks held about £34 billion of debt in Britain, or about 7.5% of all outstanding bank debt.[1] Over 55% of British lending by Japanese banks is in sterling.

[1] The lending data analysed in this paper have been obtained from the Bank of England and include all bank lending except inter-bank lending, building society loans or money lent on the local authority money markets. The data also exclude lending to overseas companies and individuals.

This paper explores the changing nature of Japanese bank involvement in Britain in three ways. First, the main parameters of Japanese bank involvement in Britain are outlined, together with the main reasons for their increased participation in the economy during the 1980s. This increase has tailed off since the onset of the recession in Britain in 1990 and as a result of the growing challenges to their capital bases faced by Japanese banks. Second, the paper draws upon data obtained from the Bank of England, together with primary research, in order to outline the economic sectors in which Japanese banks have concentrated their lending. This has substantially changed during the past decade. And third, the paper draws some geographical implications from these data. These implications are inevitably speculative - unlike some other countries there are no systematic data sources on the regional distribution of financial activity in Britain. However, it is argued that careful analysis of the lending data and interviews with senior managers in Japanese banks both in London and in other British cities suggests that Japanese bank *lending* to non-financial companies is heavily concentrated in the South East of England. The paper explores the implications of such concentration, which is in marked contrast to the more even geographical pattern of Japanese manufacturing investment.

## The growth of Japanese banks in Britain

In 1960 there were seven Japanese banks with operations in London. There had been more before, but the Second World War unsurprisingly saw a complete loss of Japanese financial involvement in, what was at the time, the world's premier financial centre. During every decade since 1960, the number of Japanese banks in London doubled, so that by 1990 there were 53. Although the 4,000 staff employed by these banks was only a quarter of employment in American banks, the dominant employment trend in the late

1980s was upward and, after British and American banks, Japanese financial institutions were the largest source of banking employment in Britain. The growth of Japanese banks in London occurred for two main reasons. First, it was part of a generalised process of the internationalisation of banking, and in particular the recent pre-eminence of Japanese institutions. Second, it has to be set against the post-war development of London as a major international centre of finance, so that now it is the European pillar of the international financial system (Thrift and Leyshon, 1988). These are now discussed in turn.

During the 1960s the banking industry was transformed from having few multinational banks into becoming a truly internationalised sector. The internationalisation of banking was stimulated particularly by the rapid growth of the Eurocurrency markets during the 1960s. These markets first appeared in the late 1950s when the USSR feared that its dollar-denominated assets were vulnerable to US political control. In order to escape American regulatory jurisdiction, these assets, known as 'Eurodollars' were held in banks in London (Strange, 1986). Bankers in general soon became aware that London-based dollar balances were free not only of American political control, but also of US domestic banking laws which stipulated minimum reserve balances and interest controls (Rabino, 1984; Strange, 1986; Lewis and Davis, 1987).

The regulatory authorities in London developed a lax attitude towards the growing Eurocurrency markets, which grew from US$11 billion in 1965 to US$661 billion in 1981 (Stafford, 1992). The Eurocurrency markets, therefore, developed an 'offshore' status because they were regulated neither by the host country nor according to the currencies being transacted. In the discourse of right wing economists this development was regarded as being straightforwardly positive, restoring freedom and objectivity to the market. Ayling (1987:4), for example, argues that the Euromarkets, 'more than any other sectors of the world's financial system, draw closely to the concept of the free marketplace. Prices established in these truly international markets tend to reflect objective valuations.' It is at least arguable, however, that the growth of international markets outside regulatory control has instilled an unacceptable level of risk into the international financial system (see, particularly, Walter, 1991).

The internationalisation of banking from the 1960s onwards was not based entirely in the Euromarkets. International banks became involved in trade finance, in servicing their domestic customers overseas, in retail banking and, most recently, in the processing of information in, so-called, off-shore back-offices (Jones, 1990; Tschoegl, 1987; Wilson, 1991a, 1991b; Sassen, 1991). Furthermore, three distinct periods of development can be identified. In the first phase, during the 1960s the growing international activity of banks mostly comprised the US 'money centre institutions' opening up branches in order to serve their corporate clients and in order to operate in the Euromarkets (Métais, 1990; Sassen, 1991). In the aftermath of the Second World War, there was an enormous growth of US overseas manufacturing investment, and US firms accounted for 47% of the stock of foreign investment in 1960 (Dicken, 1992: Table 3.2). Second, during the 1970s, US regional and European banks began to internationalise and deposit banks entered the Euromarkets as a response to slackening growth, regulatory restrictions and credit ceilings in their domestic markets. Finally, during the 1980s Japanese banks rapidly internationalised. Although this had been happening during the 1970s, the Yen-Dollar realignment of 1985 stimulated a rapid expansion of Japanese bank activity (Stafford, 1992).

As a result of these developments, there have been important changes in the geographical composition of international banking. Table 1 suggests that there has been a progressive deterioration in the relative position of American banks. In 1956, 25 of the world's largest fifty banks were American, by 1988 only two were counted in the top 50. For Japanese banks the situation was the reverse: they accounted for half of the world's largest banks in 1989.[2] Although clearly there *has* been a major structural shift in the geographic composition of the world's leading banks, there is some evidence that the data in Table 1 over-estimate the significance of the decline of US banks and the concurrent rise of Japanese institutions. This is because (i) the data do not include the growth of 'off-balance' sheet activities; (ii) the denomination of deposit size in US dollars has recently adversely affected the position of US banks; (iii) merger activity has reduced the *number* of US banks at the same time as it has strengthened the overall position of the US in the international financial system (Benston, 1990); and (iv) the market strategy of firms may also affect the adequacy of such rankings. As Dicken (1992: 369) argues

> in terms of both employment size and their international spread ... Japanese banks are rather less significant than their ... values suggest. One reason ... is that their roles are primarily to serve the major Japanese business corporations and the *soga sosha*. Their retail business is far less extensive than that of the American and European banks.

Nevertheless, it is true that the 1980s did witness significant growth by Japanese banks. As Table 1 shows, financial pressures within Japan halted this growth, although whether that turns out to be a transitory or a structural phenomenon remains to be seen (Leyshon, 1992; see also Goldberg and Hanweck, 1991).

[2] There are a number of different ways of assessing the relative size of international banks, the most commonly used being asset size, deposit size and capital strength. Each of these measures has both strengths and weaknesses. For example, capital strength gives some indication of the underlying strength of the balance sheet of a bank but tends to over-estimate the significance of banks from countries where stock market and land valuations are high, such as Japan during the 1980s.

Table 1: Nationality of the world's largest banks, ranked by deposit size (number of banks in the top 50)

| | 1956 | 1960 | 1970 | 1979 | 1988 | 1992 |
|---|---|---|---|---|---|---|
| USA | 25 | 19 | 13 | 6 | 2 | 4 |
| UK | 7 | 5 | 4 | 4 | 4 | 3 |
| Canada | 6 | 5 | 5 | 4 | 1 | 2 |
| France | 3 | 3 | 3 | 4 | 4 | 6 |
| Germany | 0 | 3 | 4 | 7 | 7 | 8 |
| Italy | 3 | 5 | 4 | 2 | 1 | 1 |
| Japan | 3 | 8 | 11 | 16 | 25 | 16 |
| Australia | 1 | 1 | 1 | 0 | 0 | 0 |
| Netherlands | 0 | 0 | 1 | 3 | 2 | 2 |
| Switzerland | 0 | 0 | 3 | 3 | 3 | 3 |
| Others | 2 | 1 | 1 | 1 | 1 | 5 |

Source: Benston, 1990: Table 2; *Euromoney*, June 1992, p108.

The parallel internationalisation of manufacturing companies and banks has led some authors to argue that it was primarily the growth of foreign direct investment in material production that led to the growth of foreign banking investment. According to this view, banks responded to the internationalisation of their clients for three main reasons: to service trade, to reduce the risks of losing their customers business in domestic markets and to exploit their knowledge of the credit-worthiness of their clients in overseas markets (Grubel, 1977; Métais, 1979 cited in Aliber, 1984; Vastrup, 1983; Langdale, 1985; Choi *et al.*, 1986). Empirical evidence for this proposition ranged from a survey by Coakley (1988), which suggested that US banks had located in London in order to service American corporations and to enter the wholesale markets, to Aliber's

> casual observation [which] suggests that the expansion of various foreign markets of banks headquartered in particular countries occurs in waves that parallels the foreign expansion of industrial firms headquartered in the same countries (1984: 664).

Drawing upon these explanations, Fujita and Ishigaki (1986) have argued that there are four distinct phases in the development of international banks. As illustrated in Table 2, in the early stages of the internationalisation process banks are mainly involved in supporting the trade-related activities of domestic clients. During this period, internationalisation is primarily achieved by maintaining relationships with overseas banks. However, following the direct involvement of their domestic clients in overseas production, banks became actively involved in overseas lending and were directly represented abroad through the establishment of branches and representative offices. In the final two phases of the internationalisation process, banks increasingly have multinational corporate clients and become involved in sophisticated financial activities. Geographically, it is argued, during these final phases banks branch out to provide full service banking to clients from a range of countries.

Table 2: Phases in the development of international banking

| | Phase I | Phase II | Phase III | Phase IV |
|---|---|---|---|---|
| Internationalisation of customer companies | Export-import | Active direct overseas investment | multinational corporation | |
| International operations in banking | Mainly foreign exchange operations connected with foreign trade. Capital transactions are mainly short-term ones | Overseas loans and investment become important, as do medium- and longer-run capital transactions | Non-banking fringe activities such as leasing, consulting multinational banking, and others are conducted | retail banking |
| Methods of internationalisation | Correspondence contracts with foreign banks | To strengthen own overseas branches and offices | By strengthening own branches and offices, capital participation, affiliation in business, establishing non-bank fringe business firms, the most profitable ways of fund raising and lending are sought on a global basis | |
| Customers of international operations | Mainly domestic customers | Mainly domestic companies | Customers of various nationalities | |

Source: Fujita and Ishigaki, 1986: Table 7.6

As a generalised framework for understanding the growth of US and Japanese banks, Fujita and Ishigaki's model is useful. However, the framework implies that all banks will follow a similar trajectory when, in reality, some banks never progress further than Phase I or II and it does not allow for a possible phase of retrenchment. For example, some American banks have recently withdrawn from their attempts to become global multi-service banks in order to concentrate on international niche strategies, as evidenced by the withdrawal of BankAmerica from European retail banking operations.

There are clear parallels between this explanation and Andreff's (1984) Marxist account of the 'international centralisation of capital'. Andreff argues that Hilferding's (1981) theorisation of 'finance capital', in which bank capital fuses with and dominates productive capital, can be applied to the internationalisation of banking:

> The essence of our theoretical view is that with transnational finance capital, money capital and productive capital *are organically linked in their internationalization*: international production and circulation are more and more controlled by MNCs and [transnational banks] merged in the form of transnational finance capital (Andreff, 1984: 66).

The problem with Andreff's argument, and with the theorisation of finance capital generally, is that it mis-specifies the nature of the relationship between bank capital and materially productive capital, according them a degree of strategic coherence that more sophisticated Marxist analyses eschew (for example, Harvey, 1985). Indeed, the securitisation of financial instruments that occurred during the 1980s (Thrift and Leyshon, 1988) suggests that industrial capital developed a means for by-passing bank capital altogether. (Although it may be true that finance capitalists became increasingly important *within* individual firms.)

In fact, changes in the composition of the world's leading banks are closely related to the cost of capital to the banks, itself determined by the individual history of the bank and, *crucially*, nationally-specific macro-economic and macro-financial aspects (Zimmer and

McCauley, 1991; Huertas, 1990). Table 3 shows the required 'spread' (or difference between the cost at which a bank borrows money and the cost at which it lends) in order to cover the cost of equity, varies markedly between banks from different countries. The table illustrates that banks from Japan have significant cost advantages over institutions from all of the major banking countries and that German and Swiss banks have competitive advantages over those from the USA, the UK and Canada. These advantages exist irrespective of the location of the capital market.[3] Yet capital costs cannot by themselves provide a full explanation of developments in the international banking system - they are, after all, an outcome of geo-political change. It is necessary to appreciate the impact of wider changes in the international financial system and it is to these that the discussion now turns.

Table 3: Required spreads on a corporate loan in various international markets

| Location of market | Home country of market | | | | | |
|---|---|---|---|---|---|---|
| | US | Japan | Germany | UK | Canada | Switzerland |
| US | 76 | 9 | 46 | 63 | 65 | 44 |
| Japan | 95 | 10 | 55 | 75 | 72 | 52 |
| Germany | 119 | 12 | 65 | 90 | 86 | 62 |
| UK | 68 | 9 | 43 | 59 | 65 | 41 |
| Canada | 82 | 10 | 58 | 75 | 65 | 55 |
| Switzerland | 62 | 9 | 40 | 59 | 65 | 38 |

Notes:
1. Spreads expressed in basis points
2. Spreads calculated on basis of 1984-90 average cost of equity, interest rates, inflation and 1990 tax rates
3. Spreads required for branches only. The figures vary slightly for representative offices.

Source: Zimmer and McCauley 1991: Table 3.

[3] As will be discussed below, Japan's advantages were reduced by the rapid decline in share values on the Tokyo stock exchange during the 1990s (Martin, 1992).

Japan has become increasingly important in the international financial system. The breakdown of the Bretton Woods system left the world economy without a hegemonic financial power. Although the Yen does not perform the same role as the dollar did during the 'golden age of Fordism', there were signs during the 1980s that, for a variety of reasons, Japan is willing to play a part in creating international financial stability. This was exemplified, for example, by the effective funding of US budget deficits by Japanese banks. Similarly, the fact that Japanese banks have had to stick to the Bank for International Settlements' rules on capital adequacy, despite real problems in doing so, is evidence that Japan plays an important role in the international financial system.[4]

More widespread changes in the international financial system (Thrift and Leyshon, 1988; Hübner, 1991) have led to the strengthening of a number of international financial 'control points'. With its intangible inputs and heavy reliance upon the 'liberating' telecommunications technologies, the banking industry should be able to free itself from the traditional constraints of location. Paradoxically, however, banking is highly spatially concentrated within a hierarchy of international financial centres (IFCs), where a large proportion of the world's banking activity is carried out. Although there is considerable disagreement in the literature about the appropriate basis on which to define IFCs, there is a growing consensus that London, New York and Tokyo constitute the 'triple pillars' of the international financial system. This has important implications for our understanding of the spatial constitution of the banking sector, not only of the world but also of the UK. This is because London is at the apex of both the international financial system and the British one.

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[4] The BIS rules are discussed further below.

Macro-level changes in financial markets have contributed to the concentration of activity in international financial centres. Despite the growing deterritorialisation of the credit system (Thrift and Leyshon, 1988; Harvey, 1989), twenty-four hours a day, global markets require a physical manifestation. London, New York and Tokyo are located in different time zones and their respective historical and economic roles in the financial system gave them an initial competitive advantage in becoming the 'regional representatives' of the international financial system. Sassen (1990) argues that the growth of securitised credit and non-bank financial institutions has increased the need for co-ordinating centres which ensure that financial markets retain an overall coherence. There are strong (and conscious) parallels here with conceptualisations of 'world cities'. These are said to have developed because the world economy is no

> longer defined by the imperial reach of a Rome, a Venice, or even a London, but by a set of markets and production units organized and controlled by transnational capital. World cities are a material manifestation of this control (Friedmann and Wolff, 1982: 311).

It is important to stress that international financial centres only co-ordinate the financial system in an economic sense. The regulatory control which is crucial to the long-run stability of the system is, as yet, elusive.

Technological developments in the telecommunications industry are the glue which binds the international financial centres together. This is due not to inertia, as O'Brien (1992) implies, but to powerful forces which engender concentration in the 'golden triangle' of London, New York and Tokyo (Thrift, 1990b). The first of these forces is simply facilitatory: telecommunications permit agglomeration (although they also permit dispersal, see Storper and Walker, 1989). Yet the second factor is more significant. Paradoxically, telecommunications underline the importance of face-to-face communication, because

> as electronic means of communication are used to co-ordinate and control geographically dispersed activities, there will be less face-to-face decision making in outlying areas and the city's role as a hub for the interpersonal exchange of information will be more important (Moss, 1987: 539; see also Ter Hart and Piersma, 1990: 83).

Processes internal to financial centres also help to sustain their dominance. Financial centres develop a pool of highly skilled labour which helps to ensure the profitability of existing capitals and to exert a pull on institutions not already represented in a centre (Friedmann and Wolff, 1982). Furthermore, as banks enter a centre for the first time - to be near clients and markets (Thrift, 1987) - they exert contradictory effects on the financial centre. On the one hand, an increase in the number of banks in a centre increases the number of competitors for business yet, on the other hand, it also increases the total size of the market (Choi *et al.*, 1986). This is particularly important for international financial centres which exert a supra-national dominance. However, the increased business that accrues is of critical importance in maintaining financial centres because it exerts a magnetic effect of financial institutions not already represented in the city.

London's position in the international financial system is reflected in (and was partially a result of) the representation of overseas banks in the City. As Table 4 shows, the number of foreign banks in London almost doubled between 1960 and 1970 and again between 1970 and 1980, although the rate of growth has declined rapidly since 1985. In contrast to the situation in New York and Tokyo, the success of London's financial centre is not primarily based on the strength of the domestic British economy, it has resulted from the role the City plays in the *international* financial system. This has meant that of the three, London has been far more open to foreign banking capitals. It therefore seems axiomatic that there are heavy concentrations of foreign banks in the City.

Table 4: Foreign banks in London by year of establishment

| Source | Pre-1914 | 1914-39 | 1940-59 | 1960-69 | 1970-74 | 1975-79 | 1980-85 | 1986-90 | Total (1990) |
|---|---|---|---|---|---|---|---|---|---|
| Europe | 9 | 5 | 10 | 15 | 35 | 46 | 52 | 17 | 189 |
| USA | 3 | 5 | 1 | 20 | 24 | 8 | 4 | -17 | 48 |
| Japan | - | 2 | 7 | 4 | 10 | 3 | 14 | 13 | 53 |
| Other | 18 | 7 | 12 | 18 | 15 | 42 | 45 | -1 | 156 |
| Total | 30 | 19 | 30 | 57 | 84 | 99 | 115 | 12 | 446 |
| Cumulative total | 30 | 49 | 76 | 136 | 220 | 319 | 434 | 446 | 446 |

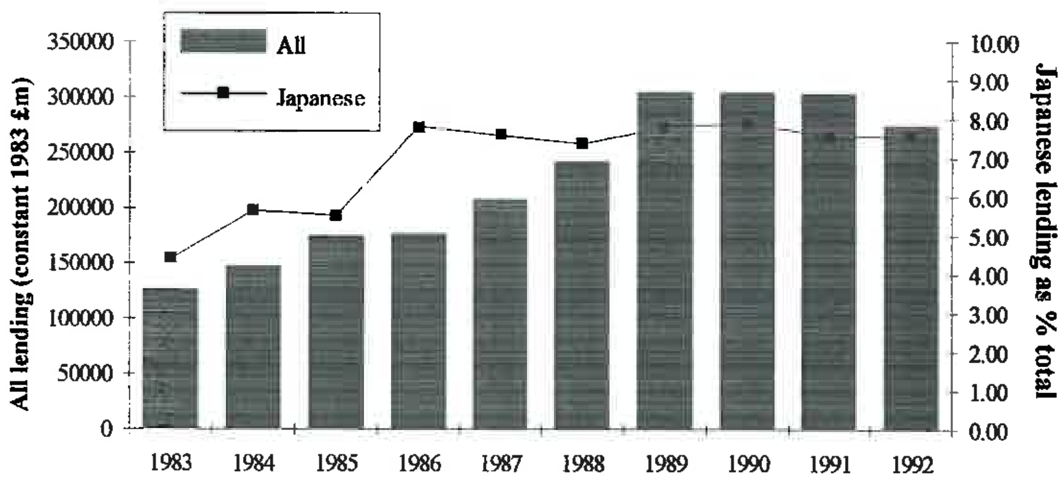
Source: Coakley, 1992: Table 2.1; *The Banker*, 1990

Although the importance of the City in the international financial system is peripheral to this discussion, I do want to emphasise the importance of this feature. Foreign banks came to Britain to do things that they were simply unable to do at home. As the world economy has become progressively international in orientation, so has banking and London's early lead gave the city a pivotal position in the changing international financial system. During the early 1980s, this position was reinforced by the abolition of exchange controls, by the breakdown of the informal system of regulation of domestic markets and the Thatcher government's ideological commitment to market liberalisation. The City and the financial service industry generally occupied a privileged role in the government's attempt to restructure the British economy.

**Banking on Britain?**

Most attention on the activities of foreign banks in London has concentrated on their international functions. This resulted from two factors. First, London's role in the international financial system and, second, the fact that foreign banks in Britain *have* retained a largely international orientation. Britain has not been one of those countries where foreign banks have made much headway into domestic retail banking environments. However, there has been a tendency to underestimate the significance of overseas banks in lending activities. In 1991, non-British banks accounted for nearly one third of all lending to UK residents, although following a dip in American lending in 1992 it fell below 30% for the first time for a decade. Figure 1 shows that the total amount of bank lending to UK residents[5] rose by just under 250% in real terms between 1983 and 1989. In 1989 outstanding debt levelled off, perhaps providing an early indication of the end of the credit-led consumer boom, before falling in 1992. What is particularly noticeable from this figure, however, is that the Japanese banks based in London managed to increase their share of lending - *at a time when overall lending was rapidly growing* - from 4.5% in 1983 to 7.8% in 1989, again levelling off in the late 1980s.

**Figure 1: Lending to UK residents, 1983-1992**




Source: Bank of England

[5] The term UK residents includes individuals and companies registered in the UK.

By itself, this chart can only tell us that the Japanese banks increased their lending activities in Britain during the 1980s. However, the Bank of England data allow us to explore the changing distribution of the lending of banks. Table 5 suggests that at the beginning of the period under review Japanese banks concentrated their lending activities very heavily in the distribution sector. While 16% of all bank lending was to the distribution sector, fully 45% of lending by Japanese banks in 1983 was to the distribution sector - and this was overwhelmingly dominated by lending to wholesale distribution companies. Although data on the borrowings of Japanese subsidiaries in Britain are unavailable, interviews carried out with Japanese banks in 1990 and 1991 suggest that the bulk of this lending was to *sogo sosha*, the Japanese trading companies. Clearly, the *sogo sosha* have close links with some of the major Japanese banks and have themselves become involved in the provision of financial services to their related companies (Dicken, 1992b). However, it is important to stress that the *sogo sosha* in Britain are primarily distribution companies which facilitate Japanese trade and the data do seem to suggest that a great deal of the involvement of Japanese banks in Britain at this time was facilitating Japanese trade. This would seem to bear out the sorts of 'stage models' of foreign investment by banks developed by authors such as Fujita and Ishigaki (1986). Japanese lending to other economic sectors in 1983 was not significantly different to the proportion of all bank activity, with the exception of the energy sector, where it was over-represented, and agriculture and personal lending, where Japanese banks had no significant presence.

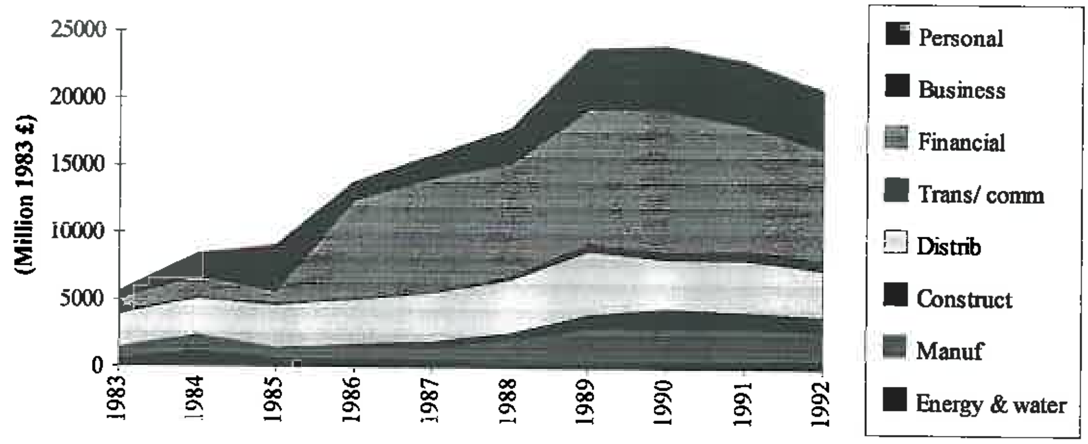
Table 5: Sectoral distribution of bank lending in UK, 1983-1992 (% of all lending)

| | Agriculture | Energy & water | Manufac-turing | Constru-ction | Distrib-ution | Tranport & comm-nication | Financial services | Business services (inc govt) | Personal lending | All lending |
|---|---|---|---|---|---|---|---|---|---|---|
| **1983** | | | | | | | | | | |
| All bank lending | 4.1 | 3.9 | 17.6 | 3.1 | 16.3 | 2.9 | 17.2 | 11.8 | 23.0 | 100.0 |
| Japanese bank lending | 0.0 | 11.5 | 13.1 | 0.9 | 44.9 | 1.1 | 18.7 | 10.1 | 0.1 | 100.0 |
| **1992** | | | | | | | | | | |
| All bank lending | 1.5 | 1.8 | 10.9 | 3.5 | 9.8 | 1.9 | 23.5 | 16.9 | 30.2 | 100.0 |
| Japanese bank lending | 0.0 | 0.0 | 11.4 | 5.8 | 18.2 | 0.0 | 42.8 | 21.8 | 0.0 | 100.0 |

Source: Bank of England

By 1992 the structure of Japanese bank lending more closely matched the overall distribution of bank activity, although Japanese banks were still over-represented in distribution and in the financial sector and lending to individuals remained entirely insignificant. Particularly interesting in both cases is that manufacturing companies received a low proportion of the funds lent by Japanese banks, in spite of the growth of Japanese manufacturing investment in Britain during the 1980s. The distribution sector had lost its dominance of total lending, although as Figure 2 shows this was more because lending to financial service companies grew rather than because lending to distributors declined.

**Figure 2: Japanese bank lending to UK residents, 1983-1992 (constant £m)**




Source: Bank of England

Below the industry headings, which broadly correspond to the Standard Industrial Classification Divisions, it is clear that there are individual industries and sectors which have been particularly concentrated on by Japanese banks, whilst others are almost entirely avoided. Overall, Japanese banks account for about 7.5% of non-interbank lending in the UK. Their lending to the manufacturing sector overall has been lower than their share of total lending. However, within the manufacturing sector, there has been a marked rise in lending to motor vehicle manufacturers and to the electronics sector. As Table 6 shows, lending to motor vehicle manufacturers rose rapidly from a very low base in 1983, reaching a sustained market share of above 15% after 1986, although it fell off again in 1992. Similarly, though less spectacularly, Japanese banks increased their market share of lending to electrical and electronic engineering firms from 3% to 10% in the same period. This is clearly important, because it provides a wider window on the types of companies favoured by Japanese banks . Rather than this being sectoral lending *per se*, interview evidence suggests that this is lending to Japanese companies. Motor vehicles and electronics are two of the sectors in which Japanese investment in Britain has been most marked. In this sense, then, it seems likely that Japanese banks in Britain are facilitating Japanese direct investment in the country, in the same way as their lending favoured Japanese trading companies in an earlier period.

Table 6: Japanese bank lending to selected economic sectors, 1983-1992 (% of total lending in sector

| | All bank lending in UK | Manufacturing | Electronics | Motors | Commercial Property | Wholesale distribution | Government (central and local) |
|---|---|---|---|---|---|---|---|
| 1983 | 4.5 | 3.3 | 3.0 | 1.6 | 0.6 | 31.3 | 18.4 |
| 1984 | 5.8 | 4.6 | 2.8 | 6.7 | 0.6 | 30.1 | 22.4 |
| 1985 | 6.4 | 2.8 | 4.0 | 5.4 | 1.1 | 31.9 | 32.6 |
| 1986 | 7.8 | 3.4 | 5.1 | 4.1 | 2.3 | 32.4 | 26.8 |
| 1987 | 7.6 | 3.9 | 6.5 | 8.6 | 4.9 | 36.1 | 31.7 |
| 1988 | 7.4 | 5.6 | 6.0 | 14.6 | 6.3 | 35.0 | 37.3 |
| 1989 | 7.8 | 6.8 | 7.8 | 13.0 | 9.1 | 34.3 | 36.2 |
| 1990 | 7.9 | 7.2 | 8.1 | 18.6 | 11.1 | 27.3 | 33.7 |
| 1991 | 7.6 | 7.7 | 8.4 | 18.4 | 11.6 | 29.9 | 31.1 |
| 1992 | 7.6 | 7.3 | 10.1 | 13.8 | 11.7 | 29.3 | 30.3 |

There are two other non-financial sectors where Japanese bank activity has been concentrated during the 1980s: commercial property and central and local government. Lending to property and construction companies was one of the main areas of growth during the 1980s for all banks. In real terms, outstanding debt in the property sector grew eightfold *in real terms* during the 1980s, which clearly contributed to the problems that are all too evident today. During the same period, Japanese institutions increased their share of lending from almost nothing to over 10%. Although the Bank of England data do not include all bank lending to government, (excluding, for example, funds placed through the local authority money market), Japanese institutions do account for a significant proportion of the government debt to banks. During the mid-1980s Japanese banks held over one third of government bank debt, although in 1992 it fell back to 30%.

The implications of this fairly detailed analysis of lending appear to be three-fold. First, changes in the volume of Japanese lending during the 1980s occurred which have to be linked to wider political and economic processes. Second, Japanese bank lending has been concentrated in particular areas which needs some explanation. Third, there are implications for the *geography* of Japanese bank involvement. These are now discussed in turn.

First, during the 1980s there was an absolute and relative increase in lending by Japanese banks which has - in real terms - gone into decline since 1989 (although the unadjusted figures still show an increase). The changing *overall* volume of lending by the Japanese institutions is related to the state of the British economy *and* to the orientation of the Japanese economy. The explosion of Japanese lending, for example, coincided with the "credit-hungry" form of growth which pulled Britain out of the early 1980s recession. However, that it was Japanese companies that satisfied that demand was due to the structure of, and changes within, the Japanese financial system at the same time. There are two main features which explain this growth of *Japanese* activity in British financial markets: (i) that historically Japanese banks have been able to get money cheaply because they have had strong credit ratings and because, as long as stock prices remained high, they had high ratios of capital; (ii) American foreign policy during the 1980s appeared to be orientated towards sucking Japanese savings into the USA in order to finance their budget deficit (Leyshon, 1992).

During the mid-1980s the Japanese were effectively forced into lowering their interest rates to weaken the Yen; and when the dollar had risen to more acceptable levels they were entreated to sell Yen and buy dollars under the terms of the Louvre Accord (Ito, 1992; Leyshon, 1992). The result of these American policies - which gave Japan low interest rates and high liquidity - was the, so-called, Hensei Boom, which stimulated Japanese corporations to invest at an enormous rate. Domestic investment was concentrated in the property sector and the stock market - which, given the way that bank capital asset ratios are determined, strengthened Japanese banks and improved their access to cheap capital. Japanese companies also engaged in massive amounts of foreign direct investment and financial institutions increased their lending on the world's money markets.

The levelling off and downturn in the real amount of Japanese lending in Britain is similarly related to economic conditions in both Britain and Japan. Real lending by Japanese banks in London rose rapidly between 1986 and 1989, peaked in 1990 and has fallen off every year since then. Just as the rapid growth took place during the peak years of the late 1980s 'Lawson boom', lending slowed down as the British recession deepened. Indeed, because Japanese banks have almost maintained their overall share of lending, it could be suggested that they are merely responding to a systemic change. However, there are a number of changes underway which are likely to adversely affect the future growth of Japanese bank activity in Britain when lending grows again. If much of the growth of Japanese bank lending during the 1980s was because they had access to cheaper capital than did banks from other countries, it is clear that those conditions have fundamentally changed (Martin, 1992). Falling property prices and stock market values in Japan are eroding the banks' capital bases, which directly affects the costs of money for the banks (see Friedland and do Rosario, 1992; Leyshon, 1992). This is because banks from all of the major countries now have to comply with the Bank for International Settlements rules on minimum capital adequacy. This means that banks have to have 'core' reserves to support their lending. These reserves may be held in a variety of ways. Japanese banks have been particularly adversely affected because during the 1980s they counted unrealised gains in shares and property in their core capital (see BEQB, 1992). These gains have now been reversed, in a very real sense wiping out their capital bases. The BIS have made it clear that they are not prepared to relax the rules. If banks do not have the reserves to support lending the only possible response is for them to reduce their total lending.

Falling property prices will also adversely affect Japanese banks in a more direct fashion because many of the loans to individuals and companies were secured on property. Some commentators have argued that the whole financial system is at risk from bad property loans worth between ¥50,000 - ¥60,000 billion (or £300-£500 million) (Rafferty, 1993). Although the largest concentration of problem debts were in the long-term banks and the credit banks, rather than the large money-centre institutions, the close-knit nature of the financial system within Japan means that bad debts are transmitted throughout the system (see Leyshon, 1992; Suzuki, 1989)

The second issue that arises from the above lending analysis is a more sectorally-specific one. Japanese bank lending appears to have been particularly concentrated in sectors where other Japanese companies are strong, such as car production or the distribution sector. A significant proportion of lending by Japanese banks in London is to the British subsidiaries of Japanese companies. Interviews with the London-based management of Japanese banks suggest that Japanese banks in London appear to have strong relationships with large Japanese corporations, the proportions ranging from 'between ten and twenty-five per cent' to 'seventy per cent, roughly speaking'.[6] The relationships that the banks have with industrial and commercial companies in Japan have been transferred to London. In Japan, there are strong, formalised inter-relationships between firms which are based on pre-Second World War industrial groupings called *zaibatsu*. Formed in the nineteenth century, the *zaibatsu* were alliances of firms whose diverse activities were co-ordinated by a holding company which was initially concerned with the organisation of trade (Goldsmith, 1983). However, the *zaibatsu* began to branch out into productive and financial activity during the early twentieth century. After the Second World War, these groups were forcibly broken up in the Anti-Trust Act of 1947 (Suzuki, 1989) which attempted to diffuse ownership and control in the Japanese economy. Although they *were* formally dissolved, the *zaibatsu* were replaced by new institutional forms, known as the *kereitsu*, which - through cross-shareholding arrangements - were effectively bank-led industrial groupings (see Leyshon, 1992). Within Britain, *kereitsu* relationships have been reproduced with, for example, all members of the Sumitomo Group banking with the Sumitomo Bank and all members of the Clover Kai banking with that *kereitsu's* lead institution, the Sanwa Bank.[7]

Like American banks before them, Japanese banks have become increasingly embedded in the domestic financial system. Relationships based on nationality become less important as banks become more firmly established in London. American banks have clearly been deeply embedded in the City over a long period of time. If Japanese banks are established in the City for the same time span it is at least arguable that they will

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[6] Source: Interview data

[7] Fuji Bank in London co-ordinate meetings of the Fuyo Group within the UK. The Fuyo Group is orientated around Fuji Bank and was formed around the ruins of the Yasuda *zaibatsu*. Influential members of the Fuyo Group include Canon, Hitachi, Nissan and the Marubeni Corporation (Fuji Bank, 1988).

develop a similar breadth of customer relationships. Indeed, it was shown earlier that the structure of Japanese bank lending in Britain changed during the 1980s, with lending to finance and business service companies growing at the expense of distribution. This change suggests that lending to Japanese-owned companies has suffered a *relative* decline in significance during the past decade. There are strong parallels between these developments and the trajectory of Japanese involvement in financial markets in the United States. Using data which allow the ultimate country of ownership of borrowing companies to be matched to the lender, Seth and Quijano (1991a, b) have demonstrated that the share of Japanese banks' lending to Japanese-owned companies in the US fell from around 75% in 1984 to less than 40% in 1989 (see also Rose, 19xx).

**The geography of Japanese banking in Britain**

On the surface, this sectoral breakdown of Japanese bank lending tells us little about geography. The nature of organisations and data collection preclude the creation of a regional breakdown of bank advances. Yet I want to very tentatively argue that they can imply a geography. On a simple level, if the 1980s producer service literature that argued that there is a distance decay effect on access to finance is correct (for example, Marshall *et al*, 1988) we can expect *a priori* that the overwhelming dominance of Japanese and other foreign banks in London would disproportionately favour firms in the South East of England. The 'costs' of doing business outside the South East are not only travelling but also include the risks for banks of not having a good access to market knowledge, which increases the risks of lending. This is more significant for lending to British firms than for subsidiaries of Japanese companies, of which the banks will already have knowledge.

The sectoral breakdown of lending suggests that this is the case. First, 42% of lending goes to the non-bank financial sector which, with the exception of the building societies, remains overwhelmingly concentrated in London. Second, 18% of advances are made to companies in the wholesale distribution sector. If such lending *is* targeted at Japanese companies, this will be overwhelmingly based in the South East because unlike their manufacturing counterparts, Japanese distribution companies have located in the south of England (see Dicken, 1992b). Third, since 1987 between 7% and 12% of Japanese lending has been to construction and property companies, helping to fuel a southern-based (though not exclusively southern) property boom.

However, despite this tendency towards lending to companies in the South East, which is by no means peculiar to the Japanese banks, it is possible that the geographical distribution of Japanese bank lending will become more even over time. During the 1980s, Japanese banks began to increase their representation in provincial financial centres. Manchester, Birmingham and Edinburgh all have Japanese bank offices which have opened since 1985. Nine Japanese banks are represented in these cities. Interviews suggest that in each case provincial offices were opened in order to serve the banks' *existing* customers. One Japanese banker argued that this was primarily a cosmetic exercise, designed to illustrate commitment to their customers, rather than to fill a gap in the bank's network:

> We do not want many offices scattered about the UK, that is not so important to us... *We are quite confident that if we wanted to, we could cover the whole of the United Kingdom from London. But the American banks ... were leaving the regions ... and we thought that it was good timing to get in.* But we knew that at the time, as we know now, that the purpose of that office was to get close to our customers ... But I think that the main thing to remember is that they could be covered from the London office.

This argument, however, stands in contrast to the views of another Japanese banker, who argued that the London branch was unable to cover the entire UK market. Although many Japanese banks opened their provincial offices almost as a courtesy gesture to companies with which they have close relationships, for some other institutions a provincial office was felt to be a necessity in order to stem a loss of customers. However, in each case it is true that the offices were opened in order to serve *existing Japanese clients*. Furthermore, Japanese bank offices tend to devote more time to Japanese companies than do, say, French banks. For example, two thirds of Japanese provincial offices have over 30% of their business with Japanese-owned companies, while only one French office out seven does. With American banks the position is even more striking - not one American bank office has more than 20% of its lending outstanding to American-owned companies, nor did those American provincial bank offices which are now closed.

Many of the Japanese provincial bank offices were initially opened *in response* to the wave of Japanese manufacturing investment in British regions during the 1980s. The provincial offices were opened in order to provide a local presence and a formal gesture of support to companies with which the banks have historically had close relationships. For example, the decision by Toyota to build its European plant in Derbyshire was followed rapidly by announcements by its main bankers - Tokai Bank, Mitsui Bank, the Bank of Tokyo and Sanwa Bank - that they were opening offices in Birmingham (*Financial Times*, 19 February, 1990). However, it is important to recognise that, having opened provincial offices, Japanese banks have attempted to increase their overall market penetration. One banker, for example, said that, "there is a very definite policy of banking for all customers irrespective of nationality. Where Japanese companies have the advantage is where their parent company has close banking ties with Fuji Bank in Japan."

Lending to home country companies is advantageous to banks for two reasons. First, by demonstrating a degree of commitment, it broadens and deepens existing relationships. Second, it provides bankers with a degree of security. Overseas markets are potentially risky for banks with limited local knowledge and intelligence gathering capacities (Oort, 1990). The Japanese have unusually high proportions of business with Japanese subsidiaries in their regional offices - most other foreign banks in Britain have much lower proportions with 'home country companies'.

Differences in the stock of foreign investment are an important part of the explanation for why banks from different countries have different proportions of business with home country companies.[8] However, as banks become more established in a provincial location, they begin to develop deeper linkages with companies from elsewhere. There is no reason to suppose that the Japanese banks will be any different from any others in this. Indeed, Japanese banks have been active in the regional commercial property sector. In Manchester the local urban development corporation actively targeted the Japanese banks for investment - even to the extent of running a seminar in Tokyo. While the construction boom in provincial cities never reached the heights of the boom in the City, the shortage of office space did stimulate an enormous construction programme in cities such as Manchester. The problem, inevitably, was that new offices became available at the same time as the early 1990s recession began to hit white collar employment, leading to local over-capacity. This has hit Japanese banks amongst others. For example, the failure to let more than 40% of a building in Salford Quays led Charter Developments to default on interest payments to Sanwa Bank in May 1992 (*Independent on Sunday*, 24 May, 1992).

It has been argued here that Japanese banking in Britain is a largely South East based phenomenon and it is important to recognise that in comparison with Japanese offices in London their regional representation remains insignificant. However, there *are* intangible benefits of having a wide spread of bank representation in regional cities. Cities may be able to sell themselves to local companies as having a critical mass of

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[8] This is discussed more fully in Tickell (1992).

financial institutions and they may be able to retain skilled labour in the financial sector. There are two other potential benefits. First, local businesses may be able to get better access to finance than if they had to rely exclusively on domestic banks, or get it at a slightly more competitive rate. A survey by Shearson Lehman in 1991 suggested that non-British banks had a 21% market share in the corporate middle market.[9] Second, Japanese banks may offer a 'demonstration effect' of good practice and thus stimulate a wider restructuring of the local financial sector than their small numbers may suggest (see Colwell and Davis, 1992, on foreign investment in banking generally).

## Conclusion

The aim of this paper has been to explore the ways in which changes in the international financial system interact with processes internal to Britain. As Thrift (1990b: 81) has argued, there is not a, "global financial structure 'out there', as a *deux ex machina*, but rather a spatially distributed network of money/social power which encompasses the globe. ... [The] local and the global intermesh, running into one another in all manner of ways." It is in this sense that the paper has analysed the underlying reasons for the growth of Japanese banks in Britain, as well as explored the economic and geographical concentration of Japanese bank activity. The paper has demonstrated that Japanese institutions increased their lending activities in Britain during the 1980s and argued that such lending was targeted at both Japanese companies and the south of England. Although it has been argued that the sectoral and geographical reach of Japanese banks has broadened recently, restructuring within Japan and the UK may cause Japanese financial institutions to reduce their activities in London.

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[9] Source: Interview with banker reported in Tickell (1992).

First, as I have already stressed, the impact of the difficulties of the Japanese economy in general - and Japanese banks in particular - may mean that Japanese banks will retrench to their core markets in Japan. This will not be sudden nor will it be total. However, during the 1970s American banks occupied a similar role in Britain (and the world) that Japanese banks do today. When the American economy came under pressure American banks did not just disappear from international financial markets, and American banks still 'own' 3.5% of British debt, but they did become less important over a period. It is quite possible that this will happen to the Japanese if their capital problems in particular are sustained. In the year to May 1991, Fuji, Dai-Ichi Kangyo and Mitsubishi Banks all reported profit falls of over 30% (Leyshon, 1992).

Second, domestic British conditions may 'scare off' Japanese banks. There is currently a perception in the markets that Britain is soft on Europe, a feature which may undermine the City's position as the premier European financial centre. Furthermore, conditions during the 1980s were unusual. Banks were undoubtedly major beneficiaries of the privatisation of British industry through the fees earned both for corporate advice and underwriting share issues and the government was embarrassed by the heavy Japanese share purchases of National Power and PowerGen - at one stage 9% of National Power was thought to be in the hands of Japanese investors (Leyshon, 1992). Deregulation made lending to the property sector extremely lucrative, a feature which is unlikely to re-emerge for some time. The local authority swaps affair, when the courts ruled that local authority activity in sophisticated financial markets was illegal and therefore the local authorities had no legal right to repay losses to banks, has also undermined confidence in the British financial system (see *Financial Times*, 5 November 1990).

The City of London's international image is also threatened in other financial sectors, demonstrated by the debacles at Lloyd's insurance market and by the failure of the

'Taurus' system on the stock market to be introduced. London's status as a financial centre is already under pressure from the levelling of the European regulatory playing field.(*Bank of England Quarterly Bulletin*, 1989), the failure of the City adequately to control scandals may create a very real danger that foreign banks of whatever source are going to think very hard about investing in Britain.

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