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Global Banking

Banking on growth: Ensuring the future prosperity of Japan

Following the launch of Japan's national strategy to revitalize growth, Japanese banks have renewed opportunities to become engines of prosperity by playing various roles in support of growth.

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1. Introduction

Japan today sits at a critical juncture in its economic history. During years of flat to negative GDP growth, a broad political consensus has developed that it is necessary to reignite the country's economic engine and unlock its latent growth potential. Japan's banks have an opportunity to participate by boldly enabling national growth. In doing so, they could transform their own fortunes.

The government's Action Plan of the Growth Strategy, launched in June 2021, outlines national priority actions to boost growth—priorities that will require support from a strong and involved banking sector.[1] In addition, recent regulatory changes in the form of amendments to the Japan Banking Act have opened doors for banks to move beyond their traditional roles into "beyond banking" activities. This McKinsey report looks afresh at the opportunities for Japan's banking sector in the context of Japan's new strategy and changing regulatory landscape.

Japanese banks can pursue a dual mission in support of national prosperity and their own growth. This would continue their long tradition of serving society and could create a positive uplift on national GDP and banking revenues in the years to 2030. Expanded banking involvement across key themes for country growth could result in a 2.0 percent compound annual growth rate (CAGR) in the country's nominal GDP, versus the 1.7 percent CAGR in GDP growth currently forecast between 2021 and 2030.[2,3] Banks today have an industry revenue of approximately $180 billion. They stand to realize a potential additional $45 billion in industry revenues if they decide to develop their roles in service of national growth, achieving 3.5 percent CAGR in industry revenue from 2021–30 versus the 1.3 percent CAGR currently forecast for the same period. This is far higher than the -3.0 percent CAGR Japan's banks have faced in industry revenues since 2018.[4]

To realize this growth potential, Japan's banks may need to reimagine their traditional roles and strengthen their capabilities in talent development, digitization, and risk management. This report outlines Japan's current macroeconomic landscape and six key themes that can help the country create conditions conducive to growth. It explores how banks can develop their roles in support of these themes and how they may need to transform internally to capture the value at stake.

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[1] Action Plan of the Growth Strategy, released in the 11th meeting of the Committee on the Growth Strategy at the Prime Minister's Office, June 2021.

[2] Japan nominal GDP in Japanese yen forecast for 2030, Oxford Economics Statistics, accessed March 2022.

[3] Forecast based on computing GDP growth across six themes: (1) sustainability, (2) investing in innovation and key industries, (3) aiding small and medium-size enterprises (SMEs) and start-ups, (4) deploying solutions for demographic groups, (5) boosting corporate development and labor productivity, (6) implementing digitization.

[4] Historic and forecasted revenues in US dollars with currency changes taken into account. The revenue forecast is calculated using McKinsey Panorama Global Banking Pools as a baseline. Additional revenue growth is calculated based on the assumption that banks play a revised and incremental role across the 6 themes of country growth. Each theme and corresponding role is assigned a weight. With the revised and incremental role of banks, additional revenue growth is calculated using three impact levels: low (0 to 1 percent); medium (1 to 2 percent); and high (2 to 3 percent).

2. The macroeconomic landscape today: Unlocking Japan's growth potential

Japan has long enjoyed an important position on the world economic stage, thanks in large part to its strong manufacturing and machinery sectors and stable national balance sheet. However, slower GDP growth in recent years has seen it slip behind the world economic powerhouses of the United States and China.[5] On the surface, Japan's economy might seem to be merely stable but stagnant, but its growth potential is immense. Japan continues to be a global innovator, with strong contributions from the automotive, chemicals, computers and electronics, and machinery sectors.[6]

Despite Japan's enduring reputation in these industries, the country's trade growth has slowed in recent years, from 5 percent CAGR in 2005–10 to a decline of 1 percent CAGR in 2010–20, even as global trade grew 2 percent over that decade. Expectations are for Japan's trade with the rest of the world to pick up between 2021 and 2030, increasing by 4 percent CAGR.[7]

One of Japan's strengths is its national balance sheet. The country's total assets rank second highest globally, at 23 times GDP, versus an average of 18 times GDP among ten peer countries (Exhibit 1). Japan also has one of the highest ratios of net worth to GDP, at 7.2 times GDP versus 6.1 times for the global economy in 2020.

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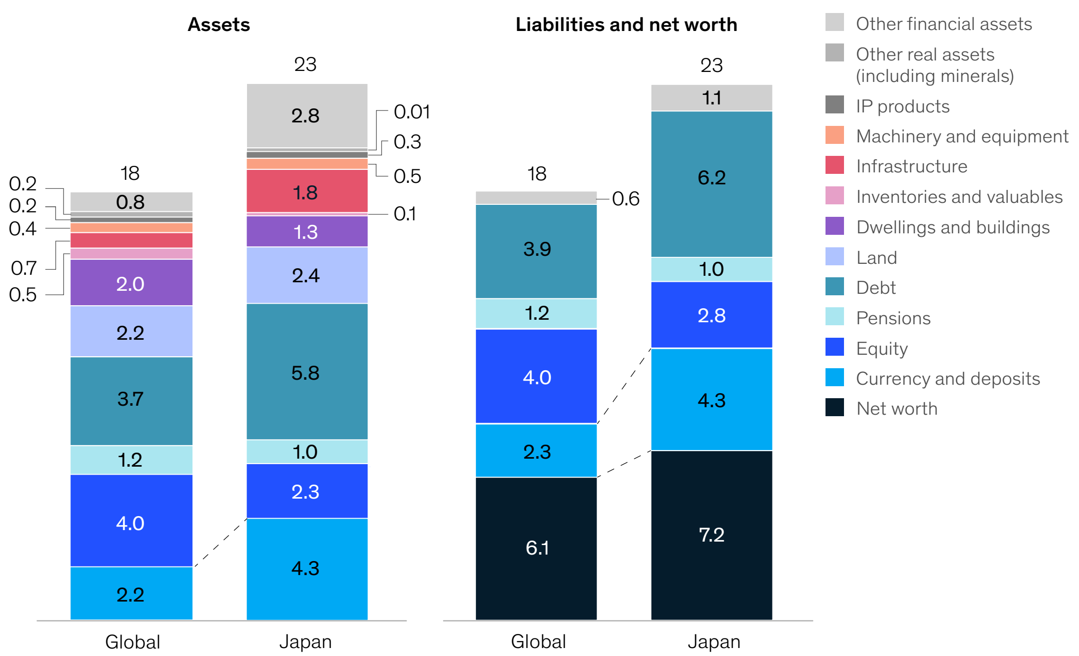
[5] Based on nominal GDP growth rate for United States, China, and Japan for 2021, Oxford Economics Statistics, accessed March 2022.
[6] Based on Gross Value Added analysis by sectors in Japan for 2021; IHS Markit Comparative Industry Service, accessed March 2022.
[7] Trade flow defined as import and export of goods and non-factor services. 2021 trade flows data sourced from IHS Comparative Industry, accessed March 2022, and UNCTAD statistics, accessed March 2022.

Exhibit 1

Japan's total assets are nearly 23 times GDP, higher than the average of 18 times GDP among ten peer countries.

Japan vs global,[1] 2020, GDP multiple



[1]The global average is an extrapolation derived from a weighted average of 10 countries based on GDP. Countries included are Australia, Canada, China, France, Germany, Japan, Mexico, Sweden, United Kingdom, United States.
Note: Figures may not sum to 100% because of rounding.
Source: CEIC; Federal Reserve Board; national statistics offices; OECD; World Bank; McKinsey Global Institute analysis

The current status of Japan's national balance sheet is an outcome of household savings. Japan is a country of wealth owners rather than wealth creators, with most of its net worth tied up in personal assets like land, pensions, and currency and deposits rather than in wealth-generating commercial assets like machinery, intellectual property (IP) products, and inventories. The level of household currency and deposits relative to GDP is higher in Japan than in several peer countries (Exhibit 2).

Exhibit 2

Household deposits relative to GDP are much higher in Japan than in peer countries.

Selected nations' GDP, household currency, and GDP growth

[1]Figures for household currency and deposits as a multiple of GDP for India are based on 2020 due to the unavailability of household deposits data.
Source: Central bank statistics; OECD; World Bank; McKinsey Global Institute; McKinsey analysis

Japan's economy continues to be dominated by large corporations (those with annual revenue greater than $1 billion). Their collective contribution rose from 38 percent of GDP in 1996 to 47 percent in 2020; in France and the United States, large corporations in 2020 contributed 29 percent and 30 percent, respectively.[8] Japan's large corporations are also expanding internationally. Their overseas sales have grown from 26 percent of total sales in 2010 to 32 percent in 2021.[9] In comparison, SMEs also make an important contribution to GDP, accounting for 25 percent in 2020, but this share has declined over the last five years.[10]

A key demographic trend shaping Japan's macroeconomic landscape is the country's aging population. The population over the age of 65 is expected to reach 38 million people by the end of this decade, representing 31 percent of the total.[11] An aging population is not unique to Japan; several other developed peer economies are likely to observe similar trends between 2020 and 2030. Therefore, Japan has an opportunity to set an example for the rest of the world in how to deal with the challenge of a shrinking working-age population.

Like other countries, Japan has committed to reach net-zero emissions by 2050. Japan is the sixth-highest emitter of greenhouse gases and relies heavily on carbon-intensive industries.[12] Today 31 percent of Japan's GDP is contributed by sectors that will see a high impact from the net-zero transition, like power and industry and the production of fossil-fuel-dependent products.[13] To decarbonize and secure low-emissions growth in the years to 2050, Japan would need to spend $330 billion per year on physical assets for energy and land-use systems.[14] This is a comparatively smaller share of national GDP than in other countries (Exhibit 3).

In addition to the long-standing trends described at the time of publication of this report, the macro-economic environment is under significant flux with rising inflation and interest rates. Equity markets and the Japanese yen are under pressure. While this report is not intended to address this rapidly changing environment, the themes discussed herein remain relevant over the short-to-midterm outlook for the country.

3. Priority actions for driving sustainable economic growth

The Japanese government's Action Plan of the Growth Strategy, launched in June 2021, sets out multiple national priorities designed to drive growth and build future prosperity and well-being for the Japanese people.[15] Drawing on the government plan, Japan's macroeconomic landscape, and the opportunities and challenges in a changing global economy, McKinsey analysis identifies six themes that stand out as particularly important for driving sustainable economic growth. These six themes include widespread digitization, investment in innovation and key industries, support for SMEs and start-ups, deployment of solutions for different demographic groups, and boosts to corporate development and labor productivity. In all of this, it will be vital to drive sustainability across industries in support of the country's net-zero transition.

Transformation across these six areas can lay the foundation for a stronger, more innovative Japanese economy. And in each area, banks have an opportunity to help create the conditions needed to stimulate growth.

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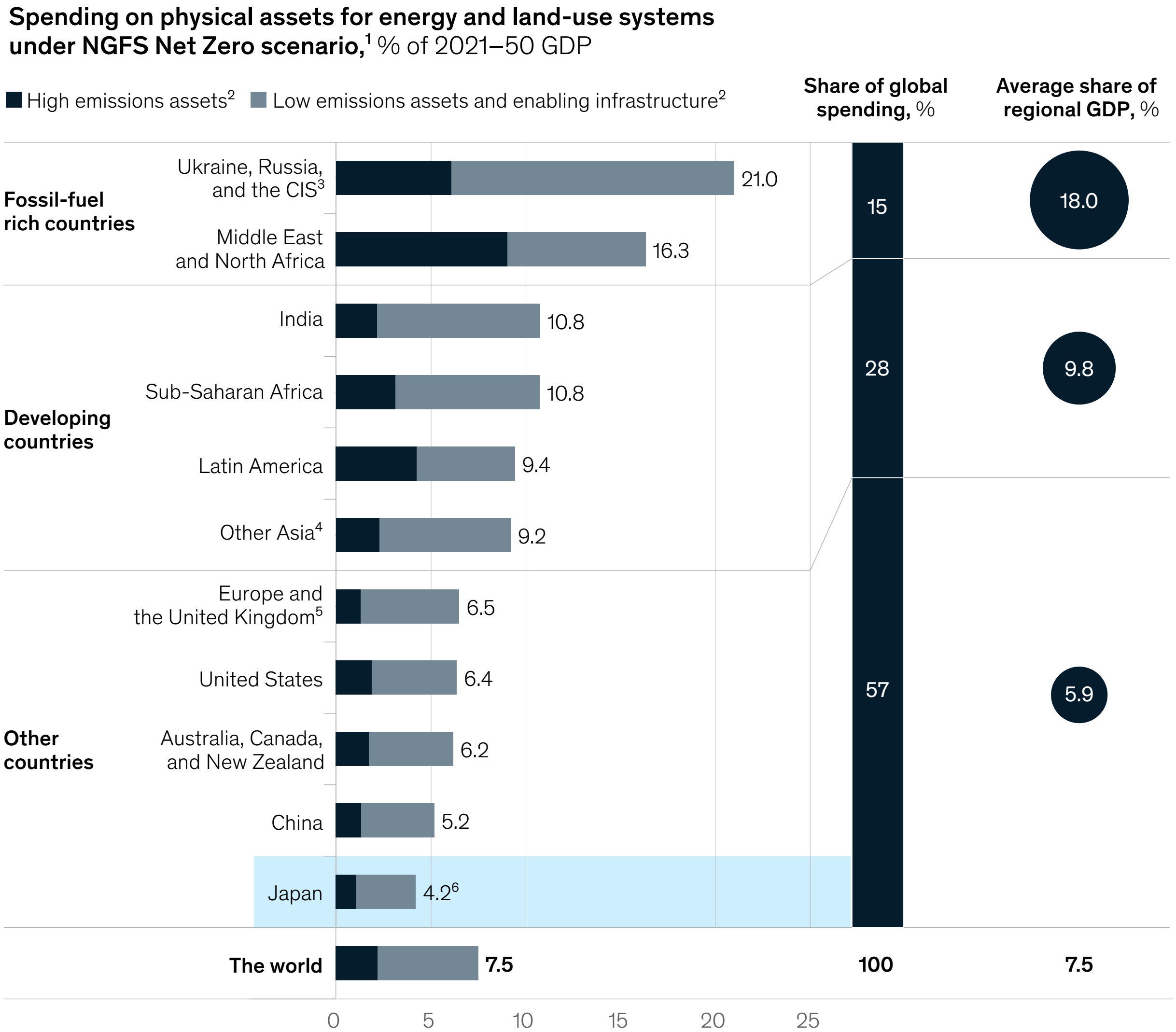
[8] McKinsey Global Institute's Companies and Economy 2020 dataset, accessed March 2022.
[9] Ibid.
[10] Policy Research Institute, Japan Ministry of Finance, accessed May 2022.
[11] Population data for total population and 65 year+ for 2030, Oxford Economics, accessed March 2022.
[12] Tasuku Kuwabara, Detlev Mohr, Benjamin Sauer, and Yuito Yamada, *How Japan could reach carbon neutrality by 2050*, August 2021, McKinsey.com.
[13] Ibid.
[14] Ibid.
[15] Japan Cabinet Office, Action Plan of the Growth Strategy, June 2021.

Exhibit 3

Compared with other countries, Japan would need to spend a lower share of GDP to decarbonize and secure low-emissions growth.



[1]Estimation includes spend for physical assets across various forms of energy supply (eg, power systems, hydrogen, and biofuel supply), energy demand (eg, for vehicles), and land use. This includes both what are typically considered "investments" in national accounts and spend, in some cases, on consumer durables such as personal cars. Scenario based on the NGFS Net Zero 2050 scenario using REMIND-MAgPIE (phase 2). Based on analysis of systems that account for ~85% of overall carbon dioxide equivalent (CO_2e) emissions today. Our analysis includes a more comprehensive view of spending by households and businesses on assets that use energy, capital expenditures in agriculture and forestry, and some continued spend in high-emissions physical assets like fossil fuel–based vehicles and power assets.

[2]Our analysis divides high-emissions assets from low-emissions assets. High-emissions assets include assets for fossil fuel extraction and refining, as well as fossil fuel power production assets without CCS; fossil fuel heat production, gray-hydrogen production; steel BOF; cement fossil fuel kilns; ICE vehicles; fossil fuel heating and cooking equipment; dairy, monogastric, and ruminant meat production. Low-emissions assets and enabling infrastructure include assets for blue-hydrogen production with CCS; green-hydrogen production using electricity and biomass; biofuel production; generation of wind, solar, hydro-, geothermal, biomass, gas with CCS, and nuclear power along with transmission and distribution and storage infrastructure; heat production from low-emissions sources such as biomass; steel furnaces using EAF, DRI with hydrogen, basic oxygen furnaces with CCS; cement kilns with biomass or fossil fuel kilns with CCS; low-emissions vehicles and supporting infrastructure; heating equipment for buildings run on electricity or biomass, including heat pumps; district heating connections; cooking technology not based on fossil fuels; building insulation; GHG-efficient farming practices; food crops, poultry and egg production; and land restoration.

[3]CIS refers to the Commonwealth of Independent States.

[4]Includes, among others, South Korea and Southeast Asia.

[5]Includes, among others, the 27 European Union members, the United Kingdom, and other countries in the region such as Switzerland, Norway, and Turkey.

[6]Number could go as high as 5% of GDP.

Note: Figures may not sum to 100% because of rounding.

Source: Network for Greening the Financial System 2021 (Net Zero 2050 scenarios) REMIND-MAgPIE model; Vivid Economics; McKinsey Center for Future Mobility Electrification Model (2020); McKinsey Hydrogen Insights; McKinsey Power Solutions; McKinsey–Mission Possible Partnership collaboration; McKinsey Sustainability Insights; McKinsey Agriculture Practice; McKinsey Nature Analytics; McKinsey Global Institute analysis

3.1 Employing sustainability across industries

In 2019, Japan was the world's sixth-largest greenhouse-gas emitter, contributing around 3 percent of CO_2-equivalent emissions. In a push toward the green transition, Japan has upgraded its National Determined Contributions (NDCs), setting a target to reduce emissions 46 percent below 2013 levels by 2030 and to reach net zero by 2050.[16]

Japan's net-zero commitment will present new opportunities for innovation and growth but at a steep cost to the economy. McKinsey's Japan report on carbon neutrality indicates that Japan is set to see a significant increase in energy transition costs in the years to 2050, which will affect its overall competitiveness compared with other countries.[17] Between 2021 and 2050, Japan would need to spend $330 billion per year on physical assets for energy and land-use systems, with the bulk of this investment going toward the power and industry sectors, which together contribute the bulk of Japan's emissions, followed by mobility.[18]

The pursuit of net zero will require identifying which industries need to undergo dramatic process changes to mitigate these impacts and assessing the transition costs across sectors. Investment and technical support will be needed to enable sustainability in, for example, R&D in the green sector.

Japan has the high stock of technological and natural-capital endowments needed to turn these net-zero challenges into investment opportunities and is well on the way to decarbonizing its economy. The country is one of the leaders globally in its number of climate-related patents and its spend on R&D as a proportion of GDP.[19]

Banks could accelerate sustainability and help Japan build a competitive edge, not only through financing transition initiatives, but also by launching carbon credit trading markets, such as Climate Impact X in Singapore. Banks might also consider building distribution capabilities for carbon credits, like ClimateSeed, which was launched by BNP Paribas and is now run by AXA Investment Managers. Banks also can propose comprehensive financial solutions—for example, specialized insurance to mitigate the short-term risks of the transition, such as price volatility and instability of supply.

3.2 Investing in innovation and key industries

Innovation will work hand in hand with technology to bring future prosperity to the country, and the government is emphasizing investment in priority industries and innovation initiatives. From an investment standpoint, disclosure guidelines could help ease strategic decision-making and encourage greater investment in intellectual property and intangible assets.

Establishing strength in the sciences—such as pharmaceuticals, oceans, and space—and international finance can be supported by attracting greater levels of foreign business investment and talent into the country. Indeed, Japan aims to improve its exposure on the world stage through events like the 2025 World Exposition and by promoting specific Japanese industries and locations through published frameworks and plans.

Banks could support the innovation agenda by building forward-looking perspectives on priority industries, helping key players articulate their investment theses, and facilitating fundraising for those players,

[16] Ministry of Foreign Affairs of Japan, accessed June 2022.
[17] Tasuku Kuwabara et al., *How Japan could reach carbon neutrality by 2050*, August 2021, McKinsey.com
[18] Ibid.
[19] Mekala Krishnan, Hamid Samandari, Jonathan Woetzel, Sven Smit, Daniel Pacthod, Dickon Pinner, Tomas Nauclér, Humayun Tai, Annabel Farr, Weige Wu, and Danielle Imperato, *The net-zero transition: What it would cost, what it could bring*, January 2022, McKinsey.com.

including those at the early stages of their innovation journeys. An example from the United States is Silicon Valley Bank, which has developed a distinct proposition for the tech sector to capture opportunities in fast-growing companies. This proposition covers tech companies at all stages of the business life cycle, from start-ups to large corporates. The bank also has a dedicated solution for venture capital (VC) funds, fronted by highly experienced relationship managers with deep VC knowledge.

3.3 Aiding SMEs and start-ups

Japan's government is highlighting the role of SMEs and start-ups in delivering growth and pursuing high-level interventions to drive investment in high-potential businesses. Efforts include reforming regulations for initial public offerings (IPOs) and special purpose acquisition companies (SPACs), as well as encouraging private placement financing and the formation of start-up ecosystems.

There is also opportunity to build greater trade fairness in Japan by encouraging a culture of cooperation between small businesses and large corporations. Creating visibility and business support for SMEs focused on agriculture and related industries could support wider efforts at regional revitalization.

Japanese banks can radically step up their support for SMEs. Banks could develop next-generation credit scoring enabled by analytics in order to provide SMEs with credit based on more accurate risk assessments beyond collateral coverage and financial statements. In one example of such innovation, ING in Germany has teamed up with Amazon to offer loans of up to €750,000 to SMEs that sell on the Amazon platform, using criteria such as their Amazon sales history to determine loan eligibility.[20]

3.4 Deploying solutions for key demographic groups

In Japan, as elsewhere, consumers are increasingly looking for specialized solutions tailored to their needs. Differentiated financial services and wealth management solutions could include creating easier access to financial services—for example, through digital services and online and mobile banking. Such offerings could serve populations in more remote regions of the country, as well as individuals with mobility challenges. At the same time, encouraging people across different age groups and regions to invest in more diverse financial products could help shift some of their wealth out of low-return assets like retail deposits.

Demographic personalization is also key where nonfinancial services are concerned—for example, in health tech and cybersecurity solutions aimed at elderly populations. These solutions have remained largely deprioritized by the banking sector as the industry focused on asset accumulation products that directly impact banking revenues. Banks can potentially resolve these unmet needs by developing a service-based model and launching comprehensive solutions for key segments. As Japan's population ages, such solutions might include providing asset decumulation planning services to unleash mass affluent and elderly customers from the predominant "wealth protection mode" and ensure a higher quality of life for customers into their later years. These services are emerging in the United States and attracting fast-expanding customer bases; for example, select US players now offer advisory services on retirement spending, asset decumulation, and inheritance support.

[20] Mark Walker, "ING provides loans to Amazon sellers," *Fintech Times*, July 3, 2020, thefintechtimes.com.

3.5 Boosting corporate development and labor productivity

Given the dominant role of large corporations in the Japanese economy, a strong and thriving corporate sector will be critical to boosting growth. Labor productivity also will be key as the country grapples with its aging population. The Action Plan of the Growth Strategy speaks directly to the need to reform Japanese corporate structures to allow for the creation of new, high-value product offerings to widen margins and boost profitability. On the labor side, the government plans to increase productivity, participation rates, and wages to reignite the labor market. This includes reforming the business environment for freelancers; promoting remote work and other forms of nontraditional employment, including short-term work; lifting the ban on second jobs; and increasing labor mobility across regions.

Recognizing the well-acknowledged role of diversity in enabling innovation, there are moves to promote greater diversity in workplaces by appointing more women, young workers, midcareer hires, and non-Japanese employees, as well as people who bring diverse international and cultural experiences.

Banks have a potential role to play in supporting broader labor deployment goals. For example, they could enhance financial support to nontraditional worker segments through upgraded credit scoring and could target offers specifically to priority sectors. Banks globally are looking at ways to support different worker groups. State Bank of India's YONO Krishi offering is a one-stop solution for the country's large farmer population, which includes financial services, a marketplace for inputs and equipment, and targeted advice for farmers.[21]

3.6 Implementing digitization

As it has done in the past, technology will underpin much of Japan's growth revitalization. Prioritizing digitization across the economy can help increase efficiency, grow revenue in existing businesses, and give rise to entirely new business opportunities. For example, artificial intelligence (AI) can unlock process efficiencies in the mobility and construction sectors, as well as increase accessibility for elderly customers in the finance sector. Blockchain can improve supply chain processes. And in more traditional sectors—for example, agriculture, forestry, and fisheries—technology and satellite information can bring newfound levels of efficiency to decades-old practices.

The development of 5G infrastructure will be critical, alongside R&D in 6G technologies for industrial applications. To support its digitization goals, the Japanese government has established a Digital Agency to drive digitization across the government and public sector.[22]

To accelerate the country's digitization goals, banks can be role models by implementing their own digital transformations. In addition, they can acquire digital capabilities specific to priority industries and can provide digitization-purposed loans to SMEs to augment the many public-support programs targeting SME digitization.

[21] Joydeep Sengupta, Vinayak HV, Violet Chung, Xiang Ji, Ervin Ng, Lingxiao Xiao, Kristy Koh, and Celia Chen, *The ecosystem playbook: Winning in a world of ecosystems,* April 2019, McKinsey.com.
[22] Japan Cabinet Office, Action Plan of the Growth Strategy, June 2021.

4. Reimagining the role of banks in enabling future prosperity

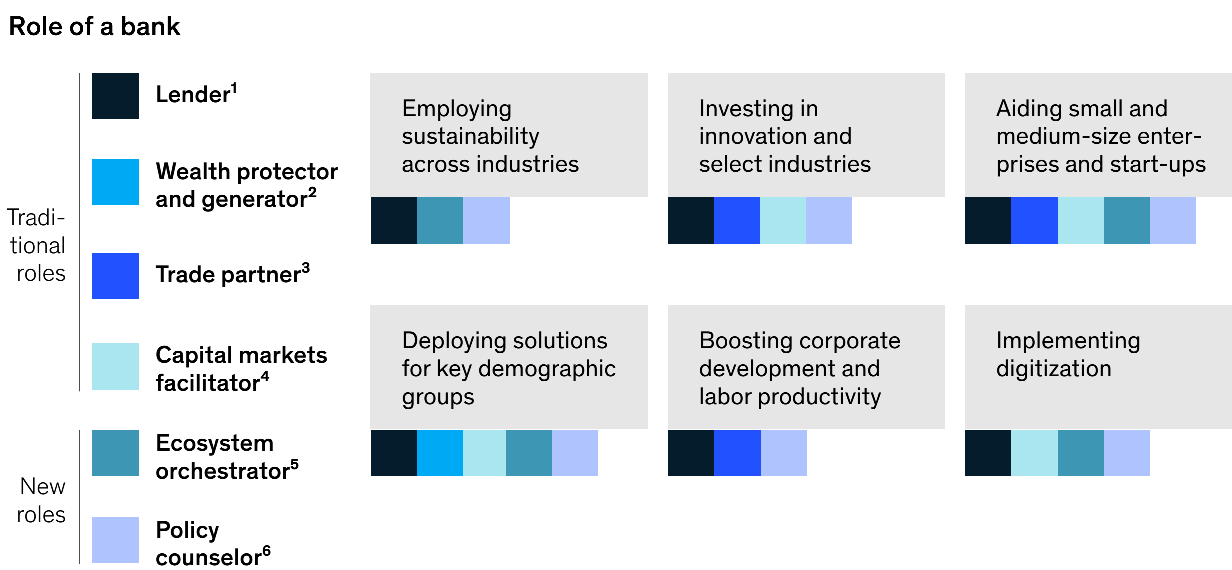
Banks have always played a special role in Japan—not just from a financial and economic point of view but also in service to society. This dual mission will arguably become more important as Japan embarks on its quest for future prosperity.

At present, Japanese banks are very traditional institutions, focused on their core roles as lender, wealth protector and generator, trade partner, and capital markets facilitator. Based on the government's strategy, these roles will evolve in the years to 2030, and banks can increase their involvement in two further roles: ecosystem orchestrator and policy counselor. Some Japanese banks are already making progress in these areas—for example, by launching healthcare-related services and expanding support for SMEs—particularly since the banking law reform in November 2021.

In each of these core and new roles, banks can enable prosperity by contributing to the priority themes (Exhibit 4).

Exhibit 4

Banks can play a key enabling role in each of six priority action areas.



[1]Provides financial support at reasonable interest rates; aids easy access to and disbursal of credit, especially in times of emergency.
[2]Protects investors' wealth through suitable, guided financial products; protects against financial risks; offers financial literacy; breaks myths about investments.
[3]Facilitates day-to-day trade operations, supply chain, and flow of payments and receivables, for smooth flow of working capital and business processes.
[4]Acts as intermediary in raising debt/equity capital; provides advisory and information services; acts as broker for trade of securities.
[5]Aids financial journey throughout different stages of life and supplements it with adjacent services and solutions.
[6]Provides inputs to government to aid decision-making on monetary policies affecting households, financial corporations, and nonfinancial corporations.
Source: Japan Cabinet Office, *Action Plan of the Growth Strategy*, June 2021; expert inputs; McKinsey analysis

- *Lender.* As lenders, Japan's banks could support sustainability by developing targeted lending programs for transition finance, such as those aimed specifically at industrial high-emitting companies looking to reduce their emissions and make the transition to green. Targeted lending could also support R&D in sustainability-led initiatives across industries. To ease access to loans for SMEs and start-ups, as well as to boost lending efficiency, banks might look to develop AI-based credit assessments and lending products. Finally, national priority sectors, including automotive and machinery, and broader goals such as digitization, could benefit from focused lending approaches.

- *Wealth protector and generator.* Banks have a role to play protecting and generating wealth on behalf of different segments, such as age groups and asset levels. Ultra-high-net-worth (UHNW) customers hold around 8 percent of Japanese wealth, followed by high-net-worth (HNW) at 21 percent, affluent at 15 percent, mass affluent at 45 percent, and mass at 11 percent.[23]

  The mass-affluent segment is currently underserved by banks in terms of skilled relationship managers, and there is an untapped opportunity for banks to develop hybrid advisory models that combine digital and person-delivered wealth management solutions for this customer group. Many millennial customers are in the mass segments; for them, banks could leverage technology to deliver digital investment solutions that offer easy access to a wide range of investment opportunities supported by user-friendly research and information. Older customers, many of whom are in Japan's mass affluent and affluent customer segments, tend to need wealth solutions that focus on inheritance, tax planning, and asset decumulation.

- *Trade partner.* As Japan looks to increase local and international trade in the years to 2030, banks could help improve the ease of doing business. Interest in this area has focused on distributed ledger technology (DLT), such as blockchain, which promises greater efficiency in enabling trade, supply chain financing, and instant payments. As Japanese banks invest in technology to make things easier for customers, they can look to other global banks, which now offer transaction banking services through a series of technology-driven solutions.

- *Capital markets facilitator.* As sustainability initiatives ramp up across industries, banks can play the role of facilitator for raising funding via equity capital markets (ECMs) and debt capital markets (DCMs). Funding for sustainability projects could be delivered through green bonds, and banks also can focus on sustainability through environmental, social, and governance (ESG)-embedded M&A diligences and ESG-linked products as part of trading portfolios.

- *Ecosystem orchestrator.* Banks globally are readily moving into "beyond banking" spaces to play the role of ecosystem orchestrator for key market segments. The Japanese government's recent banking reforms are enabling Japan's banks to do the same. A comprehensive business ecosystem for SMEs and start-ups, for example, could encompass nonfinancial services like business registrations, marketing, accounting assistance, and personalized market insights, alongside more conventional financial products such as business bank accounts and credit products. An ecosystem for older customer groups might cover financial services that include investment planning, retirement and inheritance planning, and tax planning, as well as access to healthcare, digitized medical records, and services focused on cybersecurity and digital literacy.

- *Policy counselor.* As the Japanese government looks to create an enabling environment for growth, banks can step forward as engines of prosperity, providing helpful input on a range of topics. In support of the net-zero transition, for example, banks could share their industry knowledge to advise on the key industries needing support, the priorities for various industries to make the transition, and specific financing mechanisms.

[23] McKinsey Panorama Global Banking Pools, accessed May 2022.

5. How banks can evolve in the years to 2030

As Japan's banks lean into a renewed purpose as drivers of future prosperity, they will want to consider how to meet an increasing set of demands from their customer groups. Capturing these opportunities may require banks to enhance their existing practices and approaches across each of their six core roles (Exhibit 5).

Exhibit 5

The role banks play today will expand in service of growth, with an opportunity to build dedicated ecosystem offerings.

Role of banks in Japan today

Lender

Wealth protector and generator

Trade partner

Capital markets facilitator

Future role of banks in Japan

Lender - everyday and complex financing

- Everyday banking and lending as a service
- Complex financing

Wealth protector and generator + financial-literacy educator

- Do-it-yourself, low-touch investment for the millennial generation
- High-touch wealth solutions for the aging population

Trade partner - sectoral specialization

- Information-driven trade finance and supply chain solutions; banks specializing by industries (eg, healthcare, automotive, infrastructure)

Capital markets facilitator - all asset classes

- Capital markets for traditional assets
- Capital markets for new asset classes (ie, digital assets, alternative assets)
- Capital markets for sustainability-linked products (green bonds, ESG advisory)

Ecosystem orchestrator

- Complex financing: Housing, mobility, equipment financing ecosystem
- Aging population ecosystem (including financial advisory, cybersecurity, health tech, travel)
- Sustainability ecosystem
- Digital-asset ecosystem

Policy counselor

Source: McKinsey analysis

5.1 From traditional lender to provider of everyday and complex financing

Today's lending activity in Japan is fairly traditional in serving corporations, SMEs, and retail customers. Analysis shows that banks are now developing innovative models to lend to SMEs and commoditizing basic lending products. This trend toward greater commoditization is likely to continue, with two types of distinct lending models emerging: everyday banking and complex financing:

1. In *everyday banking* and lending, banks may move toward a tech-enabled and low-touch, platform-based lending-as-a-service (LaaS) model to provide simple retail loans, direct SME loans, credit card loans, and basic banking transactions. As these services become increasingly commoditized, the bank in its traditional sense would have fewer direct touchpoints with customers.

2. For *complex financing* needs, banks may develop more specialized and structured lending products and services that support clients' major life events, including mortgages, project financing, and equipment financing.

Both forms of lending could be enhanced through dedicated ecosystem approaches. For example, banks could become e-commerce marketplace specialists to support everyday banking or fill the role of home and equipment finance ecosystem orchestrators for more complex financing.

These approaches are already finding success in various parts of the world. In Singapore, DBS is partnering with real estate agents and companies to support customers along the end-to-end home-buying journey, from planning and searching for a property to buying and moving in.[24] A leading North American regional bank has entered the car ownership journey with a service that aggregates all car ownership and maintenance services into one platform, including on-demand mobile mechanic, service booking, document storage, resale value estimates, and more. Kaspi Bank in Kazakhstan is emerging as a platform player in everyday banking, delivering a range of fintech-enabled services, including payments, an e-commerce marketplace, digital finance, and easy bill payments.[25]

5.2 From wealth protector and generator to enhanced role including financial literacy educator

Many of Japan's banks today are supporting HNW and UHNW individuals with a product-centric sales approach. There have been some early moves into providing these segments with more customized services for wealth protection and generation, including inheritance planning, but for affluent and mass segments, the offering remains largely limited to product-centric sales.

The traditional role of wealth protector and generator may evolve beyond the brokerage sales transaction approach toward new goals-based wealth management business models tailored to client needs. Banks can leverage their broad base of customer relationships and knowledge to build partnerships or ecosystem approaches to provide the suite of product and service capabilities needed for such holistic advisory programs.

[24] "DBS launches Southeast Asia's largest bank-led property marketplace," July 24, 2018, DBS.com.
[25] Kaspi Bank company website, accessed June 2022.

This expanded wealth generator role might also involve creating new value propositions and customer journeys that enable investors to make different investment choices for themselves—helping to break long-held investment behaviors in Japan. Beginning with a discovery session aimed at identifying wealth-generation goals, these journeys could align customer needs with appropriate asset allocations, making it easier for customers to select and pursue different investment choices.

Banks could also look to develop wealth-generation services that cater to different population groups. These might include asset decumulation planning for elderly and mass-affluent customers or services that make it easy for an elderly customer to add children's names on an account so they can help oversee or monitor it. For younger customers, banks could develop low-touch models, including do-it-yourself platforms for research and decision-making about different asset classes and investment vehicles.

As digitization continues to advance, banks might also consider supporting increased adoption of new investment classes, including digital assets.

In addition, the role of wealth protector and generator may evolve to include a financial literacy element that targets myths and assumptions around investment.

5.3 From generalist trade partner to deep sectoral expert

Japan's banks are already an important partner in trade for local and global corporations. This role is only set to grow in significance as banks step up to support a broader range of priorities, including SMEs and start-ups, innovation, and select industries.

One way that banks may develop their trade partner offering is by focusing on specific industries—developing deep sectoral knowledge to customize their products and services and cater for the end-to-end sectoral value chain. For example, where one bank may choose to serve the automotive industry and all its suppliers, another may emerge as the leader in serving the medical industry, including hospitals and clinics, pharmacies, and vaccine manufacturers. This sector-focused approach would be made possible by banks leveraging their knowledge of end-to-end players in the value chain to understand client needs and serve them better. Rabobank has developed a specialized offering for the agriculture sector, both in the Netherlands and globally, providing financing to the agriculture and food segments, which now account for around 25 percent of the group's loan portfolio.[26]

As international trade partners, banks seeking to provide international trade finance to Japanese corporations with strong international trading businesses could offer DLT-based trade solutions. The technology could enable faster transactions and instant settlements to support trade.

5.4 From capital markets facilitator to holistic facilitator across asset classes

While there is strong sales and trading business in Japan, serving both domestic and international investors, capital market offerings are at present limited to a select few Japanese banks. Further, compared with other developed countries, Japan has relatively low activity in primary markets. Japan's share of global primary market revenues (equity capital markets, debt capital markets, and M&A advisory) was 3 percent in 2021.

[26] McKinsey analysis based on Rabobank annual report 2021.

In contrast, the US share of global primary market revenues was 51 percent in 2021, followed by China at 11 percent and the United Kingdom at 5 percent.[27]

This is almost certainly set to change as Japan switches its investment habits to encourage greater wealth generation. Banks will have an enabling role to play within capital markets to help their clients invest in SMEs, start-ups, and sustainable businesses. Banks may also have a more critical role to play in raising debt capital through green bonds. Canadian bank RBC, for example, has launched its own sustainable finance group, which is responsible for integrating ESG in capital market services such as environmental commodity trading and ESG due diligence for M&A deals.[28]

5.5 From traditional bank to ecosystem orchestrator

The role of banks as ecosystem orchestrators is likely to be one of the most significant and evolving roles for banks globally, not just in Japan. Until now, Japan's banks have been restricted from playing in these broader spaces, but there is now a regulatory landscape that allows banks to play an extended beyond-banking role. The Japan Financial Services Agency (JFSA) has made a revision to the Banking Act, with effect from November 2021, allowing banks to do ancillary business such as consultation services, data analysis, and daily support services for elderly customers, among others. It also enables ease of approval for advanced banking services including, for example, FinTech services, regional trading services, data analysis, and marketing and advertising.

This is a real opportunity for banks to leverage their existing expertise as lender, wealth protector and generator, trade partner, and capital markets facilitator to launch beyond-banking services. Potential areas ripe for ecosystem offerings include the SME marketplace, including lending and beyond-lending products like advisory, accounting, and connecting with supply chain partners. Ecosystems geared to support Japan's aging population might cover financial, healthcare, and personal services, while house property management ecosystems could encompass a broad suite of services, including property selection, mortgage products, legal services, and maintenance.

5.6 From finance sector player to policy counselor

As the government looks to create an enabling regulatory environment for growth, banks can leverage their deep sectoral knowledge and expertise to play a bigger role in support of national priorities, especially in terms of implementing government policy. From their experience in promoting digitization, innovation, and sustainability to assisting SMEs, banks have much to offer policy makers and decision makers. To support the priority to meet net-zero targets in a phased manner, for example, banks could provide useful input on how to ensure timely priority-sector lending. And to boost SME growth, banks could advise on start-up-friendly policy and lending. In the United States, for example, Goldman Sachs has partnered with the government to support sustainable, climate-aligned outcomes in the land sector by co-launching the Forest Investor Club, a network of leading public and private financial institutions and other investors that aim to unlock and scale up investments.[29]

[27] McKinsey Panorama Global Banking Pools 2021, accessed May 2022.
[28] RBC company website, accessed June 2022.
[29] US Department of the State, Office of the Spokesperson, "Forest Investor Club Establishment at COP26",November 2, 2021, state.gov.

6. What a dual mission could mean for growth

Real value is at stake in banks pursuing this dual mission in support of national prosperity and their own growth. From a country GDP perspective, expanded banking involvement across the six priority themes could result in a greater than 15 percent increase in Japan's nominal GDP growth in the years 2021–30. As mentioned at the beginning of this report, this would mean a 2.0 percent CAGR, versus the 1.7 percent CAGR in GDP growth currently forecast, which translates into an additional GDP of JPY20 trillion. Banks today have an industry revenue of approximately $180 billion. They stand to realize a potential additional $45 billion in industry revenues if they decide to develop their roles in service of national growth, achieving 3.5 percent CAGR in industry revenue from 2021–30 versus the 1.3 percent CAGR currently forecast for the same period. This is far higher than the -3.0 percent CAGR Japan's banks have faced in industry revenues since 2018.

7. Building the capabilities required to support growth

As Japan looks toward a new growth-focused era, banks will want to look internally to assess whether they are ready for what lies ahead. Fundamentally, if they are to meet rising expectations and step into their role as engines of prosperity, banks may need to develop their capabilities in three broad areas: talent development, technology deployment, and risk management. While many leading Japanese banks are already developing in these areas, the industry as a whole can benefit from concerted efforts to take advantage of the opportunities in a changing marketplace.

7.1 Rethinking traditional approaches to talent management

The range and rate of change required within banks is likely to place new demands on leaders, managers, and employees. Specialist skills to support the evolving roles of banks—including digital talent and new capabilities to create and operate ecosystem offerings or deliver more personalized wealth management services—will be essential.

Traditional elements of organizational culture and process have served Japanese banks well in the past, but banks may need to rethink some of them to keep up with the pace of development. Japanese banks can follow the examples of other leading global banks in developing an agile and continuous-improvement approach to mastering the core capabilities of talent management.

While all areas of talent management will be important, those with highest relevance and urgency for Japanese banks include talent acquisition, attraction, and selection; upskilling and apprenticeships;

performance management; onboarding and dynamic deployment; and talent culture. There are also a number of other important, but second-order, priorities.

The most pressing talent management capabilities for Japanese banks today

— *Talent acquisition, attraction, and selection.* Given Japan's shrinking working-age population, banks will be vying to attract the right talent from a limited pool of available hires. Banks that develop a best-in-class talent acquisition strategy—complete with an attractive employee value proposition, streamlined interview process, and focused approach to identifying hidden pockets of talent in the labor marketplace—may find they are best placed to bring the right new skills into their business. Several US banks, for example, are developing a leading approach to talent acquisition by adopting AI to assist in screening applicants.[30]

— *Upskilling and apprenticeships.* As banks develop their expanded roles in support of growth, they will need to upskill existing workers. Digital capabilities are the obvious areas for development as lending becomes more commoditized and employees are expected to use a range of new technology and tools. But even in other areas, such as ecosystem development, new skills will be needed to support the creation, deployment, and ongoing management of these new services. Banks can take inspiration from best-in-class upskilling programs that combine formal training and induction programs with ongoing online learning and on-the-job mentoring and coaching involving senior leadership. The goal is to provide highly tailored learning-and-development journeys that offer a long-term learning path for all talent.

— *Performance management.* Ongoing performance reviews and continuous feedback are essential to maintaining the standards of excellence that will be needed across all banking roles. Establishing an objective and transparent review process is a key part of moving to an output-oriented culture that supports the dual mission of serving society and transforming performance. Banks can look at ways to link employee performance to revenues generated and KPIs that measure how well the bank is serving Japan's growth objectives. Performance can also be linked to learning, in support of the upskilling imperative. Leading global banks conduct 360-degree reviews that gather input from superiors, peers, and direct reports and focus on growth and development. Real-time feedback can be provided live or via web-based tools, and high-potential talent can be nurtured through increased exposure to top management.

— *Onboarding and dynamic deployment.* As banks pilot new roles, products, and services, they will face a growing need to ensure a thorough process for onboarding new workers and dynamic deployment of existing staff. This includes identifying measures to make employees more productive more quickly, along with easing cultural assimilation to the company to create a sense of purpose and belonging. Such measures cover both the administrative areas and the role-based expectations, with seamless collaboration between business divisions, HR, and administration to ensure a smooth and efficient onboarding process. These practices set up employees for success from day one.

— *Talent culture.* While specific and targeted initiatives are critical aspects of outstanding talent management, the heart of talent management is having the right talent culture. This requires a strong foundation of executives and staff who have mindsets and behaviors aligned with values and purpose. World-leading talent cultures are consistent across regions and office locations and put people at the

[30] Olivia Oran, "Wall Street hopes artificial intelligence software helps it hire loyal bankers," June 7, 2016, Reuters.com.

heart of their success. Authentic ways to bring a talent culture to life are to support individual growth and development and to enable employee work-life balance by ensuring workers take at least a minimum amount of paid vacation time, for example.

Important but less urgent areas of talent management for Japan's banks

— *Workforce planning.* To ensure the right people are deployed in the right roles at the right time to support growth, banks may need to translate their strategy into a clear view on capabilities and head count, identifying critical roles and skills gaps and how best to address them.

— *Compensation and total rewards.* Remuneration has become one of the hurdles companies need to negotiate in the competition for talent—especially for in-demand digital talent. Shifting toward a role-based remuneration approach that reflects expertise and value creation may help banks become more competitive in the market and attract and retain talent.

— *Career paths and job structures.* Employees benefit from clear career pathways and milestones. At the same time, job structures should have enough flexibility to accommodate the breadth and depth of individual knowledge.

— *Diversity, equity, and inclusion.* In its Action Plan of the Growth Strategy, the Japanese government has recognized the role of diversity in driving innovation. Japan's banks can take steps to promote greater diversity by designing fair and transparent talent selection processes, helping diverse talent radiate their expertise, and identifying their diversity and inclusion blind spots—and then by addressing these with accountability.

7.2 Revamping technology to accelerate digital transformation

Japanese companies are at risk of falling behind their global counterparts in digital transformation. Factors that have contributed to this include a lack of in-house digital talent and organizational cultures tending to show preference for in-house seniority over external talent.

A McKinsey report on digital transformation in Japan found that the accelerated adoption of digital services experienced in the wake of the COVID-19 pandemic was slower in Japan than in most other countries. Also, in McKinsey's digital industry 4.0 survey, cited in the same report, two out of three Japanese managers reported that they were not entirely ready to promote digital transformations.[31]

Banks in Japan are embarking on digitization to enable digital banking and support transaction migration, remote sales representatives, and data collection and analysis. Digitization will become more important as banks reduce their physical branch networks, build out their online advisory services, and move toward cashless banking. Already, several Japanese banks are leading in this regard.

Digital transformations are notoriously difficult to get right. Globally and across industries, only 16 percent of digital transformations are successful, versus 30 percent of all corporate transformations.[32] Often, a lack of focus is at the root of the problem, so banks can begin by prioritizing which transformation categories to pursue in the near and longer terms, before launching a broad digital-transformation effort.

[31] Michihiko Kurokawa, Takuya Matsumoto, Tomoharu Hirayama, Taro Umemura, Hiroyuki Katayama, Yasumasa Yamamoto, and Lari Hämäläinen, *Using digital transformation to thrive in Japan's new normal: An urgent imperative*, 2021, McKinsey.com.
[32] Ibid.

Digital transformations can range from holistic overhauls—where digital and organizational restructuring lead to drastic organizational transformation—to more focused efforts that build up capabilities in specific areas of the business—say, customer experience, operational elasticity, or new-business building. Whatever strategy banks undertake to digitize, they need to ensure their approach is underpinned by the appropriate skills and capabilities, core technology like cloud and supporting data architecture, and an agile operating model that allows for testing, learning, and continuous improvement.

7.3 Taking an integrated risk-adjusted approach

Amid new opportunities and a changing regulatory landscape, Japan's banks may need to reassess their risk appetite and look internally to ensure they proactively address external risks. Banks with a forward-looking, integrated, risk-adjusted mindset may be best positioned to optimize innovation, profitability, and operational effectiveness as they develop their various roles in service of growth.

Reassessing risk appetite. Japanese banks overall are well capitalized relative to their global peers in developed nations, reflecting their conservative risk profiles and carefully managed risk appetites. Risk-taking creates value when priced and managed appropriately, and Japan's banks are now favorably positioned and well capitalized to take advantage of increased risk-adjusted returns in the years ahead. Achieving this calls for thoughtful deployment of additional capital, when appropriate, to fund growth and widen risk-adjusted spreads across selected products and transactions.

Improving risk defenses. In parallel, some new or emerging risk categories, catalyzed by external factors, will become more challenging to control relative to traditional risks. Banks may need to step up their defenses across eight areas: cybersecurity, data privacy, third-party oversight, responsible AI, operational resilience, financial crimes, nonfinancial risks, and resolution planning. As these risks continue to evolve, banks will need to balance innovation with staying ahead of threats.

— *Boosting cybersecurity defenses.* Asia–Pacific recorded more data breaches than any other region for the first time in 2021,[33] likely due to lower investments in cyber infrastructure and talent relative to the European Union and United States. Global supervisory expectations continue to evolve rapidly, with EU regulators preparing to enact a Digital Operational Resilience Act, for example. Similar supervisory expectations are anticipated from the Japan Financial Services Agency (JFSA).

— *Elevating data privacy practices.* Partnerships and new ventures arising from beyond-banking activities are likely to involve the sharing of data for storage, analytics, and reporting. Banks will remain primarily responsible for any data breaches from their own enterprise as well from third parties, despite having limited control or authority to enforce standards for data collection, masking, deletion, and sending.

— *Improving third-party oversight.* The continued digitization of operational activities will see many banks developing relationships with outsourced service providers and third-party vendors. Banks must manage their use of service providers effectively, or they will expose themselves to risks that could result in regulatory action, financial loss, litigation, and damaged reputation.

— *Developing responsible AI processes.* While increased use of AI, including machine learning, can automate decision-making and optimize operational efficiencies, proper controls are necessary to minimize the risk of unintended consequences for customers or society, including through appropriate governance and independent validation.

[33] Suzanne Widup et al., 2021 *Data breach investigations report*, Verizon, May 2021.

— *Enhancing operational resilience.* New partnerships, collaborations, or acquisitions may strain a bank's existing operating systems and processes. Banks must focus continuously on technology and operational effectiveness. This is necessary to prevent outages and ensure reliable, stable, efficient, and effective operations to improve incident readiness, response, and business continuity.

— *Fighting financial crimes.* As Japanese banks increase innovation through new products and counterparties and evolve their role as ecosystem orchestrators, they will need appropriate enhanced measures to detect and report on fraud, bribery and corruption, money laundering, terrorist financing, sanctions, market abuse, and insider trading.

— *Staying alert to nonfinancial risks.* The adoption of new digital technologies such as blockchain and partnerships across a wider set of service providers will almost certainly increase nonfinancial risks, including reputational risk and risk of digital disruption.

— *Looking ahead through robust resolution planning.* Within the unpredictable context of complex geopolitical events, banks may need to develop plans for the orderly winding down of operations in special circumstances. Recent examples of international businesses halting or completely withdrawing operations from Russia serve as cautionary reminders that circumstances can and do become unsuitable for continuing operations.

Japanese banking has reached a critical inflection point. For those Japanese banks that choose to engage, there is a critical role they can play by leveraging their traditional strengths and tapping into new opportunities that are opening in response to the country's growth plan and regulatory change. To seize this moment and fulfill their dual mission of serving society as engines of growth and pursuing their own success and profitability, banks can transform to meet the changing needs of the country and their banking customers.

As Japanese banks evolve their traditional roles to meet these needs, those that prioritize talent strategies, digital transformation, and risk management may give themselves the best chance of enjoying a share of Japan's future prosperity.

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