Importance of Regional Financial Institutions in Regional Economic Development: Based on the results of corporate surveys in Japan's Tokai and Kansai regions

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-- Based on the results of corporate surveys in Japan's Tokai and Kansai regions --

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Abstract

This paper has analyzed the relationship between medium/small firms and financial institutions based on the results of questionnaires prepared for medium/small firms in the Tokai and Kansai regions.

With the development of telecommunication technology and progress in securities market infrastructure, there are fewer cases in which geographical distance poses a problem in financial transactions. However, financing for medium/small firms is expected to remain dependent on indirect finance, i.e., financing through their major trading bank, inasmuch as it will be necessary for financial institutions to play a major role in overcoming the problem of information asymmetry in that sector. More specifically, this type of relationship banking in which periodical and direct contact lends to increased company knowledge is thriving as a means to eliminate the issue of information asymmetry. The direct contact or communication, an integral part of relationship banking entail costs, and can become difficult when banks locate far from firms.

Key words: Regional Finance; Japan; Bank; SME Finance

1. Introduction

The progress of information and telecommunications technology has minimized problems of physical distance in financial transactions (stock investment, for example) (Kurihara, et al. [2006]). With the globalization of economic activity, it is not at present uncommon for both institutional and individual investors to trade directly in overseas securities markets.

But those seeking to investment in foreign markets need to limit themselves to countries wherein information is easily obtainable, and to the securities of major corporations.

Putting it differently, it is difficult for medium/small corporations to procure funds from distant investors and financial institutions, for the reasons that such corporations' credit information is not made widely public, and their financial data is lacking in credibility (for example, they are rarely audited by accountants), causing deeper problems related to information asymmetry in their financing. Local financial institutions confer frequently with medium/small firms and have long business relationships, giving them access to non-financial information which is not readily visible (soft information) and makes it possible for them to pass judgment on such firms, which may in the eyes of distant financial institutions appear a risky investment, as to their debt-servicing capability. Consequently, local firms are forced to depend on regional financial institutions, whose financial standing and credit policies impact substantially on local economies. In other words, there is a high likelihood that regional financial markets are being segmented.

On the other hand, local and regional financial institutions cannot compete with megabanks and foreign financial institutions when it comes to investment in the securities market and financing major corporations. The perception is spreading that there is no road to survival other than strengthening the financing of local medium/small firms. Recent years have thus seen progress in the reinforcement of relationship banking.

Nevertheless, although the importance of regional financial institutions is widely shared conceptually, there are few examples of quantitative analysis. In this paper, we have therefore used the results of corporate surveys in the Kansai region, including Osaka, and Tokai region, including Aichi Prefecture, for the purpose of quantitative clarification of the importance of the roles played by regional institutions in medium/small company financing. This research is important not only for ascertaining the present financial situation in several regions in Japan, but also for understanding the true nature of banking.

The key issue in the financing of medium/small firms in Japan and the rest of the world, is how to overcome the problem of information asymmetry. The long-term relationships of regional financial institutions and medium/small companies in Japan can be positively rated as one means of alleviating such a problem. In China and Korea as well, the banking

systems are being prepared with a view to bolstering banks' loan screening capabilities. The approach taken by Japan in handling this problem of information asymmetry in medium/small firms is also deemed to serve as a useful reference in addressing the same problems in countries such as China and Korea.

The composition of this paper is as follows. Section 2 reviews in very simple terms the distinctive characteristics of the Kansai and Tokai regional economies. Section 3 provides an outline of the survey. Sections 4 and 5 introduce the survey results. Section 4 looks at ties between major banks and medium/small firms in Japan and their continued dependence on them based on the results of the survey. Section 5 points out patterns in relation to the frequency of direct communication between Japanese firms and financial institutions for the purpose of eliminating the problem of information asymmetry. Section 6 serves as a summary of the main points outlined in this paper.

2. Kansai and Tokai Regional Economies

(1) Overview of Companies in Both Regions

The Kansai and Tokai regions dealt with in this paper are, along with Tokyo, important areas in Japan's tripolar economy (Figure 1).

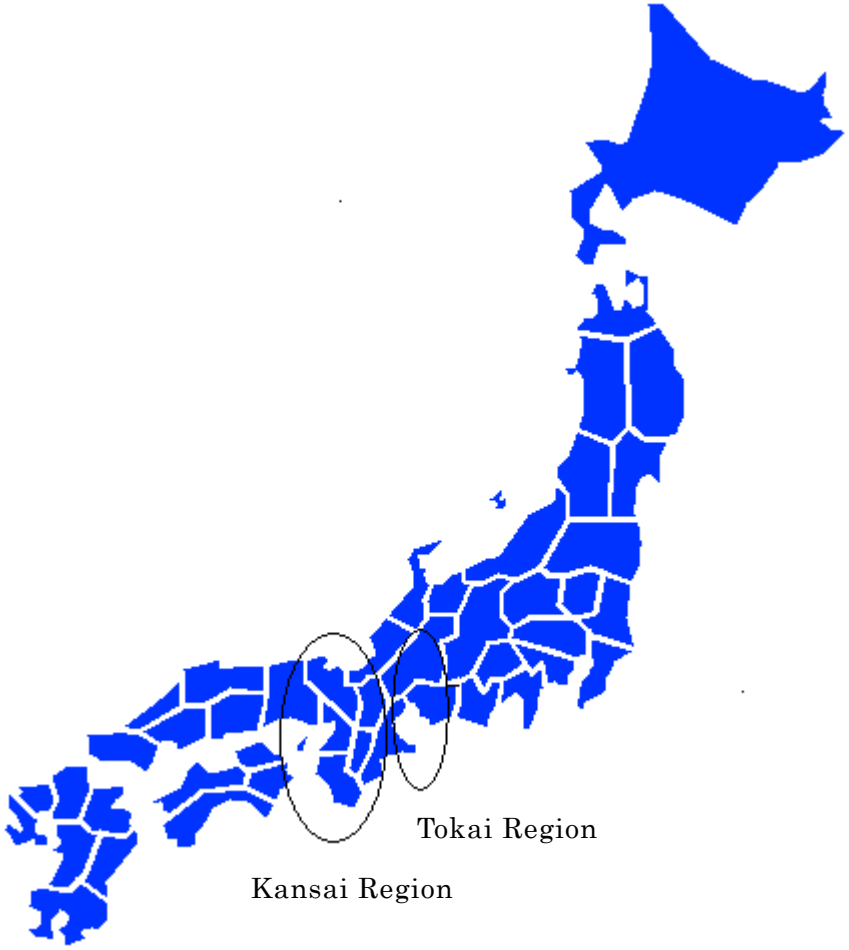
Osaka is host to the head offices of such major corporations as Takeda Pharmaceutical Co. Ltd. (market capitalization of ¥7.0 trillion as of end-August 2007), Matsushita Electric Industrial Co., Ltd. (¥5.0 trillion), Sumitomo Metal Industries, Ltd. (¥2.8 trillion), Resona HD (¥2.8 trillion), Kansai Electric Power Co., Inc. (¥2.6 trillion), Sharp Corporation (¥2.2 trillion), Itochu Corporation (¥2.0 trillion), Sumitomo Trust and Banking Co. (¥1.6 trillion), Daikin Industries, Ltd. (¥1.5 trillion), Sumitomo Electric Industries, Ltd. (¥1.5 trillion), Keyence Corporation (¥1.3 trillion), Kubota Corporation (¥1.2 trillion), West Japan Railway Company (¥1.1 trillion), Sekisui House, Ltd. (¥1.1 trillion), and Matsushita Electric Works, Ltd. (¥1.1 trillion).

Similarly, Aichi Prefecture hosts the head offices of Toyota Motor Corporation (¥24.4 trillion), Denso Corporation (¥3.6 trillion), Central Japan Railway Company (¥2.9 trillion), Chubu Electric Power Co, Inc. (¥2.4 trillion), Toyoda Industries Corporation (¥1.6 trillion),

NGK Insulators, Ltd. (¥1.4 trillion), Aishin Seiki Co., Ltd. (¥1.3 trillion) and Toyota Tsusho Corporation (¥1.0 trillion).

However, what should be noted is that while these large corporations drive the economies of both regions, it is a fact that the overwhelming majority of firms in both are medium/small in size. According to research in 2006 by the National Tax Agency, for example, there were 300,000 firms in the Tokai region (comprising Aichi, Gifu, Mie and Shizuoka Prefectures), of which no more than 0.2% were capitalized at ¥1 billion or more. Similarly, in the six Kansai administrative areas (Osaka, Kyoto, and the Hyogo, Shiga, Nara and Wakayama Prefectures), only 0.2% of 440,000 companies had invested capital of over or equal to ¥1 billion.

Figure 1: Kansai and Tokai Regions



(2) Gross Production for Both Regions

Let us now look at the size of the two regional economies, based on prefectural economic statistics published by the Cabinet Office. According to FY 2004 statistics, Aichi's prefectural gross production was calculated at ¥34.7 trillion, while Osaka's, at ¥38.7 trillion, was 12% larger. Total share of Japan's GDP was calculated at 6.8% and 7.6%, respectively.

In order to ascertain figures for each region, the regional share for the three prefectures in the Tokai area (Aichi, Gifu, Mie) was calculated at 9.7%, and 15.8% for the Kansai region (Osaka and Kyoto cities, Hyogo, Shiga, Nara and Wakayama Prefectures). These results indicate that Osaka is larger than Aichi Prefecture and that the Kansai economy is considerably larger than that of the Tokai region.

In looking at the changes from 1986 to 2004, however, Aichi's proportion of the total

domestic share increased marginally, from 6.7% to 6.8%, while Osaka's declined by 0.8%, from 8.4% to 7.6%. This represented the greatest decline among all regions in the nation, and can be interpreted as a sharp decline of Osaka over the past 20 years.

(3) Industrial Structure of Both Regions

One distinctive characteristic of the economic structure of the Tokai region lies in the large proportion of manufacturing industries. According to the 2005 census, 26.4% of the workforce in Aichi Prefecture was employed in the manufacturing industry -- the second highest figure nationally, behind Shiga Prefecture. In Osaka the corresponding figure was 17.9%, barely above the national average of 17.3%.

Differences are visible not only in levels but in changes as well. As of 1987, Osaka's ratio of the workforce employed in manufacturing was 29.2%, indicating a decline of 11.3% over 18 years. Aichi's figure has also declined, but only by 7.6% from its figure of 34.0% in 1987. In terms of absolute numbers, the number of persons employed in the manufacturing industry in Osaka in 1987 was slightly more than that of Aichi (1.23 million to 1.16 million), however in 2005, Osaka's numbers fell to 710,000 in comparison to 980,000 in Aichi.

Substantial differences also appear between Osaka and Aichi when we move away from employment statistics (input) and examine the total value of the shipment of industrial goods (output). Following its peak in the bubble era, the total value of the shipment of industrial goods in Osaka has continued to slide, while Aichi had managed to increase shipments up until the early 1990s. Then, Aichi's shipment of industrial goods has fluctuated somewhat, but remained at a considerably high level.

Osaka has thus experienced a sharp move away from manufacturing, while Aichi's economic structure has retained it as its core industry.

3. Survey Outline

(1) Tokai and Kansai Surveys

The surveys used in this paper were two surveys, one for the Tokai and Kansai regions jointly carried out by the author and Prof. Makoto Tawada of Nagoya University.

With the cooperation of the Nagoya branch of Nomura Securities, the Tokai survey was implemented over the period from February 10 to March 10, 2004. It covered 8,472 companies in the region's three prefectures, of which 684 responded. The results of the survey were put together in Tawada and Yamori (2005).

The Kansai survey was carried out in October 2006 with the cooperation of the Resona General Research Institute. It covered 10,000 Kansai firms headquartered in Osaka, Kyoto and Hyogo Prefecture, with responses received from 1,176. Details of this survey were explained in Tawada and Yamori (2008).

As the Kansai survey was prepared based on the Tokai survey questionnaire, the questions were basically the same. The questionnaires started by asking questions regarding the attributes of the respondent and the company on whose behalf they were answering for. This was followed by questions concerning company finances and industrial affiliations.[1] This paper only discusses some parts of the questionnaires necessary to analyze the importance of regional financial institutions. For full details of survey results, please refer to Tawada and Yamori (2008).

(2) Size in Terms of Number of Employees of Responding Firms

The distribution by employee numbers of the firms responding to the two surveys is shown in Table 1. In the Tokai survey those firms with 50 or less employees are lumped together, making it impossible to make any kind of comparison between the smaller companies (for example, comparisons between those with 9 or fewer employees and those with 50). The ratios of these respondents, moreover, do not accurately reflect actual differences in company size in both regions due to variations in rules when addressee lists were prepared and in response ratios.

Table 1

[1] The Tokai survey did however contain several questions about corporate governance directed at firms listed on the stock exchange. These were greatly simplified in the Kansai survey and other questions added that were more relevant to medium/small firms in line with the objectives of the Kansai survey.

Numbers of responding firms in the Kansai and Tokai surveys, by numbers of employees

	Kansai Survey		Tokai Survey	
	Number of firms	Ratio	Number of firms	Ratio
9 or less	228	19.6%	231	34.1%
20 or less	136	11.7%		
50 or less	287	24.6%		
100 or less	273	23.4%	163	24.0%
500 or less	207	17.8%	205	30.2%
1,000 or less	24	2.1%	36	5.3%
Over 1,000	11	0.9%	43	6.3%
Total	1166	100.0%	678	100.0%

(3) Equity capital ratios of the responding firms

We asked about equity capital ratios as an indicator of a company's financial situation. Table 2 shows the ratios organized in 20% increments. In the Kansai survey 845 firms that gave specific figures had an average ratio of 34%, with a median of 27%. The corresponding average in the Tokai survey was 42%, pointing to considerably high equity capital ratios for firms in that region. Although not shown in the table, it was revealed that the Tokai firms had higher equity capital ratios even when comparing companies of the same size.

The level of the equity capital ratio is a direct indicator of the financial position of a firm. The higher the ratio, the lower the possibility of non-performing debt. In considering why companies in the Tokai region maintain high ratios, it may be because financial institutions have more rigorous credit policies, i.e., their screening criteria are tighter, and firms may worry that a poor equity capital ratio may prove to be disadvantageous in future transactions with financial institutions. If such is the case, excessively high equity capital ratios (aside from the question of whether or not Japanese examples can be judged excessive) will indicate that there are problems with Japanese financial system.

Table 2

Distribution of equity capital ratios

	Kansai Survey		Tokai Survey	
20% or less	291	34.4%	99	19.1%
40% or less	270	32.0%	172	33.1%
60% or less	140	16.6%	124	23.9%
80% or less	81	9.6%	82	15.8%
Over 80%	63	7.5%	42	8.1%
Total	845	100.0%	519	100.0%

(4) Dividend Payouts of the Responding Firms

Following are the results showing dividend payouts used as an indicator of the financial position of the firms surveyed.

In the Kansai survey 515 companies (44.7%) stated that they pay dividends and 636 (55.3%) said they did not. The corresponding figures for the Tokai survey were 403 (59.9%) and 270 (40.1%). Dividend rates were higher among firms in the Tokai region.

However, it is expected that the size of the responding firms had a significant impact on these figures. Table 3 attempts to adjust for the number of employees at each firm. These results indicate that the dividend rates for firms in the Tokai region were higher than that of firms in the Kansai region regardless of the size of the company.

Table 3

Dividend-paying ratios by company size in both regions

	Kansai Survey		Tokai Survey	
	Dividend Paying Ratio	Total Number	Dividend Paying Ratio	Total Number
9 or less	27.1%	225	41.7%	228
20 or less	34.3%	134		
50 or less	40.8%	282		
100 or less	49.1%	269	58.6%	162
500 or less	66.0%	206	69.3%	202
1,000 or less	70.8%	24	86.1%	36
Over 1,000	72.7%	11	92.9%	42

4. Long-Term Relationships Between Financial Institutions and Japanese Firms

(1) Relationships with Major Trading Banks

It is said that, in Japan, medium/small firms have established long-term, continuous relationships (main bank relationships) with financial institutions in order to overcome the problem of information asymmetry. Here, we asked firms participating in the survey whether they had a major trading bank.

There may be many varying definitions in regards to the concept of a major trading bank (or so-called “main bank”). Generally, a major trading bank is thought of as a bank which provides the most financing and which is a major shareholder. There are also circumstances under which Executive Officers from a major trading bank are placed within a firm. Among businesspersons, banks with whom they have their principal clearing accounts (typically, check drawing accounts) may also be called a major trading bank. However, the surveys did not solicit responses predicated on such precise definitions. The question was not restrictive and simply asked if they had a major trading bank. Consequently, depending on the respondent there may have been some variations in the definition of a major trading bank. We think that questions were formulated leveraging the

surveys' special characteristic of ascertaining corporate perceptions, not simply numerical criteria.

In the Kansai survey 1,100 companies (94.3%) said they had a major trading bank with 66 companies (5.7%) stating they did not. The corresponding figures for the Tokai survey were 631 companies (93.1%) and 47 companies (6.9%). The results indicated that approximately 90% of companies had a major trading bank with relatively similar percentages in both regions.

Table 4 looks at the ratio of firms with a major trading bank by the number of employees. A large number of the smaller firms tended not to have a major trading bank. And, it can be assumed that regional financial institutions do not provide these firms with the services of a major trading bank. In other words, it can be assumed that financial institutions will only attempt to build relationships in the capacity of a major trading bank with firms over a certain size due to the high costs involved.

Up until now, for the smaller firms in Japan with which private sector financial institutions are unwilling to become major trading banks, government-related institutions such as the People's Finance Corp. have provided financing, and small/medium sized firms depend on public supports, such as public credit guarantee associations, regional government subsidies or guaranteed loans. However, reorganization of these government institutions and regulatory and financial reform has tended to shrink public support.

Table 4

Ratio of firms with a major trading bank by number of employees

	Kansai Survey		Tokai Survey	
	% with Major Trading Bank	Total Number	% with Major Trading Bank	Total Number
9 or less	91.7%	228	91.8%	231
20 or less	91.2%	136		
50 or less	95.1%	287		
100 or less	96.7%	273	95.7%	163
500 or less	95.2%	207	92.2%	205
1,000 or less	91.3%	23	97.2%	36
Over 1,000	100.0%	11	90.0%	40

(2) Sustainability of Relationships with Major Trading Banks

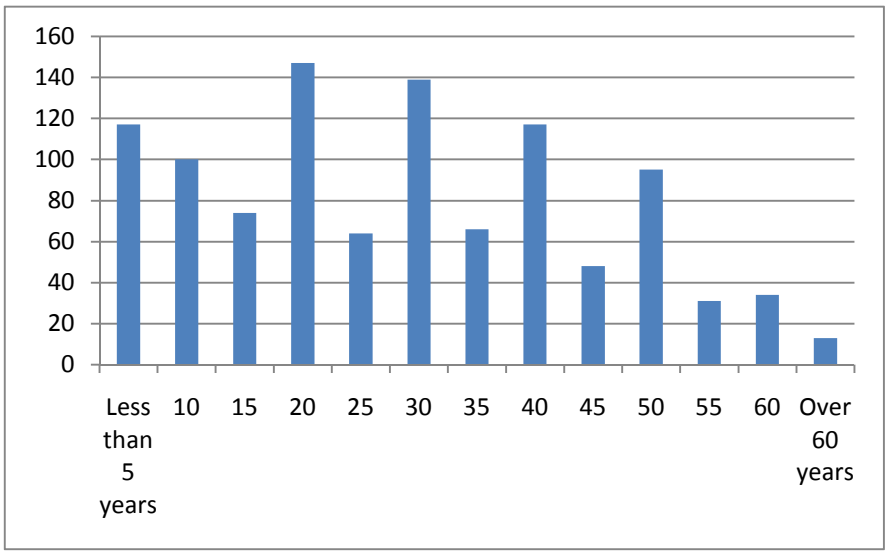
To verify the sustainability of relationships with major trading banks we asked participating firms how long they had dealt with their current bank. Excluding the period for simple deposits, this question aimed to determine how long firms had been trading with their major trading bank.

Figure 2 is a histogram showing the number of years of trading in five-year increments. The majority of participating firms, 147, were placed in the 15 - 20 year range, with 139 in the 25 - 30 year range. The average number of years of trading was 27.8 years, with a median of 30 years. The average age of the participating firms (since establishment) was approximately 40 years. This indicates that on average the majority of firms had made no change to their major trading bank following the initial 10 years following establishment. These results clearly indicate that firms are establishing stable, long term relationships with their trading bank.

Unfortunately the Tokai survey did not ask respondents to provide information on trading periods with their banks and therefore we are unable to provide a comparison in this regard between the two regions.

Figure 2

Number of years of trading with major trading banks



(3) Future of Relationships with Major Trading Banks

While large corporations are becoming less reliant on banks, is that also true of medium/small firms? To test this, we asked participating firms to select methods of fund procurement they deemed to be important in the future.

The responses in Table 5 show that 74.9% of companies in the Kansai survey selected "Procurement from major trading banks" in comparison to 68.0% of companies in the Tokai survey. These results indicate that the most important method of fund procurement will remain to be through borrowing from major trading banks.

Due to space limitation, Table 5 shows only the Kansai survey, with responses segmented by number of employees at each firm. In the smaller firms with less than 20 employees there was little procurement from major trading banks. The results also showed that sourcing funds from major trading banks was also tapering off in larger firms with 501 or more employees. This reflects that the smaller firms have a high degree of dependence on public financial institutions and local government system funding, while a high proportion of larger firms used the corporate bond and other securities markets. Banks were passive about building relations with the smaller companies, while large firms sought more

advantageous procurement methods. Strictly speaking, it was the midsize companies that formed continuous, long-term and stable relationships with the banks.

Table 5

Future fund procurement methods (respondents were asked to select two)

	Kansai Survey								Tokai Survey
	9 or less	20 or less	50 or less	100 or less	500 or less	Less than 1,000	More than 1,000	Overall	Overall
Procurement from major trading banks	71.9%	69.9%	77.4%	72.9%	77.8%	66.7%	54.5%	74.9%	68.0%
Procurement from other financial institutions	35.5%	48.5%	49.8%	54.9%	54.6%	58.3%	45.5%	49.4%	36.4%
Procurement from public financial institutions	41.2%	37.5%	28.9%	29.7%	17.4%	0.0%	9.1%	30.1%	20.2%
Local government and other system funding	11.8%	8.8%	5.6%	5.1%	4.3%	4.2%	0.0%	6.8%	4.4%
Borrowings from business partners (inter-company credit)	1.8%	1.5%	0.7%	0.7%	1.4%	4.2%	0.0%	1.2%	3.1%
Short term CP	0.0%	0.7%	0.7%	1.1%	0.5%	0.0%	18.2%	0.8%	1.6%
Long term corporate bonds	2.6%	5.1%	9.4%	7.3%	12.1%	0.0%	36.4%	7.7%	11.1%
Convertible corporate bonds	0.0%	0.0%	0.7%	0.7%	0.5%	4.2%	9.1%	0.6%	2.9%
Common stock	0.4%	0.7%	1.4%	0.7%	1.9%	12.5%	0.0%	1.3%	8.6%
Subordinated bonds and preferred stock	0.0%	0.0%	0.7%	0.0%	0.0%	0.0%	0.0%	0.2%	0.3%
Securitization of lease credit, accounts receivable, etc.	2.2%	2.2%	2.4%	2.9%	2.9%	12.5%	18.2%	2.9%	4.7%
Others	3.5%	1.5%	4.2%	3.7%	8.2%	4.2%	0.0%	4.3%	10.5%
Number of corporations	228	136	287	273	207	24	11	1166	678

(4) What Point of Their Main Bank is Highly Rated by Firms?

These relationships between firms and their banks could exist simply so that the banks can exercise their dominance over them. It may be that relationships are maintained simply because there is no other financial institution in the area or for other passive reasons such as reluctance to deal with another bank due to the problem of information

asymmetry and onerous collateral substitution procedures.

Here we asked participating firms to select three criteria under which they can rate their current bank from eight possible options. Table 6 aggregates the results.

In the Kansai survey 1,076 companies cited at least one reason. This indicates that 98% of the 1,100 firms that stated they had a major trading bank provided some kind of rating.

The most commonly cited ranking was "Company knowledge", selected by 496 firms, followed by "Prompt decision making" with 197. With weightings of 3 points for first place, 2 for second and 1 for third, a total of 1,940 points were awarded for "Company knowledge" ("Weighted totals" in Table 6), followed by "Prompt decision making."

The same question was also included in the Tokai survey, with results as shown in Table 6. As in the Kansai survey, "Company knowledge" and "Prompt decision making" were the most important criteria that firms cited for rating their financial institutions.

Considering that mitigation of information asymmetry is the objective of establishing strong relationships with their banks, it is easy to understand why firms rated their major trading banks based on the criterion of "Company knowledge".

Table 6

Rating points that firms in the Kansai and Tokai regions assigned their major trading banks

		Company knowledge	Provision of business advice	Financing	Staff Turnover	Industry knowledge	Prompt decision making	Wide range of services	Knowledge of region and markets in which company operates
Kansai	1st	496	61	132	95	13	197	64	18
	2nd	145	116	106	186	75	266	109	37
	3rd	162	99	68	129	63	214	166	94
	Weighted totals	1940	514	676	786	252	1337	576	222
Tokai	1st	220	42	82	41	16	86	89	30
	2nd	99	59	45	74	44	110	86	54
	3rd	84	60	36	58	35	72	99	83
	Weighted totals	942	304	372	329	171	550	538	281

5. Importance of Geographical Distance in Medium/Small Company Finance

(1) Geographical Distance between Firms and their Major Trading Banks

Given the increasingly widespread use of IT in finance, it has become easy to deal with distant financial institutions. If geographical distance ceases to be a problem in financial transactions, one would expect regional finance problems to disappear, inasmuch as disinclination to borrow from local financial institutions leaves open the option of doing so from institutions all over the world.

Here we asked participating firms the geographical distance separating them and the branch of their major trading bank. Table 7 shows the results of the Kansai and Tokai surveys. Of the Kansai respondents, 34.9% answered less than 10 minutes, and 50.5% answered 10 - 30 minutes, resulting in a total of approximately 85% being within 30 minutes or less from the local branch of their major trading bank. Of the Tokai respondents, a total of approximately 70% were situated within 30 minutes or less from their local branch. The results showed that there were relatively no firms trading with financial institutions out of their local area (excluding cases wherein subsidiaries of major corporations traded with the parent company's bank). Although telecommunications technology is now widely used in financial transactions, we saw in both regions that there is relatively little distance between firms and their major trading banks.

Looking at Table 8 which shows a distribution of physical distance separating major trading banks and firms by number of employees, we can see that the smaller the firm, the higher the tendency to trade with a bank in its locale. The greater the distance, the more it costs for bank employees to visit the firms. In general, banks are willing to service larger corporations regardless of distance. As the results show, smaller firms more likely to suffer from the problem of information asymmetry have a strong tendency to select financial institutions within close proximity.

In order to determine whether 30 minutes was considered "close" or "distant" in comparison to when dealing with other companies including clients and suppliers, we

asked participating firms the time required when dealing or interacting with principle business associates. Table 9 shows a summary of the responses. The majority of responses put “Primary suppliers” and “Primary clients” within the range of 30 minutes to less than 1 hour. This indicates that in a relative sense financial institutions are also very close by.

Table 7

Physical distance between firms and their major trading banks

		Kansai Survey		Tokai Survey	
1)	Within 10mins	390	34.9%	52	24.3%
2)	10 - 30mins	564	50.5%	95	44.4%
3)	30mins - 1hr	151	13.5%	56	26.2%
4)	1 - 2 hrs	10	0.9%	7	3.3%
5)	Over 2hrs	2	0.2%	4	1.9%

Table 8

Geographical distance separating major trading banks and firms by number of employees

	Kansai Survey		Tokai Survey	
	Within 10mins	10 - 30mins	Within 10mins	10 - 30mins
9 or less	46.8%	43.5%	28.9%	43.4%
20 or less	41.3%	52.4%		
50 or less	31.7%	52.2%		
100 or less	28.5%	53.9%	26.2%	43.1%
500 or less	34.5%	48.7%	17.9%	44.6%
1,000 or less	14.3%	52.4%	30.0%	40.0%
Over 1,000	18.2%	63.6%	0.0%	71.4%

Table 9

Geographical distance separating firms and other companies and organizations

	Primary Suppliers	Primary Clients	Peer companies (excluding suppliers and clients)	Other companies (excluding suppliers and clients)	Unions and industry associations	Other organizations, Industry-Academia-Government affiliations	Universities and public research institutes	Public support institutions (other than research institutes) and local government	Financial institutions
Less than 10mins	6.9%	5.1%	5.8%	3.5%	7.4%	0.7%	0.7%	1.1%	23.0%
Less than 30mins	21.0%	19.1%	18.3%	18.8%	25.0%	16.6%	10.7%	17.3%	50.3%
Less than 1hr	47.1%	41.9%	47.6%	48.0%	47.2%	46.8%	47.0%	48.0%	23.0%
Less than 2hrs	10.2%	14.7%	12.9%	14.3%	8.4%	18.8%	23.2%	19.1%	2.6%
More than 2hrs	14.8%	19.2%	15.4%	15.3%	12.0%	17.2%	18.5%	14.4%	1.1%

(2) Importance of Bank Branches

We believe it is extremely important for regional financial institutions to have a dense network of branches in and around the local area. In order to confirm this belief, we asked firms how important it was when deciding on a financial institution that they have a branch close by.

Table 10 shows the overall results and a distribution of results by the number of employees. The results showed that overall, 89.6% of firms, including those opting for "somewhat important", felt it important that their financial institution had a branch close by. As was mentioned earlier in the paper, the majority of firms are trading with nearby branches with "proximity" being a major consideration.

By company size, looking at the percentage of firms that chose “extremely important” it is apparent that the smaller the company the more important proximity becomes. Approximately 25% of companies with 9 or less employees responded with "extremely

important". We can assume that firms of this size would not be visited by bank employees and would be responsible for handling their own transactions, making proximity all the more important.

Table 10

Importance of business branch proximity

		Extremely important	Important	Somewhat important	Almost no importance	No relation	Number of companies
All sizes		164	441	432	99	21	1157
		14.2%	38.1%	37.3%	8.6%	1.8%	
By size	9 or less	24.3%	38.1%	31.0%	6.2%	0.4%	226
	20 or less	13.4%	40.3%	36.6%	5.2%	4.5%	134
	50 or less	13.0%	42.8%	34.7%	7.4%	2.1%	285
	100 or less	11.8%	34.3%	41.7%	10.7%	1.5%	271
	500 or less	9.2%	34.5%	42.7%	12.1%	1.5%	206
	1,000 or less	8.7%	34.8%	47.8%	4.3%	4.3%	23
	Over 1,000	9.1%	54.5%	18.2%	18.2%	0.0%	11

(3) Methods and Frequency of Liaison with Financial Institutions

Results have confirmed that branch proximity is thought to be important, and that the majority of firms trade with financial institutions in their local area. What this suggests is that face-to-face communication is important between firms and their financial institutions, and that there is a reason for the method of and frequency of liaison between the two.

To verify this point we asked participating firms their principal means of communicating / interacting with major business associates. The results are as shown in Table 11. As a means of communication / interaction, "Face-to-face meetings" was most commonly associated with financial institutions followed by "Primary clients" and "Primary suppliers". These results indicate that direct, face-to-face communication with financial institutions is regarded as extremely important. Despite the progress made in telecommunications technology, direct communication still plays an important part in financial transactions.

Even though the frequency may decline, physical distance, to a certain degree, does not necessarily make it impossible to make visits to facilitate direct communication. Here we asked participating firms the extent and frequency of such meetings, with Table 12 showing the results. The figures in Table 12 are in response to a question asking firms how frequently, in terms of days, they initiated direct, face-to-face communication. For example, the figure 16.3 for "Primary suppliers" indicates one direct meeting every 16 days, (or twice a month). The highest frequency was for "Primary clients", followed by "Primary suppliers". In comparison, the degree of frequency for direct communication with financial institutions was lower, however still occurred once a month or more.

Table 11

Principal means of communicating / interacting with major business associates

	Primary suppliers	Primary clients	Peer companies (excluding suppliers and clients)	Other companies (excluding suppliers and clients)	Unions and industry associations	Other organizations, Industry-Academia-Government affiliations	Universities and public research institutes	Public support institutions (other than research institutes) and local government	Financial institutions
Direct face-to-face meetings	63.7%	70.4%	48.2%	43.7%	46.5%	43.9%	50.3%	43.4%	80.3%
Phone, fax, others	27.5%	19.8%	37.9%	38.8%	36.8%	28.4%	23.2%	25.4%	15.2%
IT including E-mail	8.2%	9.1%	8.1%	10.3%	10.3%	16.5%	14.7%	15.8%	3.2%
Others	0.6%	0.7%	5.7%	7.1%	6.3%	11.2%	11.8%	15.4%	1.3%

Table 12

Frequency of contacts by direct meetings

	Primary suppliers	Primary clients	Peer companies (excluding suppliers and	Other companies (excluding suppliers and	Unions and industry associations	Other organizations, Industry-Academia-Government affiliations	Universities and public research institutes	Public support institutions (other than research institutes) and local government	Financial institutions
Once in how many days	16.3	14.6	41.3	51.3	56.3	102.8	119.1	119.0	23.3

(4) What Do Firms Demand Regional Financial Institutions?

Regional finance institutions have the majority of their branches situated in the proximity of the prefecture, cities, towns and villages in which their head office is located. Naturally, when they establish new branches in areas outside their usual business territory, they become non-local financial institutions in those areas. The megabanks have branches nationwide, and are considered non-local in areas other than those in which they have their head offices such as Tokyo and Osaka.

How do firms conceive their local financial institutions in comparison to their non-local counterparts? We asked firms if they believed there was a difference in approach towards their financing between financial institutions with their head office in the regional area and their non-local counterparts.

The results are as follows. 117 companies (10.3%) responded, "There are differences"; 436 (38.2%) said, "Somewhat different"; 478 (41.9%) said, "Almost no change"; and 109 (9.6%) said, "No change at all". The results showed that approximately half of the firms participating in the surveys noted some sort of difference in the approach taken towards their financing by regional financial institutions and their non-local counterparts.

Table 13 shows a comparison by the number of employees. Excluding "More than 1,000" as a small-sample outlier accounting for only 11 companies, we can ascertain that the

smaller the company the more likely the tendency to select "There are differences".

Then, where do firms consider the difference lies? We asked participating firms who answered "There are differences" or "Somewhat different" to state in what aspect they felt the approach to their financing differed. Table 14 aggregates the results. The majority of firms noted "Screening content" as the major difference with "Time to financing decision" close behind. What is understood from these responses is that medium/small firms believe periodical contact with regional financial institutions leads to a greater understanding of their individual circumstances. Their major trading bank has up-to-date information, meaning that when a loan application is made, screening results are readily available without the need to complete and submit additional documentation.

Table 13

Company assessments of local financial institution differences (by number of employees)

	There are differences	Somewhat different	Almost no change	No change at all	Number of companies
9 or less	18.6%	35.7%	38.0%	7.7%	221
20 or less	10.0%	40.0%	41.5%	8.5%	130
50 or less	4.9%	44.0%	40.5%	10.6%	284
100 or less	9.1%	38.1%	43.8%	9.1%	265
500 or less	9.8%	35.1%	44.4%	10.7%	205
1,000 or less	8.7%	13.0%	65.2%	13.0%	23
More than 1,000	27.3%	36.4%	18.2%	18.2%	11

Table 14

Major points of difference

Loan interest rates	152	19.0%
Screening content (necessary documentation, etc.)	186	23.2%
Loan amounts	79	9.9%
Time to financing decision	179	22.3%
Collateral requirements	38	4.7%
Support in emergencies	136	17.0%
Others	31	3.9%

6. Conclusion

This paper has analyzed the relationship between medium/small firms and financial institutions based on the results of questionnaires prepared for medium/small firms in the Tokai and Kansai regions.

With the development of telecommunication technology and progress in securities market infrastructure, there are fewer cases in which geographical distance poses a problem in financial transactions. However, financing for medium/small firms is expected to remain dependent on indirect finance, i.e., financing through their major trading bank, inasmuch as it will be necessary for financial institutions to play a major role in overcoming the problem of information asymmetry in that sector. More specifically, this type of relationship banking in which periodical and direct contact lends to increased company knowledge is thriving as a means to eliminate the issue of information asymmetry. The direct contact or communication, an integral part of relationship banking entail costs, and can become difficult when banks locate far from firms.

The medium/small firms that play an important role in regional economies must thus depend on local financial institutions in their regions. Despite progress in telecommunication technologies, this reliance is expected to continue. It is therefore believed that regional financial institutions will play a significant role in the future development of local economies.

<Reference Material>

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