

Program on Alternative Investments →

The Program on Alternative Investments, under the aegis of the Center on Japanese Economy and Business and in cooperation with the Japan Business Association of Columbia Business School, launched its first seminar on September 17, 2002. The event featured Wilbur L. Ross, Jr., Chairman and CEO of WL Ross & Co. LLC, and was moderated by Dr. Mark Mason, Director of the Program. Mr. Ross' presentation focused on the differences in private equity investing between the US and Japan, based in part on his analysis of macroeconomic contrasts between the two countries. Following are excerpts of Mr. Ross' presentation together with selections from the subsequent question and answer period. The Program on Alternative Investments will hold monthly seminars throughout the academic year on private equity, hedge fund and real estate investing in Japan and elsewhere in East Asia.



Wilbur J. Ross

The Program on Alternative Investments was established to analyze three sets of alternative investment asset classes—private equity, hedge funds and real estate—in Japan and elsewhere in East Asia. The program meets its substantive goals through a combination of research projects and seminar presentations, the latter led by leading practitioners in each of these three alternative asset classes. Throughout the year the program will sponsor the work of a number of highly qualified Columbia MBA students who will conduct cutting-edge research on these topics under the direction of Dr. Mason. For a schedule of upcoming seminar presentations, please consult the Center's web site at <http://www.gsb.columbia.edu/japan>.

Perspectives On Investing In The U.S. and Japan

I think there are four key differences between investing in the United States and investing in Japan. The first is that asset and equity values are severely depressed in Japan. Second, even now there is a higher degree of leverage—a higher ratio of debt-to-equity—in Japan even among healthy companies than is true in the U.S. Third, and related to the second point, interest rates are much lower in Japan, and fourth, non-performing loan levels are very high in Japan and the distress in the financial community is heavily concentrated at the financial institutions, particularly the banks.

Figure I is a comparison of the Dow Jones Industrial Average (lower line) and the Nikkei 225. Just recently they have crossed, and have been criss-crossing lately. For the prior twelve years the Dow has more or less been going up, and ever since the peak in 1990 the Nikkei has been going down. The destruction of asset values, however, is not confined to the Nikkei. The proportionate declines from the

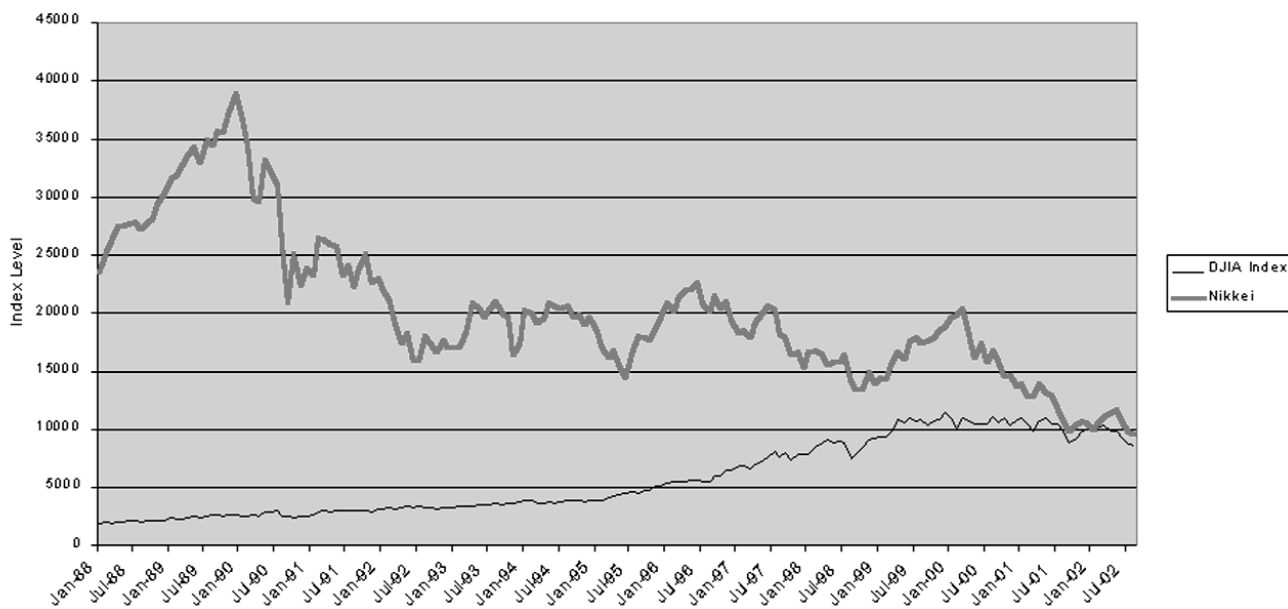
peak in the so-called bubble period have been quite severe and, unfortunately for leading Japanese businessmen, have been most severe in the value of country club memberships. Those have gone down over 90 percent from its peak, whereas stocks have decreased only 75 percent and real estate has decreased about 80 percent. Real estate values in Japan are now approximately what they were in 1983. I do not know of another major country in the world where you can buy properties more cheaply now than you could twenty years ago.

This has created a problem, but also a potential opportunity for outsiders in the form of the shareholdings that the banks have had in their borrowers. Unlike the U.S., in Japan it is commonplace for a bank to also be an equity investor in the same company that borrows from it. At the peak, which was not in 1990 in terms of total value but rather in 1996, there were over 45 trillion yen worth of bank stockholdings in non-bank (manufacturing and retailing) companies. Even now, with the combination of selling

every six months by the banks and the continued decline in market value, most of the Japanese leading banks have more than 100 percent of their own equity tied up in the common stocks of their borrowers. Banks still have a very disproportionate amount of their capital structure invested in equities of the same companies that borrow from them.

Second is the higher degree of leverage in Japan. Figure II is a composite debt-equity ratio of Japan Inc. In the late 1980s it peaked out, at which time Japan industrial companies in the aggregate had almost six times as much debt as equity. Even now, after fairly persistent declines in the debt-equity ratio, it is still very close to three times as much debt as equity. In the U.S. we regard a 3-1 debt equity ratio as a leveraged buyout. In Japan, the whole industrial economy after about 15 years of consistent reduction in debt is still as leveraged as what we would call a leveraged buyout. Curiously, Japanese banks did not think of themselves as leverage buyout lenders. In reality they were.

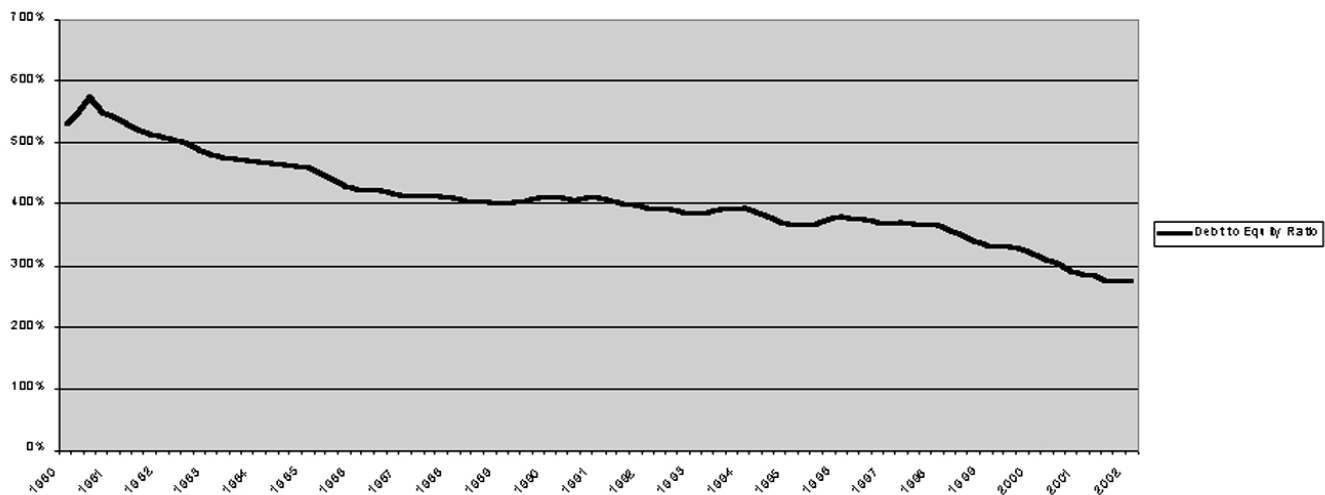
Nikkei 225 and Dow Jones Industrial Average Comparison



Source: Bloomberg data for DJIA and Nikkei 225.

Figure I

Japan Corporate Debt to Equity Ratio



Source: Ministry of Finance, Japan, through 2001.

Figure II

Bank lending is also much higher as a percentage of the gross domestic product (GDP) in Japan than it is in the U.S. It is now, after reductions in the late 1980s, still about 90 percent of one year's total economic activity versus about 40 percent in the U.S. This is a partial explanation as to why the banking crisis has been so severe and protracted. The fact is that banks are about 2½ times as important to the Japanese economy as they are to the U.S. economy. A similar level of problems in Japan is 2½ times as damaging to the economy as it would be in the U.S.

It is not just the private sector that has become leveraged. The Japanese government has one of the more leveraged economies in the world. This has contributed in large measure to Moody's' and other rating agencies recently downgrading the government. In absolute terms, the Japanese government borrowed over 40 million US dollars per hour throughout 2001.

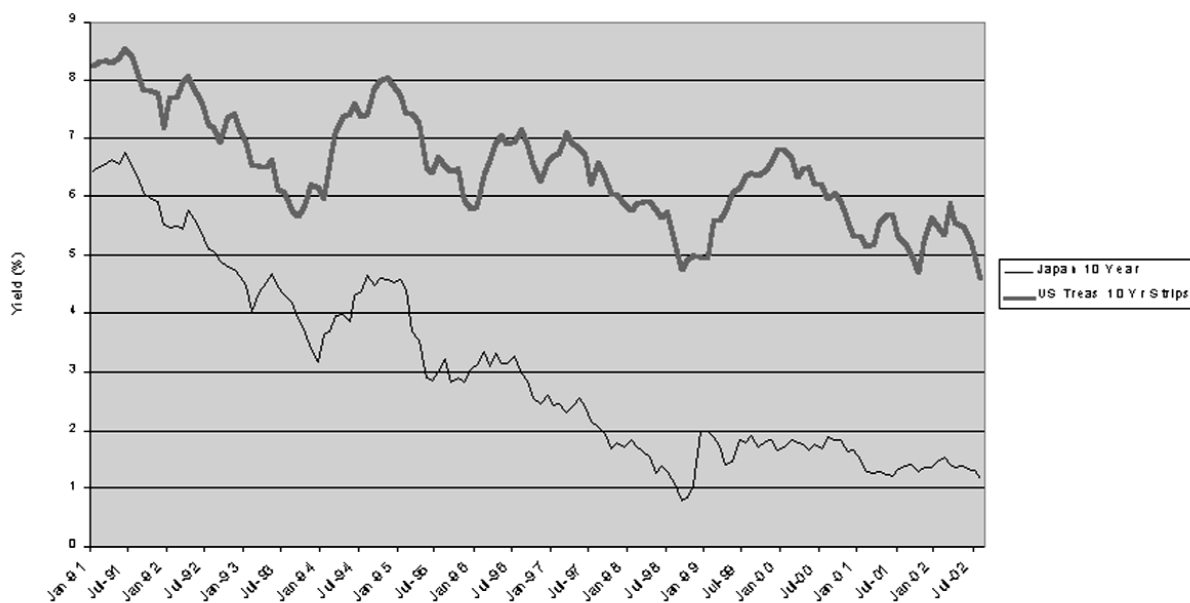
Third, and part of the reason why the whole economy has not collapsed, is that interest rates are so much lower in Japan than in the U.S. The upper line in Figure III is the interest rate prevailing on ten-year U.S. treasury bonds. The lower line is the interest

rates prevailing on ten-year Japanese government bond issues. There is a substantial gap between the two. The lower interest is part of the reason why the government has been able to afford more borrowings than would have been true in a U.S. or Western context. It is also why many Japanese companies that will never be able to repay the principal amount of their debt are in fact able to make current payments on the interest given the low rate. It also has resulted in another totally unique phenomenon that makes the market very attractive to U.S. investors who wish to invest in Japan and hedge back to dollars. In most countries, hedging back to dollars is an expensive proposition. Rarely can it be done for periods more than 1–2 years. The forward market in the yen versus the dollar is very deep. It can be done in very large size but, more importantly, your counterpart actually pays you for the privilege of absolving you from your foreign exchange risk. Why does this occur? The reason is because interest rates are so much lower in Japan than in the U.S. and there is a constant flow of Japanese institutional money buying dollars in order to buy U.S. treasuries in hedging

back to yen. Since there is a positive spread to be earned by that interest rate differential, they are willing to pay a premium at the forward end of the spectrum. Therefore, generally speaking, you profit by 1–2 percentage points per year simply by hedging your yen investment back to dollars. In Korea, for example, it is very expensive to hedge back even for a short duration. I believe this is one of the very unique features of the Japanese market that deserves more attention than it has received.

Fourth is that the non-performing loan (NPL) levels are high in Japan and the focus of distress is at the bank level. According to the government's own calculations there is approximately 35 trillion yen of bad loans as of last year. By now the figure is well over 40 trillion yen. There are constant arguments over how accurately the NPLs have been calculated and whether the figure may in fact be larger. Even if the bad loans are at the level calculated by the government, it means that Japan has a higher amount in absolute terms of non-performing loans than even the U.S. even though the U.S. economy is 2 to 3 times the size of Japan's. Just as was true that the banks are relatively

Interest Rates in the US and Japan



Source: Bloomberg, 10 year strips for Japanese Government Bonds and for US Treasuries.

Figure III

more important to Japan than banks are in the U.S., the NPL problem is quite large relative to Japan than it was in the U.S. at the peak of our problems during our banking crisis.

The NPL crisis is also very difficult to solve because of low interest rates in Japan. When America went through its banking crisis the prime rate was approximately 8 percent and deposit rates were very low. There was a good absolute amount of interest and high spreads to be earned. In Japan, absolute rates are low. A good corporate borrower pays about 1½–1¾ percent and the whole gross spread is under 2 percentage points. Whereas American banks were able over a period of years to earn their way out from under the bad loan problem, the case is different for the Japanese institutions. Part of the reason why we focus on Japan is because over time a very high percentage of these NPLs need to be transformed into equity and the companies need to be rehabilitated and recycled. Therefore, there is a bigger backlog of potential investments in Japan for foreigners than anywhere else in the world even

with the very well publicized crises we have in the U.S. currently. Figures IV and V highlight this comparison. Over the last 12 months (ending June 2002) the total liabilities, including bank debt, junk bonds and the accounts payable, of all the American companies that filed bankruptcy were about \$250 billion dollars. That is about the same amount as NPLs in Japan minus the ones that are already in bankruptcy.

The outlook, however, for continued flow of bad loans and distressed and defaulted debt in the U.S. is also quite robust now. The total universe of high-yield bonds outstanding is slightly under \$800 billion dollars. Of that \$800 billion, approximately \$120 billion is already in default, but another \$160 billion is 1000 basis points or more above treasuries. In today's world, the only reason why a bond yields 15 percent is because people do not think the interest will be paid for very long. Somewhere between one-half and two-thirds of those distressed loans in the U.S. will default over the next twelve months or so.

From my point of view, all of this amounts to a country that has already gone through very agonizing and embarrassing change. Japan has been viewed as the best-run economy in the world to one that continues to have crises and a difficult economic situation. However, in that problem lies opportunity. Most big Japanese companies, including the banks, are far behind the U.S. and the Western world in information technology. It is basically a mainframe computer-oriented information technology environment rather than PC and much of the equipment is fairly obsolete. I believe this is a major contributing factor to why most Japanese businesses have a ratio of general and administrative expenses to revenues that is anywhere from 2½–3 times the size of any comparable Western company. One of the unfortunate consequences of the lifetime employment practices that had prevailed earlier was that there was no rate of return to be achieved by substituting capital for labor. Instead, companies had a negative return due to equipment costs, borrowing, depreciation, and

hiring one additional person who knew how to run the equipment. This is starting to change and it is a very constructive development.

A second change is the attitude toward identifying the objective of the business. I think private equity investors can help business managers with this change. Most Japanese businesses had as their objective sales growth and asset growth. Capital was easy to come by. The key was growth. A consequence is that 40 percent of all the companies listed on the Tokyo Stock Exchange earn less than 1 percent after tax on their assets. That is a very low ratio and leaves very little margin for error. In a difficult economic period such as Japan and the U.S. find itself now it is easy to go into the red and become insolvent. A combination of a high degree of financial leverage and a management culture that focused much more on top line activity rather than return on equity and assets and profit margin on sales is an area where the private equity community can help to effect change in Japan. It is easiest to effect the change in the context of a distressed or bankrupt company because at that point all constituencies have acknowledged that radical change is needed because the company is in trouble. I think that more conventional leverage buyout activity with American sponsors will find it trickier to introduce the same kinds of change to companies that are healthy and that are now becoming acknowledged leveraged buyouts than it is in the distressed sector.

Our activity with Kansai Sawayaka Bank illustrates this phenomenon. The bank is based in Osaka with branches in Kyoto and Kobe. It failed because it had too many real estate loans. We ended up buying it and because it had already failed we were able to close all of the money-losing branches at the time of takeover. The total head count was reduced by about half from where it had been, but because there were so many assets that needed liquidation, the people

that we did not bring over into the Kansai Sawayaka Bank still had jobs, but they were in the liquidating company rather than the Bank. There was little social disruption. Meanwhile, we allocated a very large amount for information technology because the bank we bought, like many other banks in Japan, had the practice of having its ATM machines operate only while the bank was open. We thought there was great logic in re-programming the teller machines so they would be convenient for people and permit them access to their accounts even when the bank was closed. We also made an arrangement with the postal saving system. Now the postal savings system accepts our cards at all of their branches. This allows our customers to have access to their accounts anywhere in Japan rather than just in the Kansai region. We also began a program of making small, unsecured loans to small and medium sized enterprises and individuals by bringing in the U.S. concept of the scoring system. The scoring system tells you how much of a loan to extend to the person or business and is based on specific criteria. In most Japanese banks, decisions on small loans are

left to the individual bank manager and that can make for a very uneven distribution of credit.

On February 26, 2001 we closed on the Bank. We recently completed our first fiscal year, which ended March 2002, and the Bank earned about 17½ percent on equity during that period, which is a very high level. It continued at that level during the first half of this year. Meanwhile, the loan portfolio grew somewhat debunking the claims that there are no borrowers in Japan. There are plenty of borrowers in Japan who want money in the small and medium size company area, but many of them need it on an unsecured basis. Our loans are up and the total level of NPLs is lower than when we bought the Bank. This is one example of what can be done if you get set up correctly, and all of this was done with Japanese management. Our Japanese and Korean offices are only staffed with local nationals. Many of them had worked for Citibank or General Electric Corp, and many had some education in the U.S. All went to undergraduate school in Japan. We think this is the secret to private equity investing in Japan now. First is to locate



Dr. Mark Mason, Director, Program on Alternative Investments

what can be turned around within one's lifetime and second is to recruit people who are Japanese enough to work within the system and not create disruption, but Western and determined enough to understand the great need to inculcate change. Inculcating change will modify values and the outcomes of the companies. Fundamentally, you want to create a blend between the best attributes of both Japanese and American management practices. Eventually, I believe there will be global concepts of management.

Question and Answer

Q: What changes could spur the more rapid development of the market in Japan?

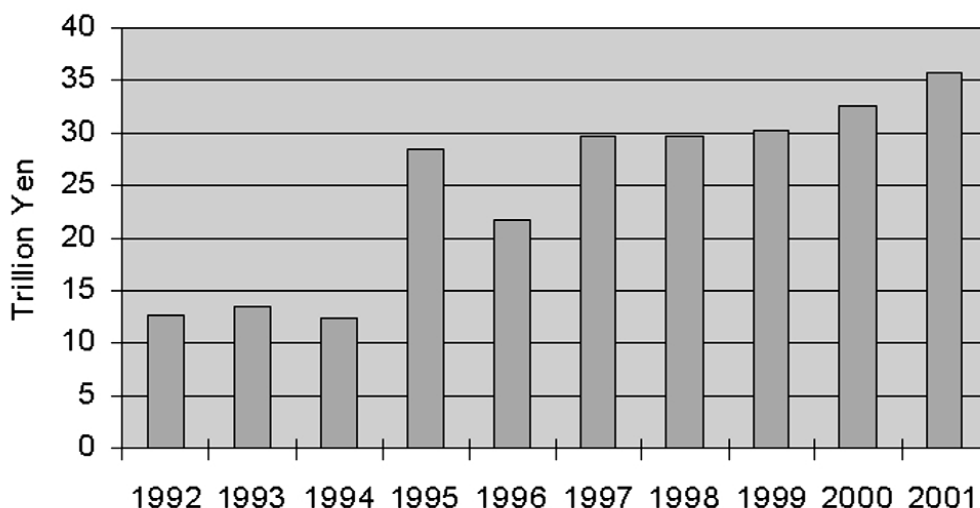
Ross: Many Western private equity firms have been spoiled by the ease with which they can get deal flow in the States. Deal flow mostly consists of having good posture and keeping your eyes open all day so you can look at the books. Japan, and most other countries, is not set up in this manner. First, in Japan, maintaining control of company change is more of an emotional event because even though the company may be technically public very often the management and controlling shareholder think more of it as their own private company than they do as a public company. You must figure out what kind of company you want to be in and who the players are. Second, people complain about how long it takes to get a deal done. However, if you use that year properly, you can get to understand the company much better and time to recruit people. In the U.S. the whole process is completed in

a much shorter period of time, and the transition period is not very smooth. The third complaint is that there are not enough professionals to help you do due diligence. I do not agree with that. The problem with due diligence in Japan is that it is very expensive. If you can get over the hurdle of putting that money at risk, it is possible to find the professionals. I think many of the complaints Americans have about Japan is that they really want Japan to be like the U.S.

Q: Where is your bank allocating its resources now?

Ross: We have invested about \$50 million dollars in information technology for the Bank. We are up to speed with information technology and have had good results. When we took over the Bank, it had an ATM card with about 600,000 members, but no credit card. We developed a credit card with two magnetic stripes on it—one for the credit card and one for the ATM. That proved to be a very popular product. For us, however, it is a high margin product because in Japan you cannot

NPLs Outstanding in Japanese Banks

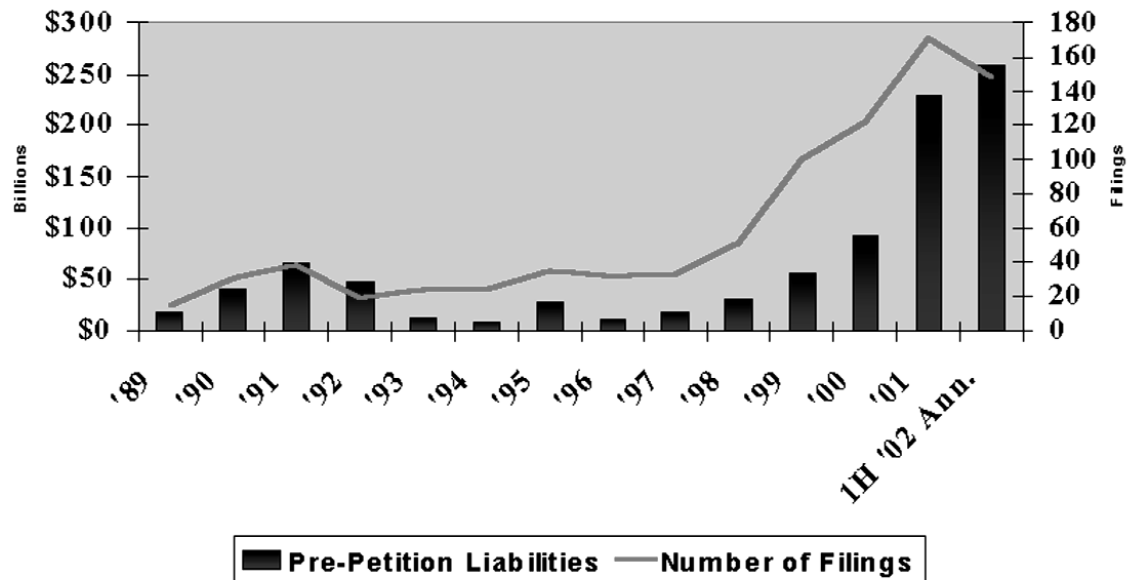


Source: Financial Services Agency, data through September 2001.

Figure IV

In absolute terms, the Japanese government borrowed over 40 million U.S. dollars per hour throughout 2001.

Total Liabilities of Public Companies Filing For Chapter 11 Protection



Source: Altman-NYU Salomon Center

Note: Minimum \$100 million in liabilities; 1H '02 figures are annualized; does not include WorldCom.

Figure V

charge people to issue credit cards, you have to issue them free. Now we only have to issue one card instead of two, which saves about \$30 per card. In addition, people need to only maintain one monthly account, not two.

Q: What is your opinion about Japanese companies participating in private equity?

Ross: Some companies have been active. Mitsui has a venture with Rothschild in Japan. Ripplewood has Japanese industrial investment. I do not think it is a mainstream activity. I think some of the large corporations are nervous about being identified with business practices that may raise societal issues, such as layoffs and restructuring. I think it will be more on a deal-by-deal basis.



Professor Lee Branstetter, Columbia Business School

代替(オルタナティブ)投資講演シリーズ (1): ウィルバー・ロス氏

EDITED BY

Joshua Safier
Associate Director
Center on
Japanese Economy and Business

ASSOCIATE EDITOR

Yoko Mochizuki
Program Officer
Center on
Japanese Economy and Business

PHOTOGRAPHY

Columbia Photo Bureau

DESIGN/PRODUCTION

Melanie Conty

CENTER ON JAPANESE
ECONOMY AND BUSINESS

Columbia Business School
321 Uris Hall
Mail Code 9155
3022 Broadway
New York, NY 10027
Phone: (212) 854-3976
Fax: (212) 678-6958
Email: cjeb@columbia.edu
<http://www.gsb.columbia.edu/japan>

2002年9月17日、コロンビアビジネススクールの日本経済経営研究所と日本ビジネス協会は代替(オルタナティブ)投資講演シリーズをスタートさせました。本講演シリーズでは、本研究所以代替投資プログラムのディレクターであるマーク・メイソン氏をモデレーターに、毎回ゲストスピーカーを迎え、プライベートエクイティ、ヘッジファンド、不動産、の3つの新しい投資形態の東アジアにおける可能性を考えていきます。シリーズ第一弾は、破綻した幸福銀行を買収、関西さわやか銀行として再生したウィルバー・ロス氏によって行われました。ロスチャイルド時代からパイアウトの王道を歩んできたロス氏は、ウィルバー・ロス & Co. LLC の会長として代替投資の第一線で活躍されています。

投資の日米比較

暴落する資産価値と株価

日米の投資を比較すると、以下の4つの重要な違いが上げられる。まず第一に資産価値と株価の暴落である。ダウ・ジョーンズ工業平均と日経225(平均)を比較すると(図1参照)、過去12年間、ダウが上り調子であったのに比べ、日経は下り調子である。資産価値の崩壊は日経だけにとどまらず、不動産価値は1983年レベルにまで落ち込んでいる。米国と違い、日本においては銀行が貸付先会社の株式に投資することは普通であり、銀行が従来保有してきた債務会社に対する株式の保有というかたちで外国人に投資の好機を提供している。

膨大な負債

第二に、日本企業は、米国企業に比べ負債資本比率が高い(図2参照)。1980年代後半より負債資本比率は減少を続けているが、今日でも、負債は資本の3倍のレベルである。米国では、3:1の負債資本比率はレバレッジド・パイアウト(LBO)におけるような高い負債比率である。日本においては銀行貸出が GDP に占める割合は90%と、米国における40%よりもかなり高くなっている。つまり、日本の銀行の日本経済に対する重要性というのは、米国の銀行の米国経済に対する重要性の2.5倍であり、金融問題も2.5倍経済にダメージを与えていると言える。

低金利

第三番目の相違点は、なぜこれまで日本経済崩壊が避けられてきたかの一つの説明でもあるが、日本では米国に比べ金利が非常に低い点である。日本政府が発行する10年満期国債の金利は、米国財務省発行のものよりかなり低い(図3参照)。低金利は、日本政府が債務を重ねるのを可能にしてきた。債務の元金を決して返済することのできない日本企業が利息を経営的に支払うことができるのも、低金利のお陰である。低金利は日本に投資してドルにヘッジバックしたい米国投資家にとって魅力的な要因となっている。

巨額の不良債権

第四に、不良債権が政府発表で40兆円まで膨らみ、金融機関、特に銀行が苦しい立場に置かれている。行く行くは不良債権の大部分が株式に転換される必要があり、企業の建て直しが計られなければならない。その意味で、現在の米国経済の不振を考慮しても、日本は世界のどこよりも、潜在的なプライベートエクイティ投資先として魅力があると言える(図4, 5参照)。

低迷する日本経済にこそ投資機会

日本企業の大半は IT(情報技術)の分野で欧米にかなりの遅れを取ってきた。また、これまで売上・成長・資産増加を目的とし収益性を最優先の目的にしてこなかったが、この2点に関し、近時変化が見られるようになった。株主利益率や収益性の重視に向けた変化において、プライベートエクイティ・コミュニティは大きな役割を担うことができる。すでに経営難に陥っている会社や倒産した会社は、抜本的な変化が必要との認識があるため、変化をもたらすのは比較的簡単だ。ウィルバー・ロス & Co. LLC が再生に乗り出した幸福銀行は、大阪に本社を置き京都と神戸にも支社があったが、不動産ローンを抱えすぎたの経営破綻となった。破綻後の買収となったため、収益を上げていない支店の閉店、人員削減ともにスムーズに行われた。関西さわやか銀行の人員は幸福銀行時より半減したが、清算の必要のある資産が多かったことから、削減された人員は清算会社側に職を得たため、混乱は最小限に抑えられた。経営建て直しのため、IT に投資をし、ATM(現金自動預け払い機)を24時間稼働させ、全国郵便局でもさわやか銀行のカードを使用できるようにした。また、アメリカ式の信用採点制度を導入し、中小企業及び個人に小規模の無担保貸付を開始した。2002年3月決算によると、幸福銀行破綻から1年で、株式に17.5%の利益を出し、融資も好調で、不良債権額は減少している。我が社は、日本でのパイアウトでは、シティバンクや GE などで職務経験のある、日本の大学卒でアメリカでの教育も受けている日本人のみを雇い、アメリカ人を経営陣に送り込むことはしない。日本でのプライベート・エクイティ成功の秘訣は、どこを建て直すか見極めること、そして日本のシステムで無理なく働けるという意味で十分日本的でありながら、変革の必要性を理解し、強い意志を持った西洋的な日本人をリクルートすることである。根本的には、日米の経営の一番良いところをブレンドさせ、グローバルなコンセプトの経営を目指して行くことだ。