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The Human Resources Market
for
The Financial Services Business in Japan - 3
(English Version)

~ Demand dramatically expanding for talented people ~

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Preface

Finally, the decade-long and nation-wide problems of overly capitalized investments, growing unemployment and excessive debts in Japan have basically been solved, and the Japanese economy has begun to recover steadily. Japanese mega-banks are now shifting their management focus to the profitability of the profit and loss accounts from the soundness of the balance sheets. Reflecting these changes, the Japanese equity market has grown by about 40 % during 2005. As such, last year was a turning point for the Japanese economy after undergoing ten years of financial struggle. Under this situation, the Human Resources market for the financial services business has expanded explosively, changing dramatically both in quantity and quality.

This REPORT is written as a series of HR market reports, which began in 1994 when the writer joined his former company, Heads Japan. This REPORT is the third version at his new company, Executive Search Partners (ESP).

The REPORT describes the financial services industry in Japan from a human resources perspective for the latter half of last year.

Summary of the Report

The summary of this REPORT is as follows.

(1) The Japanese financial services industry has been taken over by the three mega-banks as an Oligopoly. Japanese banks unburdened by excessive bad loans are well regarded and trusted in this market, and in fact, the three mega-banks has been flooded with huge influx of customer business. Therefore, demand for people at the three mega-banks and their affiliated securities firms was extremely strong. At the same time, we saw a difference among the three mega-banks in their hiring policies in line with the reform strategy of each bank.

Meanwhile, we did not see same positive outlook for foreign financial institutions in general as we saw in 1990s. In those days, most foreign firms hired many professionals in most areas including trading, sales, fixed incomes, and investment banking, thus earned a great deal of profits. However, we now see a big difference between major U.S. investment banks and the other financial institutions in operating their Tokyo offices. The top-tier investment banks are still very active and are producing huge profits, and the rest are struggling to survive, and some of them decided to leave the Japanese market. However, under the changing market environment,

even top-tier investment banks are also forced to change strategy and focus on their particular strengths in business. For example, a U.S. investment bank does not expect much from customer business now, and concentrates on principal investment by investing its own capital in targeted assets such as golf courses and resorts. The firm still earns a huge profit in the business.

It is widely recognized that only top ten to fifteen foreign financial institutions could survive in this market.

(2) Dramatically expanding M&A

As we saw in the media, major hostile takeover battles took place in 2005. As such, M&A transactions by Japanese corporations expanded reflecting the steady recovery of the Japanese economy. We will see the same trend in 2006 since capital cost management policy will be adopted more by Japanese corporations under the new corporate law taking effect on May 1, 2006. Demand for people in this business was for those who had capabilities to propose valuable ideas on customers' M&A strategy and in-depth knowledge of various types of financings as well as an extensive network of investment funds with which to cooperate.

(3) Fund Capitalism

Fund investment expanded reflecting excessive liquidity on a global basis. The market has named it "Fund Capitalism." This business also showed a strong demand for professionals. The investment business includes buy-out funds and hedge funds as alternative to conventional asset management.

(4) Structured Finance and Credit Risks

When bankers are engaged in M&A, fund investment, and asset finance, they provide financings aiming to improve investment return. Financing for those transactions comes in the form of loans or through securities underwritings, by taking high credit risks. In need were bankers who can analyze and handle high credit risks involved in such transactions. The credit derivatives business (credit default swaps) also recovered.

(5) Others

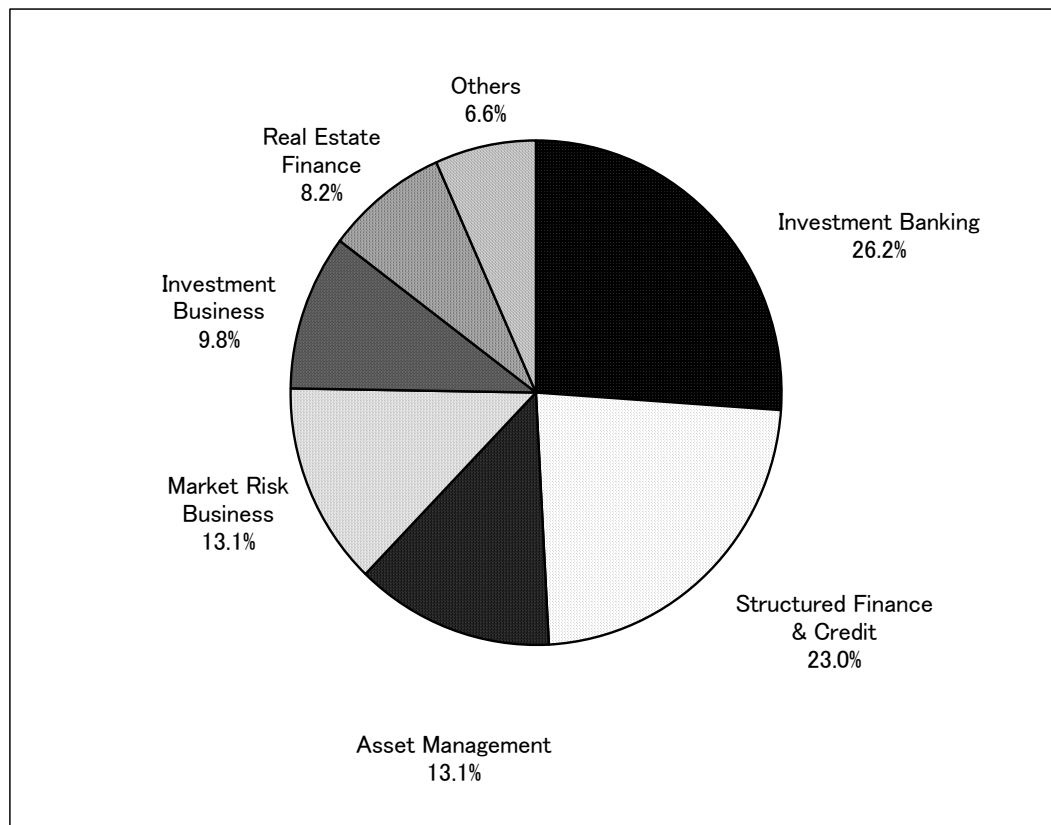
Since the Japanese financial services business recovered, there was a good demand for talented people even at the traditional fixed incomes/derivatives business and wealth management.

Chapter I Analysis by Financial Product

The chart below shows the number of assignments to ESP as of the end of December 2005.

Assignments of ESP (As of December 31, 2005)

<i>Business</i>	<i>Number</i>	<i>%</i>	<i>Products</i>
Investment Banking	16	26.2	Coverage, M&A, underwriting, IPO
Structured Finance & Credit	14	23.0	Structured finance (ABS), M&A finance, high yield finance (mezzanine), PFI, syndicated loan, credit derivatives (CDS)
Asset Management	8	13.1	Alternatives, hedge fund, asset management, mutual fund
Market Risk Business	8	13.1	Derivatives, structured bond, JGB, FX
Investment Business	6	9.8	Buyout, fund or principal investment, VC
Real Estate Finance	5	8.2	Real estate investment, securitization, execution. private fund, REIT
Others	4	6.6	Equity, research, operation, others
Total	61	100.0	



1. Investment Banking Business

(Overview)

The Japanese capital market was very active in 2005, and the year was named “The Opening Year of the M&A Era,” reflecting the strong recovery of the financial positions of Japanese corporations. Significant events seen in the market were the takeover battles between Livedoor Co. and Fuji TV to acquire Nippon Broadcasting System, Inc., and the Rakuten Inc.’s merger bid for Tokyo Broadcasting System, Inc. (TBS). These events urged many listed companies to take measures to protect themselves from hostile takeovers. This situation kept many foreign investment banks and Japanese securities firms busy in providing advisory services for their corporate customers’ self-defense. It also created a great deal of demand for talented people. What were required for candidates working in this area were not only expertise in this business, but also a strong sense of mission and the will to protect corporate clients from hostile takeovers, by enhancing corporate value. In early 2006, the Livedoor scandal was revealed. Executives of the firm allegedly manipulated the stock market by using illegal capital transaction schemes to artificially inflate the firm’s level of capitalization. They reportedly took advantage of loopholes in the securities laws. We expect the government authorities to take prompt measures necessary to fix the system.

M&A

M&A transactions increased significantly in 2005. According to Thomson Financials’ statistics, the total value of M&As completed stood at 20 trillion yen on a public basis (this includes the merger of Mitsubishi-Tokyo and UFJ Group), a 109% increase from the previous year. The number of transactions was 2,552 on a public basis, a 23.3% increase from a year earlier. The Japanese M&As ranked no.3 on a global basis in terms of value, following the U.S. and U.K., and ranked no.2, next to the U.S. in terms of number of transactions. However, the value of Japanese M&As accounted for only 4 % of Japan’s GDP, as compared to the M&As accounting for 10% of the U.S. and 23% of U.K. GDP. Therefore, we believe the M&A in this market has more room to expand. Such strong demand for professionals in the M&A business was reflected to that largest number of assignments to our firm (as seen in the chart).

(Demand for people)

The significant aspects and details in demand for people are as follows.

- ① M&A involving investment funds expanded, standing at approximately 2 trillion

yen in 2005, which accounted for about 10% of all M&A transactions. Number of transactions grew to 358, up 21% from a year earlier. In particular, MBOs were pursued with fund support in many cases: in some MBOs, funds lead the buy-outs. Therefore, candidate requirements for M&As included an extensive network of funds to cooperate with. In return, the candidate requirements for fund investment included having a strong network with M&A professionals. M&As and the fund investment business were interdependent.

The details of fund investment business will be reported later in this REPORT.

② M&A deals offered together with financing increased, as were deals supported by investment funds. There are various methods used for acquisition, such as the use of cash on hand, acquisition funds procured by bank borrowing, issuance of debts and equities, and through the creation of a holding company over the two operations. M&A bankers tend to offer financing arrangements since simply arranging M&As does not generate sufficient fees for them. Financing includes buy-out finance, mezzanine loans, MSCB, DCM, and ECM. Japanese banks provide simple financing while foreign investment banks offer sophisticated schemes. Both domestic and foreign banks earned handsome profits from this business.

The financing details will be reported later.

In addition to offering financings, some foreign investment banks encouraged other departments within the bank such as the fixed incomes/derivatives department to cooperate with the M&A department to obtain more profit opportunities. They were well aware that M&A is not profitable without offering combined products such as derivatives. They believed such a strategy follows customer needs as well. It must be pointed out, however, that they have to conduct the business carefully avoiding any conflict of interest issues.

③ As we will explain in the Chapter II, currently almost of Japanese financial businesses are given to the Japanese mega-banks, and dramatically increasing number of Japanese M&A deals are first brought to the front desks of Japanese banks. These opportunities range from big to small. They are separately handled by the bank or the securities firm within the group depending on the size of transactions. The basic rule is that M&A deals with the potential to earn more than 20-30 million yen in revenues are handled by securities firms, while smaller ones remain at banks. One of the reasons why many M&A opportunities flow to mega-bank groups but not to foreign

firms is that major foreign investment banks will not take M&A opportunities from which they cannot expect fees of more than 1-1.5 million US dollars.

Among the top ten M&A firms on a transaction disclosed basis, six were foreign investment banks, two were mega-bank groups' securities firms, and another was Nomura Securities. Number of M&A transactions completed by three mega-bank groups' securities firms was three times larger than that of foreign investment banks. However, total value of deals completed by the mega-bank groups' securities firms amounted to only 80% of total value of M&A transactions completed by the foreign investment banks. This clearly indicates that foreign investment banks focus on big deals. In addition, some market players pointed out that the mega-bank groups' numbers were actually much larger than the reported, since the figures only reflected the transactions on a disclosed basis.

④ Market sources have pointed out that the focus of M&As in 2006 will be shifted from “ restructuring troubled companies ” to “ strategic selection and concentration .” This change reflects improving financial conditions of Japanese corporations so that they can afford to allocate more resources to pursue strategic investments. The implementation of the new Japanese corporate law taking effect on May 1 will accelerate this trend. Therefore, hiring of professionals will target those who can make valuable proposals to customers according to the prospect' s specific capital strategy as well as financial restructuring.

However, some in the market are skeptical of the view that M&As in 2006 will increase dramatically. They pointed out that the traditional Japanese corporate culture still effective in this market will be a firm obstacle to the increase of M&A deals, for a couple of reasons. For one, Japanese corporations are not truly convinced of this new capital cost strategy, and are unlikely to sell non-core subsidiaries and divisions as long as they generate profits. Capital efficiency is not the first priority for the Japanese firms. Also, executives at Japanese corporations still believe human resources are the most important asset for a company, viewed almost like family, and that they should not be sold to other firms. We share the same view with the above concerns.

⑤ Most financial institutions engaged in M&A business, either foreign firms or Japanese, have announced that they will not support hostile takeovers but rather would support defensive M&As. They believe hostile takeover attempts will not succeed as

have been seen both in the U.S. M&A business and in the case of the Rakuten Inc.'s bid for TBS. Here we believe that acquisitions should focus on and secure corporate value (knowledge value) of the targeted company if their goal is to expand business through acquisition, and that acquisitions should not be driven purely by desires for shares or financial assets. Even if more than 51% of shares of a targeted company have been purchased, particularly at software and high-tech firms, this does not necessarily mean total corporate value has been acquired. The real value of a corporation is largely owned by employees in those businesses. The acquisition of more than half of the shares cannot buy the mind of people.

As Peter F. Drucker has said, the core value of a corporation in today's knowledge society is its human resources. Today's capitalism is very different from the traditional "industry-led capitalism," where the chemical and heavy industries lead the economy. Therefore, management now has to pay more attention to the value of human resources. Failures in recent takeover attempts indicated that the top executives of the acquiring companies did not understand the essence of this post-modern view of corporate value. According to statistics, the corporate value of no more than 50% of U.S. companies merged with other companies had increased after the merger. We believe this indicates the inherent difficulty of M&A transactions, and M&A professionals have to take this into serious consideration.

⑥ Japanese mega-banks now plan to expand M&A activity at their overseas offices. They are seeking to hire foreign M&A professionals with excellent track records for cross-boarder M&As. What we would point out here is about the market's assessment on the M&A business of Japanese financial institutions and their systems. To be frank, the market rates it very low. Denying his interest in the M&A position at a Japanese firm, a top-level foreign professional commented to us, "Japanese financial institutions have neither the capability to conduct global M&As nor have any philosophy and commitment necessary to pursue M&A and investment banking. Japanese financial institutions are just pursuing mandate-hunting for deals. Working at a Japanese firm would hurt my professional career." Managements of Japanese financial institutions must listen closely to this comment.

⑦ As for compensation for M&A professionals, we understand that M&A deals at either foreign or Japanese firms are pursued by a team, not by a player. In fact, we saw most recent M&A deals concluded, not by individual super-stars, but through brand

names and general capabilities of the M&A firms. Therefore, compensation of players in M&A tends to be determined by quality assessment. In other words, basic salary and bonus of players are determined generally by his or her seniority in the group. This trend was particularly evident at Japanese financial institutions.

General Coverage and Underwriting

Japanese corporations have suffered from serious financial problems for many years, and have undergone severe blood-shedding through debt-restructuring. As a result, they now have huge amounts of cash on their balance sheets. At this time, the excessive cash possession is regarded as evidence of poor management of their assets and capital, and firms have become targets of takeover bids by activist funds. Therefore, cash-rich corporations seek advice and support of Japanese or foreign investment banks, to protect from hostile takeovers or to learn about a proper capital policy. In fact, demand for coverage bankers for these jobs rose largely at Japanese mega-banks in 2005, rather than at foreign investment banks. Japanese mega-banks took advantage of their close relations with corporations, showing that the traditional Japanese banking system is still effective. As a matter of fact, a recent market survey confirmed that “main banks” were expected to take such roles for possible takeovers. Therefore, banks had a great deal of demand for professionals possessing experience in capital policy advisory. As for the securities underwriting business, market professionals said that demand for financing would be for debt finance rather than for equity finance in 2006, as corporations, in general, would need to raise their debt ratio. As a matter of fact, the total value of equity finance deals in 2005 was 4-5 trillion yen, a 25% decrease from a year earlier. The demand for people would reflect this trend in 2006.

In 2005, 158 IPOs were completed, down seventeen from the previous year. Total value of these issues stood at 763.1 billion yen, a 44% down from a year earlier. The listings were handled by 25 securities firms, including internet securities firms. Some of these internet firms did not conduct appropriate screening for the issuers' eligibility, and created a bad image for their IPO business. Therefore, their hirings were not successful. Another reason for their problem in hiring was that market players did not consider IPO underwriting for a business of internet securities firms, even for small deals, and that the focus of internet securities firms should remain with day-trading.

2. Investment Business

Investment Business in this analysis includes such areas as distressed business, corporate turn-around funds, regional reconstruction funds, real estate investment funds (private and public), orthodox private equity funds, general buy-out funds, activist funds, principal investment by securities firms, and venture capital funds. Those are the businesses that invest funds in targeted companies and assets according to their own philosophy, restructure balance sheets, improve cash-flows, introduce new business models, and collect invested funds by selling-out.

(Overview)

Investment business grew under the affluence of money both in global and domestic markets amid scarce investment opportunities. In addition, this business was driven by the fact that financial institutions, particularly foreign investment banks, did not secure enough profits through the M&A advisory and fixed incomes/derivatives businesses as they had enjoyed previously. They had no other choice but to take risks investing their own capital.

Following is an analysis on the investment business by investment style and the demand for people.

Distressed Business

Distressed business did not have demand for people. Some major foreign investment banks once created huge profits in this business, and profitable traders of distressed assets were paid a big bonus. Just about one year ago, the writer suggested a young trader to prepare for his next career step since Japan's bad-loan problem would be solved sooner or later. He did not listen to the suggestion, arguing he would continue trading as long as it makes money. Then, he was forced to leave the firm due to his poor performance. The writer wonders where he now works.

Turn-around Business

Turn-around business's time has also basically come to pass. The Industrial Revitalization Corporation, a government-support entity and a symbol of revitalization funds, will be disbanded one year earlier than originally scheduled. The Corporation had selected 41 troubled companies by the end of March 2005 and decided to invest in them approximately 1 trillion yen. The Corporation will reportedly register profits. To be frank, we are not sure at this moment that they have fulfilled their mission. The Corporation originally planned to invest 10 trillion yen provided

by the government, and the market initially expected the entity to play a significant role in revitalizing many troubled businesses throughout Japan. However, the government now argues that the Corporation will cease its operation earlier than originally scheduled, because there are no more major bankruptcy concerns, particularly among big firms. However, we see there are still so many troubled middle-sized and small companies in the market experiencing difficulties. The Corporation had dealt with only big firms, and Japanese banks are said to be still struggling with a huge number of small troubled companies behind the scenes.. As a whole, demand for people in this business declined.

Private Equity

It is said there are approximately 50 “active” buy-out funds, either domestic or foreign, excluding real estate funds and venture capitals. Our analysis here focuses on the “orthodox” private equity and the so-called “independent” buy-out funds. The inception of full-fledged private equity fund activities goes back to around 2000 when The Carlyle Group opened its Tokyo office. In the beginning, they faced difficulty in finding investment opportunities and were struggling, but recently, most of these funds have found a good number of investments. But each fund operates at a different pace. One fund has established its fourth fund, and another fund has not withdrawn all of its first fund yet. The size of each fund is usually 50-100 billion yen. According to statistics, private equity funds invested 1.4 trillion yen in 2004 and 1.2 trillion yen in 2005 (Jan.-Oct.). Some funds have moved to the “exit” stage and sold investments to other funds or succeeded in IPO. Those “exits” amounted to 200 billion yen in 2004 and 300 billion yen in 2005 (during the same period as above). This trend will continue in 2006.

However, competition is intensifying and earning a good profit is becoming more difficult in this business. The keys for these funds’ success are to secure : ① the capability to find investment opportunities, ② the capability to manage the companies invested in through hands-on efforts, ③ the capability to improve the business through restructuring and to strengthen the business model by introducing new business opportunities, etc., ④ the capability to lead to “exits” by selling-out or IPO. In other words, the success of private equity rests heavily on the capabilities of key players. With competition intensifying in the private equity business, a reputed player commented that probably 70% of the 50 to 100 funds currently in operation would leave the market within a few years.

(Demand for people)

As reported earlier, buy-out funds in general have operated successfully so far. Some funds have successfully sold out investments to other funds or have completed IPOs, and hiring needs have generally been fulfilled. But we do not believe the Japanese private equity industry has met the expectation of the market. The amount of investment by private equity funds is only about 1 trillion yen annually. This figure is too small relative to the Japan's GDP, comparing to the figures of major countries in terms of private equity investments relative to their GDPs. It is understandable that private equity management firms pursue this business trying to maximize their investment return for investors. But we would feel disappointed if they do not prioritize playing a social role driving recovery and growth of the Japanese economy as well. Some investment funds such as KKR plans to invest in the Japanese market. We expect them to take aggressive stance in investment, by not simply calculating investment returns but by playing social roles and producing more HR needs.

The most important strategy for private equity in Japan is to strengthen sourcing capability. Therefore, the targets for hiring were those who have a strong network of possible investment targets as well as with M&A professionals at investment banks and mega-banks for sourcing purposes. Private equity investment managers are expected to find investment opportunities through his or her personal relations, avoiding competition with outside bidders at auction. Another important qualification required for them is communication skills they use to negotiate with the invested company's managements after acquisition. They have to propose drastic restructuring plans on finance, HR management, and business strategy, and to convince managements and employees to accept these changes. The big difference can be seen in capabilities and personalities between those who joined from M&A business and those who were originally private equity professionals. M&A professionals are often hired for their strong sourcing capability, but we have sometimes seen former M&A professionals causing confusion to the invested companies due to their straight-forward negotiation style. Therefore, proper candidates for private equity had to possess both capabilities required at M&A and private equity.

Only strong demand for people was for young execution staff. Their jobs include due-diligence (in accounting, tax, law, HR), cash-flow projection, valuation of the firm or its assets, restructuring its financial positions, etc. What we often saw

at recent private equity firms, and understand it as a reason for the rather strong hiring need for young staff, was their frequent leaves for other opportunities. We believe such high turnover by young staff reflected recent changes of young bankers' career strategy.

Principal Investment

Some major Japanese securities firms and foreign investment banks actively invested, using their own money i.e. principal. Principal investment is pursued given more flexibility in investment decisions than fund investment, since fund investment is operated with strict conditions given by investors. Principal investments do not have to invest if no attractive investment opportunities are available. However, investment with own money has to be made in consideration of the ROA and ROE requirements for securities firms. Therefore, principal investments tend to invest in opportunities with high risks/high return, or those that have to sell out investments in short period. Therefore, those firms frequently appeared in the media in acquisition battles. Such investments by securities firms should be regarded trading rather than investment. There is a good deal of demand for the experienced people in principal investment, but it is not easy for job applicants to succeed since the firms are very selective in hiring. They, in general, prefer faster-paced people compared with the orthodox private equity.

M&A Support Funds and Anti-TOB Funds

Several financial institutions such as Japanese mega-banks, trust funds, and insurers established funds to support M&As. The funds are to support customers' acquisition plans or to protect them from hostile TOBs. But Japanese financial institutions in most cases moved internal commercial bankers to these jobs. Therefore, although the size of the fund is quite large, we are skeptical that they can make a big impact on the market.

Activist Funds

PBR below 1 is said to represent poor management. About 30% of Japanese listed companies registered this figures in early 2005, and over 300 companies were still in the category at the end of last year. To them, activist funds suddenly became shareholders and requested to pay out excess cash and securities investments on the balance sheets, claiming that those were inefficient investments. This action could be highly appreciated in light of improvement of Japanese corporate management and

globalization of the Japanese capital markets. However, these proposals do not necessarily boost corporate value. To the contrary, pay-outs of cash as dividends could be regarded as a decrease in corporate value of the invested company. If activist funds work only to make money for themselves, they would lose social support in the market.

As we explained above, numbers of young staff at orthodox private equity management firms left their firms. Since the private equity business usually takes five to seven years from investment to exit, young execution staff are not patient enough to be engaged in a particular invested firm for such a long term. Some of them wanted to move to activist funds, which they believe pursue shorter cycle of investment. In other words, the retention cycle for young bankers is becoming short under this rapidly changing environment in the financial services business. However, the writer does not believe that such short term engagement will help them develop their professional capabilities. As for the types of activist funds, market players prefer to join “friendly” funds rather than “hostile takeover” funds. As for demand for people, activist funds are looking to hire talented people.

Venture Capital

Venture capital, which had suffered destructive damage from the collapse of IT bubble a few years ago, was recovering and seeking to hire talented people. But both of venture capital firms and capitalists shifted their investment focus to buy-outs.

Real Estate Investment Funds

Bulk sale of banks’ distressed assets started in 1997 in Japan. Foreign investment banks and overseas investment funds had purchased a huge value of distressed assets from Japanese banks in financial struggle at very low prices (almost 10% of face value). They either sold them to other investors or collected them to earn huge profits. In most cases, distressed assets contain real estates as collateral. Starting with such distressed business, major foreign investment banks expanded to the real estate business bringing in overseas real estate funds.

Meanwhile, in the middle of 1990s Japanese independent real estate management firms were created, in most cases to engage in due-diligence, serving overseas funds. Then, they established their own domestic real estate funds. Since then, they have expanded quite successfully and dramatically. In most cases in the initial stage, their

business model was to purchase claims on the real estates of bankrupted borrowers, such as buying office buildings from banks. They applied their due-diligence capabilities and DCF methods to assess the fair value, which methods had been introduced from the U. S. market. They provided remodeling of office buildings, and sold them to other investors. However, since such a simple business has become less profitable these days, they are trying to create more value-adding investment businesses, such as developing of large scale real estate projects and providing professional operating services to manage real estates such as hotels or office buildings under their management.

In fact, performance of real estate fund management firms still keeps growing and executives of these management firms express optimistic views on their future performance as well.

On the other hand, Japanese mega-banks have almost disposed of their bad-loans, and real estate investment opportunities given by the banks have significantly decreased, and in addition, official land prices in 23 wards of Tokyo have begun to rise for the first time in 15 years. These reflected both improving financial positions of Japanese corporations and aggressive investment in the real estates with the huge money flowing into the market reflecting excessive liquidity both from domestic and overseas markets. Therefore, investment opportunities with good returns are becoming unavailable. Moreover, in most cases investors have to join auctions and compete by bidding. For example, the cap-rates for investment in good office buildings in the central Tokyo at auctions, have declined to 3% level, by which is said very difficult to earn profits.

Since competition is becoming intense to push real estate prices surge, some market players are concerned that the current real estate business would be in “bubble.”

However, the writer does not support the view of a real estate “bubble” because the value of real estate in Japan is still on the downward trend as a whole. And the areas regarded as in a bubble state are limited to major cities of Tokyo, Osaka and Nagoya. It is too early to conclude that the Japanese real estate business is in bubble. Under the paltry 2% economic growth of Japan, if real estate prices and rents of office buildings go up at particular areas in economic expansion, the value of other assets and in other areas must be falling down. Therefore, in order to secure stable expansion in the real estate business, the industry needs to develop value-creating business to support dynamic economic growth.

However, as a whole, the Japanese real estate investment business is still expanding, solving the problems and changing their business focus. The outstanding balance of private real estate investment funds stood at 3.3 trillion yen and public funds of J-REIT at 2.6 trillion yen as of the end of 2005. This growing trend will continue and total balance of both Japanese and foreign real estate investment funds is said to grow to more than 10 trillion yen by the end of 2006.

(Demand for people)

Under the industry environment as above explained, some real estate investment funds seek to join projects from the start. They seek to develop shopping malls or commercial facilities in front of large train stations, and offer proposals of unique financing schemes such as innovative securitization and low cost finance. Some foreign funds specialize in investment in distribution facilities such as warehouses, and offer their expertise. Some funds provide professional property-management services to the invested office buildings to improve efficiency in operation. Others focus on their strong areas such as hotels, resorts, and leisure facilities like skiing resorts or golf courses. The operation of those funds requires specific expertise and needs to hire such professionals. If the industry cannot secure those professionals and produce new value, the real estate investment business will face a real “bubble.”

Non-recourse loans for real estate investment are provided aggressively by Japanese trust banks, mega-banks, foreign banks, Japanese and foreign securities firms as major lenders. The loans by major Japanese banks currently stand at as large as 4 trillion yen, and regional banks are also expanding the loans. Therefore, there is still strong demand, particularly from Japanese banks, for people experienced in the sourcing and execution of real estate non-recourse loans.

One of the “exit” strategies for real estate investment is sale to domestic financial institutions, pension funds, and overseas investors. Those investors are increasing investment in real estate opportunities as alternative investment. Demand for professionals for this business was steady. Some overseas investors expanded investment in the Japanese real estates to seek higher returns as they were disappointed with declining returns in their domestic real estate holdings. Some investors sought for a modest yet stable return as well. Therefore, some Japanese private real estate funds and J-REITs targeted such overseas investors to sell their

products, and had demand for marketing staff.

3. Asset Management Business

Conventional Asset Management

(Overview)

Conventional Asset Management, which is engaged in fund investment targeting market benchmarks such as TOPIX, seems to have hit the bottom and been turning around. The recovery has been seen both at investment trusts, and investment management contracts for institutional investors.

For investment trusts, we confirmed the recovering trend, seeing that the outstanding balance of listed equity investment trusts stood at 34.8 trillion yen, as high as at the last peak in May 1991. Adding 10.8 trillion yen of listed bond investment trusts, total balance of listed investment trusts rose to 45.6 trillion yen (another statistic indicates the figure rose to 55.3 trillion yen as of the end of December, close to the industry target of 60 trillion yen). In addition, private investment trusts achieved an historical high balance of 22.1 trillion yen.

However, some pointed out the investment trusts should expand further since the outstanding was still very low compared with the U.S. mutual funds. They also pointed out that the increase in the outstanding was attributable chiefly to the growth of particular investment trust, “Global Sovereign Open,” with an outstanding balance of about 4 trillion yen, and that the popular funds such as BRICs funds were mostly foreign bond types (foreign bond investment trusts are in the category of equity investment funds in Japan). They pay dividends to investors on a monthly basis, which attracts elderly investors. However, ordinary Japanese equity investment trusts did not grow as much as foreign asset funds.

Expansion of Japanese 401(k) is required for further growth of investment trusts. Japanese 401(k) was introduced in October 2001, but has not expanded as originally expected. Number of 401(k) contracts for corporate employees grew constantly and has reached to over 1.5 million, but the number for independent individuals is still only around 50,000. This overall slow growth is attributable to several factors, chiefly to the lack of advantages such as low limits of premium to be paid by individuals. Another driver for the growth of 401(k) will be the continuing recovery in the Japanese equity market.

As for the investment management contracts for institutional investors, the outstanding balance of 125 contracts with authorized discretionary investment agreements stood at 124.2 trillion yen as of the end of September 2005 thanks to surging stock prices. That balance was the historical high having increased by 16.3 trillion yen (up 15.1%) from the end of March. Particularly, money from overseas increased by 29.4 % from the end of March.

(Demand for people)

Even though conventional asset management business, both at investment trusts and investment management contracts, has been recovering as explained above, demand for people remained weak. One of the reasons for that was that the increase in the balance was basically attributable to the rise in stock prices. And, most of new investment management contracts had been given to passive style management firms. Therefore, the increase in the outstanding balance under the investment management contracts did not generate a good demand for people. As for demand for people in investment trusts, banks, which sold more than half of all investment trusts at their windows, procured the staff internally and did not hire from outside sources.

However, the basic reason for the weak demand for people was that Japanese asset management firms had not conducted drastic job cuts when they were in troubled times three to four years ago, and therefore still held hidden unemployment within their offices.

As explained in this report, though we saw strong demand for people for most financial businesses, we did not see this to be the case for the conventional asset management.

Alternative Investment

Alternative Investment, adopting alternative investment methods are now attracting investors' attention in this market. These include hedge funds, real estates, commodities, and private equity. Here we analyze hedge funds and their demand for people.

(Overview)

Total value of hedge funds in the world market rose to 1.2 trillion dollars at the end of last year. But, this figure accounted for less than only 1 percent of total value of all financial assets in the global market. However, the influence of hedge funds should be regarded as significant, since the funds usually use leverage through

borrowing and take strategic actions. There are various hedge fund styles such as global macro, market neutral, long/short, CB arbitrage, event driven, distressed securities, etc. In addition, there is fund of funds investment, which invests in other funds diversifying investments designed to minimize risks. Performance results differ according to the styles and market conditions.

Now there are 12,000 hedge funds in the world and 15,000 hedge fund management companies registered at SEC in the U.S. As the number and the volume of hedge funds continued growing, the performance results in the business as a whole declined. Actually, the average performance result of hedge funds (HFRX Index) is currently as low as 3% level, and there are not many funds which achieved over 10% returns. According to industry sources, about 500 funds are performing well but among them only 10% could be rated successful.

Under the above environment, hedge fund investments by Japanese investors expanded. The outstanding balance of hedge fund investments by Japanese investors stood at about 8 trillion yen, among which life insurers was the biggest investor, investing about 1.6 trillion yen. Investments by banks such as mega-banks, trust banks, regional banks, and shinkin banks (small local banks) amounted to about some 6 trillion yen. However, compared with securities investment by Japanese banks whose outstanding balance was as huge as approximately 100 trillion yen, hedge fund investment was very small. (The ratio of securities investments against total deposits of banks is about 25% at present, and most of the securities invested are Japanese government bonds). Under the current environment where the risk of investment in Japanese government bonds is clear as interest rates are expected to rise sooner or later, there would be much interest in alternative investments. In fact, Japanese banks purchased hedge funds aggressively (most of them are fund of funds). This trend was a reason why the year of 2005 was called as “the first year of Japanese banks’ investing based on their own decisions.”

(Demand for people)

Under the current environment as above explained, banks sought to hire fund managers to invest in hedge funds i. e. fund of funds. The hiring need was for “gate-keepers.” They travel to New York, London and Hong Kong to find such excellent fund managers as could be called “Ichiro” in the fund management business. Therefore, gate-keepers must have excellent selection capability for excellent fund managers and funds. However, since there were only a few truly professional gate-keepers among the

Japanese, Japanese banks had to accept semi-professionals. Banks also had hiring needs for professional staff in risk management and operation of the hedge fund business, but banks could not hire good ones. Basic reasons for the Japanese banks' failures to secure professionals for these businesses was not only the scarcity of such professionals in the market but the banks' out-dated hiring policy. Japanese banks are reluctant to delegate the authorities to the hired officials and pay fair compensation. Banks argued that the job of fund of funds investment was simply to invest in funds invested and managed by outside professionals. Banks do not see any specific expertise necessary to conduct the investment. This stance represents management philosophy of Japanese banks: they little appreciate professionalism in business.

Some U.S. and European hedge funds opened Tokyo offices to invest in Japanese equities and tried to hire professionals. This move would be a reflection of the recovering trust of overseas investors in Japanese equities. Therefore, there was a good deal of demand for professionals for this investment. On the other hand, many professional Japanese equity traders and fund managers tried to seek jobs at top-tier overseas hedge funds. However, few obtained the jobs because most applicants did not have successful track records for hedge funds investment.

Some traders established their own hedge fund management firms and tried to raise funds. They had good track records having developed their own unique investment methods and quantitative investment models. Though some succeeded, most of them faced the difficulty to raise funds, even seed-money. It seems that the market did not regard good performance achieved at his major financial institution as the player's own track record, commensurate to a new, outside position. The market regarded it as his team's record. However, around the end of the year, the market environment for hedge fund players changed, and funds were becoming available to good fund managers, reflecting the affluence of money in the market. In addition, we saw new businesses emerging related to hedge funds, such as those who provide various infrastructures to newly established hedge funds, like "prime brokers" and "administration managers." As such various problems being solved, hedge fund business grew in this market. We would like to see more professional Japanese hedge fund managers playing in the global market.

Major overseas hedge funds strengthened their marketing/sales capability in Japan.

They sold their products through their tie-ups with foreign financial institutions in Japan or through their own Tokyo offices. There were hiring needs at both institutions.

Demand was for structurers who create investment trusts to follow the Japanese regulations and to minimize the risks involved with the products, by providing sophisticated guaranty schemes to secure par-value of trusts (fund derivatives, etc.).

Demand was also for marketers who have an extensive customer network with financial institutions, and have in-depth knowledge of hedge fund schemes such as fund-derivatives. The hedge fund marketers are also required to explain the risks involved in the funds, particularly when they sell to Japanese banks and securities firms for their retail customers (particularly to the wealthy people). They have to help the distributors understand on the products. We also saw some consulting firms looking to hire professionals who cover pension funds. They provide services to help them with selection of funds, evaluation of performance, and risk analysis.

As for the Basel II regulations, Japanese banks are set to apply the new regulations from the end of fiscal 2006, but the market was confused with the new rules particularly on banks' hedge fund investment. Some say the risk weight on hedge fund investment by banks will be 1,250% if the contents of the funds cannot be clearly analyzed, but others deny such understanding. Therefore, some regional banks were reluctant to increase the investments. The confusion created a negative impact, to some extent, on hiring needs for marketing staff of the product covering banks. Meanwhile, foreign investment banks created ideas and schemes to avoid Basel II regulations, aiming to help them buy more hedge funds. Such activities are unique to foreign investment banks, which tend to seek profit opportunities under any circumstances.

4. Credit Risk Business

(Overview)

Indirect financing (banking) as opposed to direct financing (securities business) has been overwhelming in Japan's financial services industry since the end of the last war. It was the MOF's strategy at that time to achieve the nation's objective to recover from the defeat in the war as quickly as possible, guiding commercial banks to provide funds concentrating on the core industries. In those days, banks were put in the center of the Japanese financial services industry in line with the MOF's strategy. In fact, when the writer was a young banker, commercial banks provided debts

to borrowers as de-facto equity finance, and were deeply involved in the management of companies. Therefore, bankers in those days were required to possess strong insight into what banks should finance for. However, since then competition among financial institutions had been intense due to the expansion of the Japanese economy and the deregulation policy pursued by the government, and that trend finally created the financial bubble. During that time commercial bankers lost their sense of mission as a banker, and became mean pawnbrokers who loan money against real estates put up as collaterals. They did not pay attention to the business itself of borrowers. On the other hand, securities people did not pursue their business thoughtfully saying that equities were simply risk money. They did not conduct earnest analysis on corporate value versus stock prices, and traded and underwrote shares only based on demand and supply conditions. Reflecting those stances in the market, the Nikkei Stock average grew to as high as 40,000 yen at the peak in 1989. But finally, the bubble collapsed and Japan experienced a “Lost Ten Years.”

(Demand for people)

Understanding on credit risks

The market clearly indicates that bankers who possess deep knowledge and professional experience in the credit risk business will play in the center of the financial services industry from now.

“Credit risk” is the most important factor when to analyze “corporate value.” The right side of balance sheet of corporation (debt and capital) constitutes senior debts, junior debts (subordinated loans or mezzanines), and capital. The risks involved in those financial instruments are ranked in a chain following the degree of risks and are correlative (as K·M·V analyzes). Therefore, the expected return of each instrument has to be calculated according to the degree of each risk being reviewed with correlation with other credit risks. However, traditional Japanese financing has handled these credit risks as independent to each other, and ignored the risk/return policy. In other words, Japanese banks have historically been taking only senior credit risks, avoiding high credit risks. Securities firms have handled equities as lump of risks. However, there must be a part in the balance sheet standing between the two instruments in terms of degree of credit risk. Now, the market is paying more attention to higher credit risks and seeks for relating new business opportunities.

Furthermore, it is well known that credit risks are part of corporate value, and that

corporate value constitutes both treasury value and knowledge value. Treasury value is represented in the balance sheet and the profit and loss account. Knowledge value is abstract and is not shown on the balance sheet, but will be realized as treasury value in the future. Knowledge value is made of “formalized knowledge” such as patents or designs of new cars as well as “tacit knowledge” such as corporate culture and management. Therefore, handling credit risks without analyzing knowledge value of the borrowers makes no sense. We expect financial professionals who are engaged in credit risk business to extend understanding of the relation between corporate value and credit risks.

Challenging high credit risks

There was strong demand for professionals who can analyze and structure credit risks involved in a transaction. In fact, the technologies to structure credit risks are used for various financings, such as asset finance, real estate finance, business finance, and finance for M&A or private equity. The profile of ideal candidates will be explained in the section “Finance.”

Financing by Japanese banks (corporate lending) is aimed to obtain market share. They extend loans without applying interest rates commensurate to the degree of credit risks. As a result, the average interest rates at their loans have constantly been declining. On the other hand, major foreign investment banks in Japan have groups responsible to promote high yield finance for such opportunities as real estate business and structured finance. The groups, which are usually consisted of foreign professionals, seek to apply sophisticated analytical capabilities for high credit risk deals. However, Japanese banks compete against them offering very cheap financing, which frustrates foreign professionals. Japanese banks still seek to secure large profits in volume. It seems that Japanese banks are going down the same road as they did in the past, to develop huge amounts of bad loans again. Japan’s FSA is much concerned about the move and is considering taking a full-scale measure to inspect banks’ lending practices and portfolios. FSA is said to take it through the implementation of Basel II regulations. Then, Japanese banks would be forced to adopt appropriate risk/return credit policy.

Recently a major Japanese securities firm entered the credit risk business (it is not the trading of investment-grade corporate bonds). If the firm aims to establish the credit risk business as financing, we believe it too difficult for securities

people, because the high credit risk business is essentially different from the market risk business. The market risks such as bonds and foreign exchanges can quantify risks involved. However, credit risks basically cannot be quantified, and high credit risks are difficult to sell out in the market, particularly in the conditions where the quality of credit risks deteriorates. Also, expertise in the credit risk taking business can be obtained only through long struggles in lending as commercial banks have experienced with their bad loan problems. Securities firms should not enter the credit business unless they are ready to take on such troubles.

Trading credit risks

In the last several years the credit derivative market (CDS: credit default swap) has been rapidly expanding in the world market. The outstanding balance of credit derivatives on a notional basis stood at 12 trillion dollars as of the end of June 2005, grown by 2.3 times from a year earlier. ISDA rules for this product were in place. In the overseas markets, professionals in bond, CDS, and equity were trading their product referring to the other markets. In addition, some hedge fund managers frequently use CDSs, and the expanding synthetic CDOs use CDSs.

However, the market of CDSs for Japanese credits was small yet, accounting only for 1% of CDSs of the global market. This was because the Japanese CDS market had been moving in one direction, as Japanese financial institutions, the major players for this product, always sold CDSs in order to earn guarantee fees. These actions distorted the market. Foreign financial institutions blamed Japanese banks for destroying the Japanese credit risk market. However, just recently the credit market in Japan became active due to several factors such as the recovery of the Japanese equity market (money from financial institutions now flows to the recovering stock market), the GM shock, and the down-gradings of some corporate bonds such as at Sanyo Electrics. The credit risk spreads in CDSs and corporate bonds widened, and credit risk prices were becoming fair. Trading of high credit risk bonds also become more active, and investments in CDOs (synthetic and cash) and CLOs grew in the market.

Therefore, this business had a good demand for the experienced people. Candidates in need were traders of CDS (sought at both Japanese and foreign financial institutions), structurers of foreign CDOs (structuring of Japanese CDOs are still very difficult), traders of CDOs, as well as marketers of these products. Traders of bonds with BBB level credit ratings were also sought for. But staff for credit risk management at banks were procured internally.

Analysis on credit risks

Demand for analysts on credit risks increased. The needs were at rating agencies and foreign financial institutions. Experienced people for this analysis were very scarce some years ago and were not available to hire, however such professionals have now increased and have become available to some extent. Now in demand are quantitative credit analysts for various credit businesses.

As such, demand for people in credit risk business in general was strong, and it is predicted the business will continue to grow according to the improving financial environment in Japan (i.e. rising interest rates).

5. Finance

(Overview)

As reported above, when M&A and fund investment are proposed, debt financing is offered as well, in order to boost profits. At this time, capabilities to finance high credit risks are more in need. As such, demand for people in various finance businesses expanded.

(Demand for people)

MSCB (Moving Strike Convertible Bond)

MSCBs are used by weak credit firms. With this product, securities underwriters can secure at least 10% profit from a transaction even if stock price drops after the instruments have been issued. When underwriters use short-selling strategy along with this product, if appropriate, they can earn more profits. This product was introduced to this market by the revision of Commercial Code in late 1990s. Recently Lehman Brothers was said to have earned some 15 billion yen by providing this product to Livedoor Co. for its acquisition of Nippon Broadcasting System, Inc. Number of MSCB issues in 2005 totaled to 14, and total value amounted to 220 billion yen. In early of 2005 there was strong demand for marketing professionals of this product. However, the product turned out to be unpopular in the latter half of the year due to the dilution of equities for existing investors as well as the mass-media's negative coverage. Potential issuers became reluctant to issue, being concerned about market reputation. Therefore, demand for people declined.

However, rather small corporations continued to use this product, issuing a relatively small value of MSCB. Corporate marketing teams at investment banks which handled

relatively small listed corporate customers continued hiring marketers to promote this business. Such investment banks argued that they sold MSCBs to their affiliated overseas funds to manage them as a portfolio investment, and did not sell out to the market to gain profits immediately after underwriting.

LBO/MBO Finance

As reported above, we now see that M&A, fund investment and financing are leveraged in the same deal. Those are offered cooperatively, e.g. finance people are asked for support by investment funds to improve investment efficiency and by M&As to procure money necessary to complete big deals. In return, finance people approach investment funds and M&A bankers to seek more business opportunities. Financing for ordinary credits is offered by Japanese banks and trust banks, and finance for higher credit risks is proposed by foreign investment banks applying their highly analytical and trading capabilities. According to statistics, total value of LBO/MBO finance by the three mega-banks stood at 1.4 trillion yen, an increase by 0.2 trillion yen from the previous year. This trend will continue, as will the rise in demand for staff. Hiring needs will come both from mega-banks and foreign investment banks.

Asset Finance

Asset finance was very active being applied for various assets such as real estates, account receivables, consumer finances, and medical institutions' claims. When they provide financing, the arrangers usually establish SPCs, and invite equity investors for the equity portion and procure funds for the debt portion through non-recourse loans. Non-recourse loans are collectively structured to CMBSs for sale to investors. Trust schemes rather than SPCs are also often used.

Capabilities required for young staff were in valuation, assessment of real estate value as collateral, due-diligence, balance sheet analysis, cash-flow projection, credit protection schemes with various covenants as well as knowledge on laws, accounting, and taxes related to the execution business. Trust bank staff with the knowledge of the trust schemes were also in great demand. All of these areas of knowledge and experience were required in most financial services such as M&A, but one person was not necessarily expected to have all these capabilities.

Young staff in charge of execution were very busy and had to work all day long through the year, and were called "slaves" in the financial service industry. There was also strong demand for professionals in sales of CMBS and ABCP. The sales staff belong

to the fixed incomes sales department covering financial institutions in the central areas and regions.

Profitability in securitization for traditional assets such as receivables and consumer financing declined. Some financial institutions closed their operations for the business. In the meantime, securitization for new assets rose. These were for claims on medical services, pachinko game instruments, funeral services, and various soft assets such as movies, etc. Since the asset finance extends finances to the projects and not to the originators, the banker had to have capabilities to analyze business risks rather than corporate risks as a whole and collaterals. In other words, it is widely recognized that the securitization business would be profitable only when pursuing “business finance” targeting the business itself, rather than targeting the assets as “asset finance.” This move was seen both at foreign investment banks and Japanese banks.

Mezzanine and Subordinated Loans

Return has been falling in financing and securitization for real estate investment, MBO/LBO, and private equity. When SPCs are created for those businesses, they usually procure about 70% of funds through non-recourse loans. But these days they finance 75-85% through debts in order to raise equity return. They often use subordinated loans or mezzanine finance for the schemes. People who have expertise for these financings were in great need.

Required there were capabilities to analyze such high credit risks and to provide pricing for them. Such professionals are in great demand due to their extreme scarcity. We expect two routes for quality bankers to grow to become professionals in high credit risk finance: ① commercial bankers who have experienced only with senior credit risk finance but have deep thoughts on high credit risks, and want to upgrade their capability down to junior debt financing, and ② investment bankers who have experienced only with equity underwritings but have deep understanding on various equity financings, and want to expand their knowledge up to debt financing. Reflecting this market trend, some overseas funds came to Japan to provide mezzanine financing, and sought for staff. Japanese banks also established mezzanine funds and invested in other mezzanine funds. It is a clear trend that demand for people qualified in this business will grow.

Asset Backed Securities (ABS)

Non-recourse loans for real estate and various other assets are restructured to securities. The securities are sold to various investors such as pension funds. Total value of ABS issuance in 2005 stood at 6.2 trillion yen, which surpassed 6.1 trillion yen of corporate bonds. The increase was significant, up from about 4.0 trillion yen issuance in 2004. The outstanding balance of ABS was second only to that of Japanese government bonds.

The significant expansion of ABS was attributable to the increase in issuance of residential mortgage backed securities (RMBS). In 2005, RMBSs were issued by 2.9 trillion, which accounted for approximately 47% of all AMS issuances. The large amount of ABS issuances generated a great deal of demand for execution staff both at foreign financial institutions and large Japanese securities firms. Their jobs included cash-flow projection, restructuring cash-flows, making securities, and obtaining credit risk ratings.

6. Syndicated Loans

Mega-banks strategically expanded syndicated loans as a major source of revenue as well as a leading product to promote “marketed indirect financing”. The outstanding balance of these loans by all banks now stands at over 20 trillion yen. However, as was pointed out by the market people, these loans have become a product for banks to generate profits by forcing weak credit borrowers to take, though they can borrow loans on ordinary conditions. Banks can earn additional fees from the arrangement. This business created demand for people at mega-banks.

7. Bonds/Derivatives/FX business

The Fair Trade Commission of Japan ordered one of the mega-banks to review its business operation. It was reported that the bank had forced middle-sized and small corporate borrowers to buy derivatives that the borrowers did not need. As were the cases with syndicated loans, banks took advantage of their influential position over the borrowers. The Commission regarded the derivative business as an “unfair” transaction. However, other banks also, more or less, promoted that business to raise profits under intense competition in lending.

Major foreign financial institutions also had a good deal of demand for professionals in fixed incomes sales for regional banks, corporations, and mid-markets. Producing structured bonds taking advantage of their cutting-edge technologies and strong

global trading capability, some of them earned good profits from selling these products to the above customers directly, and through small and middle-sized securities firms as distributors for their retail customers. Among them, one major foreign investment bank is said to keep raising a very large profit from derivatives marketing to corporate customers.

However, the general trend we saw in the market was declining profitability in the fixed incomes and derivatives business at foreign financial institutions (they call the division “Global Markets”). Foreign financial institutions used to earn huge profits from derivatives during 1990s. In those days these products generated approximately 60-80% of all profits of the Tokyo branch. However, we do not see such high profitability now, since even Japanese banks have the abilities to produce ordinary structured bonds at present. Moreover, we see a huge difference between mega-banks and foreign financial institutions in their customer bases. Therefore, foreign financial institutions have to concentrate their resources on creating very complicated securities to survive. However, it is widely recognized that only ten to fifteen foreign institutions will make it in the market.

In the FX business we recently saw a good number of reputed professionals at foreign exchange specialty firms and foreign banks changing jobs. These moves probably reflected the market situation where investors were buying foreign currency denominated financial instruments under the global “excess money” situation. However, we are not sure if this trend would continue for long. We have often seen foreign banks expanding their FX business operations in Tokyo and then moving them back to the overseas offices such as Singapore and Hong Kong in consideration of cost efficiency. Therefore, if they cannot create and offer a value-added FX business they have to shrink their Tokyo’ s operations again when the volatility of these products decreases.

This business needs to develop attractive products such as long-term FX and exotic schemes if they want to survive.

As for other businesses, mega-banks were prepared for intermediary business for securities business, which was recently allowed for banks to enter. They, however, had already hired the staff for the business including from outside sources, and did not have additional demand for people.

8. Equities

Overseas investors bought more Japanese stocks than they sold, by 10 trillion yen in 2005, and the trading volume by individual investors accounted for 38% of all Japanese stock transactions. As a result, the Nikkei Stock average rose by approximately 40% in the last year, and the total capitalization of the Tokyo Stock Exchange rose to over 500 trillion yen, for the first time in 15 years. However, we did not see much demand for professionals in conventional equity business. This was probably because overseas investors traded through their foreign securities firms and major Japanese firms, and individual investors traded through internet securities firms in day-trading.

9. Wealth Management

According to statistics, only 1.5% of all Japanese households (780,000 out of 49 million in total) has more than 100 million yen in personal financial assets for each, among the total personal financial asset value of 1,500 trillion yen nation-wide. Various financial institutions tried to obtain wealthy customers to help them manage and grow their financial assets. The wealth management business include various types of businesses such as highly reputed traditional private banking in Swiss, wealth management developed in the U. S. investment banks, personal banking of Citibank Tokyo, priority banking of European universal banks, etc. Japanese securities firms aggressively sold "wrap accounts" to rich families. However, due to the difficulty of establishing a long lasting, promising strategy for the Japanese private banking, many foreign private banks have tried to create the business for this market, but have always been unsuccessful. Therefore, though there was some demand for private bankers, it was not as strong as in the previous year.

Mega-banks also strengthened their wealth management capabilities using banks' branch networks, affiliated trust banks, securities firms within the groups, etc. Some banks tied up with overseas private banks for their high quality products. We believe if the banks want to succeed in this business, they have to secure professional private bankers from outside sources who will bring in innovative ideas, and to establish new internal organizations. They also have to create internal management systems such as a revenue-split rule between existing account managers at branch offices and professional marketers hired from outside sources for this project. However, most Japanese banks waned to pursue this business without reforming any existing system, being afraid of creating internal conflicts. Moreover, they do not have any philosophy

or strategy on how to conduct “true private banking.” Therefore, professional private bankers in the market did not apply to the Japanese banks.

Chapter II Analysis By Financial Institution

1. Mega-bank reform and the demand for people (Overview)

Japanese mega-banks, which have solved their immense bad-loan problems, have an overwhelming influence over the Japanese financial market. Market players often tell us that almost financial businesses are streaming to the three mega-banks, although we do not have any statistical figures to confirm the situation. In addition, professionals of foreign financial institutions said that their competitors used to be other foreign firms in the past, but they now have to compete in most cases with mega-bank group firms. Now the focus of mega-banks’ management is on “profitability,” having shifted from “soundness”. In order to make money under the present environment, all three mega-banks have strong demand for people, to handle the huge customer deal flows, although we see a difference among the three in strategy for hiring.

It is predicted that each mega-bank will achieve a huge operating profit of between 5 billion yen to 1 trillion yen every year from now, and will steadily increase its capital. Sooner or later, the mega-banks will pay back all public finances to the government and gain freedom for their HR management. Just a couple of years ago many people in the market made cynical remarks that the bank and the securities firm within the same group were not getting along and that political war was taking place among staff separated by former banks. However, they now respond to this rumor, saying that mega-bank employees are too busy to join such internal politics. We were pleased to know the mega-banks had begun to move forward towards reform.

Meanwhile, Mr. Heizo Takenaka, currently Minister of Internal Affairs and Communications and one of influential lawmakers of the ruling party recently said at a press conference that only the reform of corporate governance at the mega-banks had been left unachieved yet among the “Takenaka Three Principles” **that he had** mandated for the Japanese financial institutions some years ago. He added that the other two principles of the strict assessment of mega-banks’ assets and the improvement of their capital ratio could be deemed realized. We could agree to his comments and also have concluded from our experience that mega-banks have not changed their corporate governance system at all even after the so-called “Lost 10 Years.” Both the

capitalization of mega-banks and their asset size have become among the biggest in the world market, but their profitability is still very low compared with top class financial institutions elsewhere in the world. The reason for the problem is that mega-banks have never adopted the “capital cost management” policy. Since most Japanese banks are not managed with the “committee-based governance” stipulated in the recently revised Japanese corporate laws, top executive officials of Japanese banks are nominated and selected by the development of internal political events (such as favorites of the president or those who seem to be getting along with other executives), and not based on the capitalistic judgement and the degree of mission that candidates have set to themselves. Therefore, those who vocally demand drastic management reform are usually not appointed top executives.

Mega-banks do not have a CFO post in their management structure, which most Japanese corporations already have these days. So, capital allocation and treasury operations are not managed in a capitalistic way. In addition, in the Japanese banks, executive committee members usually do not speak about matters in the charge of other executives as they do not want to create internal confusion. “Respect for Unity” is the culture deeply rooted in the Japanese society. Therefore, no one expresses questions or objections to the management decisions and strategies of other executives even if the operations are not properly run. Therefore, executives have freehand for their operation, and pursue their business in the way they want. Or they may just follow conventional practices, such as overstaffing for unprofitable areas. For example, the lending business is a core source of revenue for banks, and they are trying to increase outstanding of loans with competition intensifying among banks. They, therefore, dump interest rates, which is their traditional strategy to win customers. As a result, Japanese banks do not earn enough interests to cover relevant credit risks, however, the banks do not care.

Another example is that HR management of Japanese banks is still based on the traditional system of “promotion by age.” Japanese banks hire people from outside sources only because they are very busy in their daily operations, but not to pursue a mid-term or long-term corporate strategy. They do not intend to introduce a performance based HR system because they basically do not appreciate professionalism in business. They highly appreciate generalists as they believe generalists have a sense of balance. Therefore, compensation of Japanese bank employees is quite low. However, when they need to hire professionals with specific skills from outside

sources, Japanese banks have to offer higher compensation to attract them than to existing employees, but the new employees question on the reasoning for the higher amount of pay. As such, we see far too many problems with the management of Japanese banks and see no sign that they have begun effort to change. In our “HR Market Report-2”, we sent questionnaires as to the quality of the management of the Japanese banks to about 3,000 in the financial services industry including executives of Japanese banks. Most of the executives answered that the management of Japanese banks is unacceptable.

However, we are not asserting that all of the mega-banks have lost the sense of mission or the pledge to improve Japanese financial business. We see a difference in the degree of commitment among the three banks. In fact, there are many executives and bankers who are exerting efforts to push reform forward with the strong sense of crisis. We respect them and are trying to help them providing information on the HR market. And we believe that Japanese FSA will push forward its reform policy for the Japanese banks with Basel II regulations set to be in force soon. We expect that the FSA will take a firm stance to urge the managements of Japanese banks to pursue fundamental reform.

(Demand for people)

There was very strong demand for people at mega-banks and affiliated securities firms in order to handle a great deal of financial deals provided by the huge influx of customers. At banks, the strong needs were for structured finance (securitization of real estates and other assets, and non-recourse loans), syndicated loans, corporate advisory, M&A, and derivatives; and at securities firms, for M&A, fixed incomes, derivatives, principal investment. The details of the needs are explained in Chapter I.

Compared with banks, which are still controlled by the government, securities firms had more freedom in hiring. Securities firms could offer more flexible choices on employment contracts, i.e. ① permanent employment contract as ordinary employment, ② term employment contract called “professional contract”, which are for professionals who have specific expertise and are paid a performance bonus depending on their performance results, ③ employment contract between the above two, i.e. permanent employment contract, but for those who have specific expertise and are paid bonus depending their performance results. These contracts were also applied to the hiring at some banks. But for any of the employment contracts ①, ② and ③,

compensation is not comparable to that of professionals at foreign financial institutions. In conclusion, the HR system and the compensation system of banks and their affiliated securities firms are still out-dated. If Japanese financial institutions seriously wish to expand profitability to compete with major financial institutions, we believe they must carry out fundamental reform for the HR system.

The largest problem at mega-banks hiring professionals is the fact that department heads and executives cannot be deemed professional at all. Except for very few cases, the positions of department heads and executive officers at Japanese banks and securities firms are never offered to people hired from outside. Senior positions are given only to those who have been working at the same bank since graduation from his or her university. They are treated as elite internally, and have been offered various positions to be educated and trained to grow as generalists. They experience these positions as job rotations to get prepared to become executives of their firms in the future. Furthermore, most employees at Japanese firms have been and are still put on a career course within the same bank, filled with the dreams to become executives some day in the future. But these promises are never realized. That is the core practice for Japanese HR system, which we believe is still effective at banks.

This iron-clad system seems impossible to destroy at this time and stands as a big problem to professionals employed from outside. Because, a professional pursues his business taking various risks and does not always win, and if his boss does not understand why the loss took place, he as a subordinate professional cannot do a good job. In conclusion, the reasons why Japanese financial institutions cannot hire excellent professionals are with their HR system as well as low compensation.

Mega-banks, who are now ranked among most highly capitalized firms in the world markets, are taking measures to expand overseas operations suitable for global banks, and are looking for talented people in their overseas offices for this purpose. However, the markets still remember that Japanese banks during the bubble times expanded their assets in overseas markets, investing huge money with very low interest rates applied. Japanese banks showed their presence in that way to the world markets in those days, but eventually just piled up mountains of bad financial assets. The question now is whether they have made the present strategy having learned from the past failures. We are concerned that the mega-banks' expansive strategy towards overseas markets would be only because they would feel shamed if they do not have an operation big enough to be suitable for world class banks. In addition, they now cannot use huge

money as they did in the past. We are closely monitoring how they pursue their overseas strategy.

As for demand for personnel for preparation and implementation of Basel II regulations, banks had already gathered enough staff internally and did not need to hire from outside sources. Therefore, demand for people for the new regulations was limited to at consulting divisions of accounting firms as well as at IT system firms.

2. Foreign financial institutions and the demand for people

(Overview)

As explained above, now, almost financial transactions in Japan are given to mega-banks. The customer base of foreign financial institutions is too small to be compared with mega-banks, and the advantage of foreign firms in technology is disappearing. As such, we do not see a bright future, in general, for foreign financial institutions in Japan, as we did during 1990s. On the other hand, top-tier U.S. investment banks still stand out in the market, generating a great deal of profits. In other words, we clearly see two tiers among foreign firms, separated by U.S. investment banks and a few European universal banks versus the rest. Generally speaking, European universal banks do not have established, clear strategies for the Japanese market and were not operating successfully. Some of them were shrinking their operations or leaving this market.

(Demand for people)

Demand for people at successful foreign financial institutions is still strong, but mainly for the business areas in which they possess their greatest strengths. These strengths are in principal investment, securitization, M&A, underwriting securities issuances, fund investment, structured finance, high yield finance, hedge funds, fund derivatives, credit derivatives, etc. In great need were professionals with excellent track records for these businesses, as were young, smart aggressive bankers with high potential.

Although it might sound contradictory to the above view, some major foreign financial institutions claimed that they did not need super-stars any more. Strong demand in the past existed for professionals who had obtained knowledge of new high-tech products from their overseas offices and sold those products to customers in this market. They achieved excellent performance applying his or her strong marketing

capabilities or unique strategies. However, these types of professionals are very scarce now and are not in great need. This is because financial products with cutting-edge technology have become scarce, and business value at major foreign investment banks comes mostly from their global network or their brand name rather than from capability of individual players. Therefore, even senior professionals at foreign institutions are put in routine positions so that all staff members, whether senior or junior, now look same. This trend frustrates professionals with excellent records. This is a reason why foreign firms do not look attractive these days.

One of the concerns of top managements at the overseas head offices of major foreign financial institutions is that they do not have many senior Japanese in their Tokyo offices with high quality management capability. Overseas executives said to us that they have many professional players who generate a great deal of revenues from his or her specialty areas and earn a lot of bonus for their performance, but they do not see managers who possess high degree of mission and vision set with them, in general. They would like to employ such quality managers as have been promoted to managing directors due to their excellent performance, and then can make excellent proposals in strategy for the Japanese market to the head offices. They also pointed out they do not have many professionals who can close big deals that could give significant impacts to the Japanese business overall. We understand one of the reasons for the scarcity of such bankers is that foreign firms choose candidates based too much on their track records and skills rather than on their overall quality. We hope more quality bankers from Japanese financial institutions move to major foreign institutions and challenge in the global markets. We also hope excellent professionals at Japanese financial institutions and foreign firms will compete, making full use of their own capabilities and strengths, to contribute to improvement of the Japanese financial business.

Conclusion

Takafumi Horie called “Horie-mon” was arrested recently. There were various opinions as to what Horie-mon had done to the Japanese business. The negative view saw a political and social problem, seeing Horie-mon’s transgressions as the result of Koizumi’s reform policy. Others took a more positive view of Horie-mon spurring positive change for the Japanese business and society. However, the writer will raise

an important question: who supported 700 billion yen of capitalization for Livedoor Co.? The great deal of losses suffered by many individual day-traders was their own responsibility. They traded stocks without knowing anything about the trading, likening stock trading to a high-tech pachinko game. But we should not overlook that professional equity analysts of major financial institutions had recommended the stock as a “buy.” This should be regarded as a serious “quality” problem of the Japanese investment management business. The writer, who was a commercial banker and is an amateur in the stock business, can easily tell after a quick look at the firm’s financial statements that the Livedoor’s capitalization is not worth as huge as 700 billion yen. This judgement is just a common sense for commercial bankers and investment bankers who have learned any financial analysis. If the analysts who supported that valuation insist the 700 billion yen was fair, they must have visited Horie-mon and the executives frequently, obtained insider information, and understood their corporate culture having conducted many interviews with the employees. However, we have not heard that they did. We, of course, know that stock prices are determined not only on cash-flow analysis but also on demand/supply balance in the market. However, if some simply assert that stock prices will continue to rise as long as people buy, they have not learned from the past failures. As we still remember, people bought stocks in the bubble times in that way, and suffered vastly destructive damage from the collapse of the stock market. However, it is a great surprise and disappointment to know that a highly reputed global investment trust management firm bought a great deal of Livedoor’s shares to sell to individual investors.

We believe professionals in the financial services industry must always ask themselves what constitute corporate value and what the stock prices represent.

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Profile of the writer:

Katsunobu Komizo graduated from Tokyo University (International Relations) in 1968. He worked for Sumitomo Bank for 16 years, and in 1984 moved to First Chicago Bank as Head of the Relationship Management Group, to market various U.S. corporate finance products. In 1989 he began his career in executive search as a consultant with the Whitney Group Japan, a New York based search firm specializing in the financial services industry. In 1993 he joined Heads Japan as Managing Director responsible for the Financial Institutions Division. He became one of highly reputed executive search consultants in the Japanese market with his frequent exposure to mass-medias such as TV, news papers, writing for many professional magazines, speaking at conferences, seminars, etc. He is also well known in the market for the successful completions of many assignments given by clients both from foreign investment banks and Japanese major financial institutions. He left Heads Japan in 2004 to start his own company, Executive Search Partners.

Company statement and purpose:

Executive Search Partners is the first true executive search consulting business in Japan. Founder and CEO Katsunobu Komizo is building the consulting business based on his 17 years experience, philosophy, business knowledge, and human relationship networks. Executive Search Partners is approved by the Japanese government as a licensed recruitment company.

For details about ESP, please refer to its Web Site (www.espartners.co.jp).