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Different classification results on the same loan

Evidence from Japanese corporate lending in the USA[1]

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Abstract

This essay reports on cross-national differences within bank loan classification approaches, which determine the soundness of bank loans. It is based on 20 in-depth interviews carried out as part of an ongoing PhD research project. The essay first offers an overview of banking supervision under the Basel Accord and locates bank loan classification within the context of this global framework. Second, through analysis of a government-commissioned report available only in Japanese, the essay compares the two countries' normative approaches to bank loan classification and qualitatively describes cross-national differences. The interview results support their report and reveal that Japanese bank loans booked in the USA are assessed differently by Japanese banks and the US banking authority. The findings suggest that regionally shared ways of thinking play an important role in the process of bank loan classification. The essay discusses why regionally shared ways of thinking differ between countries, and which side delivers the correct classification result. It concludes that the loan classification approach mirrors the respective social systems, including the regional ways of conducting businesses and the contents of education.

Keywords: bank loan classification, BIS, FRB, Japanese FSA, perceived risk, parent company behaviour, regionally shared ways of thinking.

Introduction

In the World Bank working paper, *Bank Loan Classification and Provisioning Practices in Selected Developed and Emerging Countries*, Laurin and Majnoni (2003) present their research findings obtained from a survey of current practices in countries represented on the Basel core principles liaison group. They begin with general comments on financial reporting: "How banks account for credit losses in their loan portfolios is important for the presentation of banks' financial positions in their financial statements. Therefore accounting for credit losses is an area of significant interest for banking supervisors worldwide" (2003:v). They then place a summary of their findings: "Despite its relevance, a well-recognised international standard to which national authorities and bank supervisors may refer is unavailable" (2003:v). They report as their research conclusion that there is no global standard on bank loan classification that determines how banks account for credit losses in their loan portfolio. Their conclusion potentially has many implications: For instance, a bank loan extended to the bank's client company may appear to be the bank's high quality asset to the bank but low to the banking supervisor, if the bank's decision is foreign to the supervisor. This may be problematic because either of the two different classification results on the loan may inaccurately represent the loan quality. Simply put, one loan has one destiny: It is paid off or becomes delinquent. A good loan is paid off at maturity in some way, for example by the borrower or some refinance means. A bad loan is not paid off and becomes delinquent, and eventually the bank has to write it off. If a good loan was rated bad or if a bad loan was rated good, the classification result would be in actual fact inaccurate in that it distorted the presentation of the bank's financial positions. The actual rating system is on a scale of possibility and is more complex than this simple example, but the point is that distorted classification results can be undesirable in the light of the important theme of presentation of banks' financial positions as Laurin and Majnoni (2003) state. The present essay indeed reports on different bank loan classification results delivered by different nationals on a single loan. This essay first offers an overview of banking supervision under the Basel Accord and locates bank loan classification in Japan and the USA within the context of this global framework. Based on in-depth interviews with experienced banking professionals, the essay reports on real cases where Japanese bank loans booked in the USA are assessed differently by Japanese banks and the US banking authority. The findings suggest that the classification differences are ascribed to some of the regionally shared ways of thinking that differ between the countries yet are the bedrock of the perceived risks of the loans.

An overview of bank loan classification and bank supervision

According to the World Bank working paper, *Bank Loan Classification and Provisioning Practices in Selected Developed and Emerging Countries*, "loan classification refers to the process banks use to review their loan portfolios and assign loans to categories or grades based on the perceived risk and other relevant characteristics of the loans" (Laurin and Majnoni 2003:1). The terminology can be alternatively used for regulatory classification systems at the government level and internal classification systems at the bank level. From the perspective of the banking supervisors (i.e., the national or state agencies), bank regulations are tools for monitoring purposes, used to keep banks financially and operationally sound. At the bank level, banks often use "more complex internal classification systems than the more standardised systems that bank regulators require for reporting purposes" (Laurin and Majnoni 2003:1). There is a related terminology, loan review, defined as "an on-going monitoring process, which relies on classification of loans into various categories of performance as an analytical tool," in which "classification is also often used by bank supervisors as a benchmark in assessing a bank's soundness" (Cortavarria et al. 2000:5), according to their IMF Working Paper. Loan classification is "either a management responsibility or a regulatory matter" (Laurin and Majnoni 2003:9); for both Japan and the USA, it is a regulatory matter. Both Japan and the USA have a satisfactory supervisor for bank loan classification, according to IMF (2010; 2012): the country reports of the financial sector assessment program, administered by the IMF.

Loan classification or loan review is often discussed together with provisioning, which can be "a technique to translate loan review results into the balance sheet" (Cortavarria et al. 2000:1), or more precisely, "a method that banks use to recognise a reduction in the realisable value of their loans" (Laurin and Majnoni 2003:1). From an accounting perspective, a loss of loan value will be "recognised as an expense to the bank by establishing a provision" (Cortavarria et al. 2000:5) according to the loan terms and conditions and borrower performance as discussed in the following paragraphs. The present research does not focus on provisioning, but it remains relevant in that a provision is a cost determinant for banks. A provision reduces profits in the bank's income statement to a varying degree: More provision expenses are required for poorly performing borrowers, and less for better performing ones. Banks extend loans to various types of borrowers, some of which are performing well, and others of which are not as much, often losing money. From the banks' standpoint, supporting a poorly performing borrower negatively affects profits, and as a result, minimising loans for such borrowers is one way of reducing lending cost in general. As for profit drivers, perhaps obviously, the higher loan margins become, the more banks increase their revenues.

In *Core Principles for Effective Banking Supervision* (2012) by the Basel Committee on Banking Supervision, the Committee states "The supervisor determines that banks have an adequate credit risk management process that takes into account their risk appetite, risk profile and market and macroeconomic conditions" (Principle 17: Credit Risk). The BIS expects the supervisor to determine that a bank's senior management implements their "credit risk strategy" and develops their "policies and processes," which "establish an appropriate and properly controlled credit risk environment" (2012:46-47). Below is a policy description pertinent to bank loan classification that the Committee details:

(c) effective credit administration policies and processes, including continued analysis of a borrower's ability and willingness to repay under the terms of the debt (including review of the performance of underlying assets in the case of securitisation exposures); monitoring of documentation, legal covenants, contractual requirements, collateral and other forms of credit risk mitigation and an appropriate asset grading or classification system (excerpted from Essential criteria, Principle 17).

The principle can be interpreted as such: Banks should evaluate the borrower's financial standing and repayment ability, and the loan classification system should incorporate the pertinent components, such as the outcomes of credit analysis. For the measurement and management of credit risk, banks have started moving onto the internal rating-based ("IRB") approach to rate their borrowers since 2004, which is when the Basel Committee issued a revised framework (Basel II) on International Convergence of Capital Measurement and Capital Standards. In *An Explanatory Note on the Basel II IRB Risk Weight Functions* (2005, hereafter the "July 2005 note") by the Basel Committee on Banking Supervision, the Committee offers non-technical explanations on the IRB approach and its risk weight formula.[2] In this approach, banks are allowed to use their own internal measures for key drivers of credit risk as primary inputs to the capital calculation, determine the borrowers' probability of default ("PD") and rely on own estimates of loss given default ("LGD") and exposure at default ("EAD") on an exposure-by-exposure basis. Banks use these three factors in order to forecast the average level of credit loss (hereafter expected loss or "EL") that they reasonably expect to experience. The EL amount can be determined by multiplying the three risk parameters above. The bank's capital structure in general improves as the EL is decreased,[3] because the EL negatively affects the bank's capital under the Basel Accord. In a practical sense, credit relationships with borrowers with low risk parameters favour banks' profit and capital structures. The PD and LGD correlate with "a borrower's ability and willingness to repay under the terms of the debt" (which is expressed as the borrower grade or borrower rating) and credit risk mitigation in the Principle 17 (Basel Committee on Banking Supervision 2012), respectively. Credit risk mitigants determine the credit facility rating (or simply called the facility rating; see Carey 2001). In short, the better the borrower rating, the better (the lower) the PD: For example, a guarantee pledged for the borrower improves the facility rating and lowers the LGD (Carey 2001).

From the perspective of lenders, an important goal of corporate banking is to minimise credit loss, while maximising profits gained from their portfolios. To attain this goal, banks strive for good practices (Song 2002) in conformity with the bank regulations in the country, as well as with the global framework, the Basel Accord. The bank loan classification outcome affects the bank's cost structure and represents the quality of the bank's credit portfolio. Despite the importance of loan classification, as previously quoted, "a well-recognised international standard to which national authorities and bank supervisors may refer is unavailable" (Laurin and Majnoni 2003:v), and the number of literature works on cross-national analysis of loan classification appears somewhat limited. This casts a question regarding the absence of a well-recognised international standard in the rapidly globalising banking sector. A possible reason can be that the contents of "perceived risk and other relevant characteristics of the loans" (Laurin and Majnoni 2003:1) vary depending on the country, making international standardisation unrealistic. The present research focuses on cross-national differences between Japan and the USA.

Fundamental difference in bank loan classification between Japan and USA

In the USA, the Office of the Comptroller of the Currency ("OCC") provides the definitions of bank loan classification. The OCC sets forth the following in their publication, "Rating Credit Risk: Comptroller's Handbook":

Assigning Regulatory Credit Classifications

The regulatory agencies use a common risk rating scale to identify problem credits. The regulatory definitions are used for all credit relationships—commercial, retail, and those that arise outside lending areas, such as from capital markets. The regulatory ratings special mention, substandard, doubtful, and loss identify different degrees of credit weakness. Credits that are not covered by these definitions

> are "pass" credits, for which no formal regulatory definition exists, i.e., regulatory ratings do not distinguish among pass credits. Examiners are expected to assign ratings in accordance with the guidance in this booklet, regardless of the system the bank employs (2001:15-16).

As stated, bank loans are classified as follows in order of soundness:

1. Pass
2. Special mention
3. Substandard
4. Doubtful
5. Loss

The OCC provides the definitions for each of the last four categories: For example, below is the one for substandard:

> A substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness, or weaknesses, that jeopardise the liquidation of the debt. They are characterised by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected. (2001:17)

The regulatory classification pays much attention to the liquidation of the debt, which can be a distinctive characteristic. In the USA, the supervisor assesses bank loans in accordance with the pertinent guidelines, regardless of the bank's credit rating system. From the bank supervisor's viewpoint, "the primary consideration in examiners' credit risk assessment is the strength of the primary repayment source" which is defined as "a sustainable source of cash" (2001:14). The OCC also provides their instructions for bank loan classification: "The risk rating process starts with a thorough analysis of the borrower's ability to repay and the support provided by the structure and any credit risk mitigants" (2001:21), which include "collateral, loan guarantees, letters of credit, credit derivatives and credit insurance" (2001:25-30). "The borrower's ability to repay" and "credit risk mitigants" pertain to the PD and the LGD respectively, as discussed earlier. The results of bank loan classification are available to the general public. The Federal Deposit Insurance Corporation ("FDIC") provides the aggregate performance results of the member banks in the Quarterly Banking Profile ("QBP").

In Japan, the Financial Services Agency of Japan ("JFSA") supervises banks and provides their financial inspection manuals[4] which include guidelines for loan classification. In accordance with the manuals, banks conduct self-assessment which is the initial process for loan classification. During the process, banks first classify the borrowers, not loans, into five categories, namely in Japanese: Hatansaki, Jissitsuhatansaki, Hatankenensaki, Yoochuuisaki and Seijyoosaki. While all banks in Japan must use these categories, the English translations of these terminologies vary widely between banks. Below is a summary of major banks' English terminologies:[5]

- MHFG: Bankrupt Obligors, Substantially Bankrupt Obligors, Intensive Control Obligors, Watch Obligors and Normal Obligors.
- MUFG: Bankrupt, Virtually Bankrupt, Likely to Become Bankrupt, Close Watch and Normal.
- SMFG: Bankrupt Borrowers, Effectively Bankrupt Borrowers, Potentially Bankrupt Borrowers, Borrowers Requiring Caution and Normal Borrowers.

In addition to the varying terminologies used by the real-world industry players, Inaba et al. (2005:116) provide the categories listed below in their BIS working paper:

- Bankrupt, De Facto Bankrupt, In Danger of Bankruptcy, Need Attention, Need Special Attention and Normal.

While the English terminologies are not uniform, the bottom line is the same: Bank managers are expected to conduct self-assessment properly and implement write-offs and loan loss provisions according to the self-assessment results. The self-assessment results are translated into loan classification results in four categories:

Bankrupt or De Facto Bankrupt, Doubtful, Special Attention and Normal,[6] similar to the U.S. classification, and publicly released[7] in two forms: i) Risk management loans, and ii) loans disclosed under the financial reconstruction law (cf. Inaba et al. 2005) according to the legal frameworks.

In collaboration with PricewaterhouseCoopers, ChuoAoyama Audit Corporation researched cross-national differences in bank loan classification between Japan and the USA (ChuoAoyama 2002, available only in Japanese). They report the fundamental difference of primary consideration for loan classification: Japanese banks first conduct self-assessments to classify borrowers, and then loans are classified into four categories as already examined, according to the borrower classification results (2002:20). Similarly, the Japanese Bankers Association (JBA 2012) states that the outcome of borrower classification, or the borrower rating, is the basis of loan classification. In the USA, by contrast, the primary consideration for loan classification is the primary repayment source of cash and credit risk mitigants (OCC 2001), not borrower classification (ChuoAoyama 2002). The primary source of repayment can be cash or cash conversion of trading assets shown in the balance sheet and cash generation expressed in the cash flow statement, but it does not necessarily equate to the borrower rating, which is decided through a number of factors: not only the primary source of repayment but also all the features of the financial statements and the surrounding business conditions such as the industry climate. Soft information (i.e., qualitative factors) may also be incorporated into credit analysis (Berger and Udell 2006), in cases where it obviously drives the financial condition. Indeed in Japan, the primary repayment source of cash—*hensai genshi* as a reasonable Japanese translation—plays no crucial role in the JFSA's financial inspection manual, including its appendix (JFSA 2012) for bank loan classification. To summarise, the literature and the empirical documents provide the following cross-national difference in bank loan classification:

	Japan	**USA**
Primary consideration for loan classification	Borrower classification	Repayment source of cash

Highlighted in the works of ChuoAoyama and the JBA, borrower classification—the process of assigning credit ratings to borrowers—is an indispensable and much valued part of the whole process of loan classification in Japan. While borrower ratings weigh against the Japanese approach, they are not the primary consideration for bank loan classification in the USA. The cross-national differences in the classification logic may lead to different classification outcomes for a single bank loan—the present essay's research findings in fact—in a cross-national setting, depending on the location of the loan examination.

Methodology and Data Collection

This research adopted the qualitative method of interview, which was suitable for the research aim of finding various topics related to loan classification in cross-national settings. The ontological orientation of the research aim is constructivism, which required a qualitative approach (Bryman 2004:20). Literature suggests that qualitative research provides "information about the human side of an issue" and its benefit is "to provide complex textual descriptions of how people experience a given research issue" (Mack et al. 2005:1). Gray (2009:370) notes "interviewing is a powerful way of helping people to make explicit things that have hitherto been implicit—to articulate their tacit perceptions, feelings and understandings" (Arksey and Knight 1999:32). The method can be particularly effective for the banking sector, which is usually highly secretive due to its confidentiality constraints; its constituents are unlikely to reply to random paper-and-pencil questionnaires. The 20 in-depth interviews were conducted among the top three largest Japanese banks during 2014 as part of the researcher's ongoing PhD research project. Table 1 reports a summary of the interviewee profiles. The top largest banks were selected on the assumption that they would have more cross-national activities taking place than smaller banks with modest foreign operations. The data presented in this essay were collected through face-to-face interviews or by phone. All of the interviewees have resided and worked for banks in the USA. Interviews were conducted in English with US nationals and in Japanese[8] with Japanese nationals. All interviews started with a very generic topic about working for a Japanese bank in the USA (i.e., in a cross-national setting), and all interview questions were carefully constructed in order to avoid leading questions.

This research chose interviewees who had cross-national professional experience, defined as i) serving outside the country where the interviewee was raised, or ii) serving an employer whose management and employees consisted predominantly of nationals different from the interviewee. This ensured that the interviewee was empirically exposed to foreign people and foreign practices on a daily basis. All interviewees had at least seven-years of banking experience, and most had a management-level corporate title, such as Assistant Vice President and/or Associate or higher at the time of interview. 95% of them had worked for two of more companies or offices over the course of their career by either changing employers or being transferred within the employer network, making the interview results more general without bias, rather than specific to their current employer. The subjects had reasonable "requisite knowledge" (Bryman 2004:156) on banking expertise and the cross-national matters that were compared between the countries. They were able to articulate their ways of thinking and business practices, making comparisons between the Japanese and Americans at the individual level and between Japanese and American business practices at the organisation level. Their requisite knowledge indeed aided the researcher in detecting the cross-national differences effectively, without having to pose any leading questions.

Table 1: Interviewee profile

	Country of origin	**Employer**	**Job Title**	**Job Function**	**Professional experience**
1	Japan	Japanese Bank A	Director	Japanese Corporate Banking	17 years
2	Japan	Japanese Bank A	Vice President	Asian Corporate Banking	10 years
3	USA	Japanese Bank A	Assistant Vice President	Japanese Corporate Banking	17 years
4	Japan	Japanese Bank A	Vice President	Japanese Corporate Banking	13 years
5	Japan	Japanese Bank A	Vice President	Global Corporate Banking	10 years
6	Japan	Japanese Bank A	Assistant Vice President	Japanese Corporate Banking	10 years
7	Japan	Japanese Bank A	Banking Officer	Japanese Corporate Banking	17 years
8	USA	Japanese Bank A	Vice President	Credit Examination Office	9 years
9	USA	Japanese Bank A	Assistant Vice President	Credit Examination Office	9 years
10	Canada	Japanese Bank A	Director	Credit Examination Office	35 years
11	Japan	Japanese Bank B	Vice President	Planning for Corporate Banking	16 years
12	Japan	Japanese Bank C	Vice President	Japanese Corporate Banking	16 years
13	Japan	Japanese Bank A	Vice President	Japanese Corporate Banking	25+ years
14	USA	Japanese Bank A	Vice President	Credit Examination Office	35+ years
15	Japan	Japanese Bank A	Vice President	Japanese Corporate Banking	18 years
16	Japan	Spanish Bank A	Credit Analyst	Japanese Corporate Banking	8 years
17	USA	American Bank A	Vice President	Japanese Corporate Banking	12 years
18	USA	American Bank A	Assistant Vice President	Japanese Corporate Banking	9 years
19	USA	Japanese Bank A	Assistant Vice President	US Corporate Banking	8 years
20	Japan	American Bank A	Senior Manager	Japanese Corporate Banking	32 years

Findings: Different classification results for the same loan

The interview results unveiled, among many related topics, the complex cross-national differences which created the assessment discrepancies in bank loan classification. The below dichotomy outlines the different classification results on the same Japanese loan[9] booked in the USA:

	Japanese loan favoured	**Japanese loan disfavoured**
Classification difference	The Japanese bank (the lender) assessed the loan as special mention or worse, but the US banking authority assessed it as a pass credit.	The Japanese bank (the lender) assessed the loan as a pass credit, but the US banking authority assessed it as special mention or worse.

These classification differences are attributable to the cross-national differences in primary consideration for bank loan classification reported by ChuoAoyama (2002): At Japanese banks, including their US operations, bank loans are classified according to the borrower classification results (or the borrower rating), whereas in the USA, the primary consideration for loan classification is the primary repayment source of cash and the credit risk mitigants (OCC 2001), not borrower classification. An experienced Japanese relationship manager who had worked for the Japanese corporate banking divisions in the two countries within the network of a large Japanese bank recounted:

> We (a Japanese bank)[10] classify corporate loans according to the borrower ratings. Naturally loans extended to financially strong companies are rated better, and those extended to poorly performing companies are rated worse under our credit rules. In conjunction with the credit division in the headquarters in Japan, I need to watch those adversely rated borrowers closely and regularly. In the USA however, I do not have to pay attention to loans extended to poorly performing borrowers that much, if the loan is guaranteed by a cross-border letter of guarantee provided by its creditworthy parent company in Japan. Such loans with a good guarantee are considered good loans (pass credits) in the USA, though they are problematic loans under the Japanese standard.

The interviewee maintained that a bank loan extended to a borrower with a weak borrower rating, which meant to have a high PD, was problematic to the Japanese, but it was not to the American auditors because the loan was secured with a guarantee, which lowered the LGD. As a result, the American examiners assigned a favourable grade to the loan, which was not so for the Japanese. All interviewees who mentioned the topic in fact pointed out that the differences in primary consideration, which was the decision basis for loan classification, caused different interpretations of the loan and different classification outcomes on the single loan.

The primary consideration differences appeared to stem from different ways of perceiving the credit risks embedded in the bank loan. A Japanese national who was employed as Vice President of credit planning at another large Japanese bank in the USA explained:

> Every year we (a Japanese bank) have the same disagreements with the FRB examiners on corporate loans extended to pass-grade borrowers under the Japanese rules. They are pass-grade loans in our standards, but some of them are assessed as special-mention or substandard loans under the US rules. A typical case is that the loan was unsecured, and the borrower was not performing very well, though the borrower had a pass grade based on soft information—being a subsidiary of a financially strong parent company listed in Japan—which was perfectly justifiable for us. The Japanese parent does not abandon its US subsidiary, our borrower, but the examiners never believe our explanation. The examiners also told me that all the three Japanese mega-banks had the same type of classification discrepancies with the FRB.

In this case, the loan was disfavoured under the US standard because it was judged to have a weak payment source and had no credit mitigant, which meant to have a high LGD. The Japanese banking professionals assessed the borrower as strong due to the soft data of background information, which notched up the borrower rating resulting in a better PD than what it would have been in American corporate banking. The loan classification discrepancies occurred because perceived risks associated with the unsecured loan, which was extended to the poorly performing US subsidiary of the Japanese parent company, differed between the Americans and the Japanese. The interview results suggest that all Japanese banks likely have the same type of classification disagreements with the FRB standard. Below is a summary of the interview results regarding the differences of perceived risks associated with the unsecured loan extended to the poorly performing US subsidiary of the financially strong Japanese parent company:

	US corporate banking[11]	**Japanese corporate banking**[12]
Perceived risks	High risk because financial support from Japanese parent company to their poorly performing US subsidiary is uncertain.	Low risk because financial support from Japanese parent company to their poorly performing US subsidiary is certain.

Note that in reality the actual perceived risks may not be as binary as the two extreme patterns presented above because it depends on personal interpretation and other relevant factors. The findings however suggest that the patterns generally represent the modal ways of perceiving risks in the respective countries.

All the relevant interview results indicated that the perceived risks were strikingly different, because the parent company's normative behaviour radically differed between the countries. A Japanese Vice President, who had worked for American and Japanese branch offices of the Japanese Bank A, and currently employed at their international planning department, elaborated:

> The Japanese professionals believe that the parent company will financially help its subsidiary if truly necessary, meaning that the borrower has a low PD in practice which was the basis for their borrower rating, and the parent companies actually do, just like human parents. But American banking professionals do not have the same way of thinking because parent companies are investors for them. In the US, the parent company is viewed as someone who will abandon the poorly performing subsidiary at any time, meaning that the borrower has a high PD.

The interview results gave shape to nationally normative behaviour for the parent companies towards its subsidiary in financial distress in the context of parent-subsidiary relation in each country. In the US it should be an investor who is capable of making financially sensible decisions on its subsidiary for the sake of the parent company. If the subsidiary is not making satisfactory returns to the parent company's investment, the subsidiary should be sold. In Japan it should be a parent who provides financial support for its subsidiary even at a loss of the parent's money. These different ways of thinking result in difference ways of perceiving the risks associated with the poorly performing US subsidiary: The Americans perceive it as high risks, while the Japanese perceive it as low risks.

	US business	**Japanese business**
Parent company in parent—subsidiary relation	The parent company is an investor capable of making financially sensible decisions on its subsidiary for the sake of the parent.	The parent company is a parent who provides financial support for its subsidiary even at a loss of the parent's money.

Note that, similar to the preceding dichotomy regarding perceived risks, the actual parent-subsidiary relationships may not be as binary as the two extreme patterns presented above. These extreme patterns are intended to capture complex variations in parent-subsidiary relations. In reality the actual parent-subsidiary relationships stand somewhere between the extreme patterns, depending on the borrower's and parent company's management decisions, which determine how close to the extreme pattern.

For Japanese corporate banking professionals, parent support for its subsidiary is highly taken for granted. When the financial strength of the parent company is higher than its subsidiary, it improves its subsidiary's borrower rating under their credit rules. This rating logic is normative to Japanese corporate banking but illogical to US corporate banking, where parent support is not at all taken for granted, unless the loan is secured with a legally-binding letter of guarantee or similar pledged by the parent company. The gap of logic between the countries appeared quite uncompromising. An experienced American Vice President who underwrote Japanese corporations at a US bank underscored:

> Our group (Japanese corporate banking division within a US bank) is totally alien to the whole bank (my employer). Our team is very segmented—totally different from American standard—a very distant, isolated part of the bank. Our credit division (the final credit authority within the bank) does not understand Japanese ways of relationship-based businesses and lending decisions based on them. For the American credit division, it is not bankable to keep lending money to poorly performing US subsidiaries. [Big difference.][13] Yes. I know that the parent companies in Japan provide financial support for borrowers (US subsidiaries) in the US and do not abandon subsidiaries—it is an unspoken rule in Japan.

Japanese banking practice is alien to US banking professionals who tend to terminate their credit relationships with poorly performing borrowers. All relevant interview results pointed out the significance of the gap between the shared ways of thinking.

Discussion

The research results have manifested the cross-national differences in regionally shared ways of thinking on how the parent companies treat their subsidiaries. This section discusses why these regionally shared ways of thinking differ between the countries and which side delivers the correct classification result. One distinct cross-national difference is the parent company's normative decision on its subsidiary in financial distress. In the US, the parent company should be an investor who is capable of making financially sensible decisions on its subsidiary in financial distress. The poorly performing subsidiary should be sold for the sake of the parent company, so it does not negatively affect the parent's consolidated financial performance. In Japan the parent company should be a parent who provides financial support for its subsidiary even at a sizable loss of the parent's money. The Japanese parent's behaviour is contrary to the US parent's behaviour, which aims to maximise the parent's current profit. The interview results regarding the US parent companies appeared to delineate the standard corporate goal often discussed in academia: "The goal of financial management is to maximise the current value per share of the existing stock" (Ross, Westfield and Jordan 2003:11). Ross, Westfield and Jordan go on to state "There is no short-run versus long-run issue" (2003:11), and "we explicitly mean that our goal is to maximise the *current* stock value." Their argument appears to be based on the idea that "If the stockholders are winning in the sense that the leftover, residual, portion is growing, it must be true that everyone else is winning also" (2003:6). The literature in the discipline of corporate finance can make perfect sense to their target audience in the English-speaking countries, correlating with the interview results on the US ways of thinking. If a poorly performing subsidiary is eroding its parent's consolidated results, it should be sold to improve its parent's current performance, which is the major factor of their current stock value. The US corporate mission, which the US banking professionals follow, appears to epitomise the idea that the overriding purpose of a firm is to maximise the shareholder wealth, by maximising the current share value. A classic work which still appears to suit the standard goal in English-speaking countries to a great extent is the well-known "Friedman doctrine" which states that companies have a single responsibility of maximising profits (Friedman 1962:133).

The above standard arguments, or the theories "based on the writings of 20th century Western scholars whose disciplinary orientations were heavily grounded in economics and classical sociology" (Thomas 2002:189), contradict the Japanese parents' behaviour portrayed by the interviewees. The "Western"[14] standards do not fully explain the Japanese parent company's behaviour, because Japanese parent companies are also targeted to increase shareholder wealth, and the Japanese social systems in general demand that too. In that sense, the Japanese in principle have the same goal as the US businesses' mission. Then why is the Japanese parents' behaviour noticeably different from the USA? Totten, an American scholar who has spent most of his adult life in Japan as an entrepreneur, writes of his research findings (1998:90)[15] with regard to Japan's formula for its post-war economic miracle, expounded by its business leaders, including Konosuke Matsushita, Soichiro Honda and Toshio Dokou.

1. The goal of society is the happiness of its citizens.
2. The role of companies is to provide goods and services that contribute to the happiness of citizens and jobs that enable citizens to earn the money required to pay for those goods and services.
3. Companies should take only the minimum profits required to pay for investment to provide goods and services as well as jobs.
4. Companies should abstain from taking further profits, instead lowering prices of their goods and services to their consumers or increasing wages and benefits to their employees.

With a well-versed ability of understanding the Japanese ways of thinking, Totten agrees with the formula and adds constructive ideas, such that the goals of companies include the pursuit of profit and sustainable growth—concepts generally agreed in the study of business administration. The 'Japan's formula' above, or "Japaneseness" (Dore

1994:390), however appears very much to be community-thinking, and not all Japanese audience or companies may agree with it at first. Most Japanese companies, especially multi-nationals, do not seem to "abstain from taking further profits" due in part to globalisation and the resultant requirement of global competitiveness. Nevertheless, the interview and research results—supporting the poorly performing subsidiary at a loss of the parent's money—meet the Japanese formula to a certain extent. The parents attempt to secure local jobs with their subsidiary that enable citizens to earn the money required for the payment of those goods and services in the region. Parents are not maximising their current stock values, as they retain their poorly performing subsidiaries, which are dragging the parents' consolidated business results. The findings suggest that the Japanese ways of thinking still follow the Japanese formula to a certain extent, rather than the Friedman doctrine. Probably in reality the modal US businesses are closer to the Friedman Doctrine than the Japanese ones are, and the modal Japanese businesses are more of Japan's formula than the US ones.

In relation to the preceding discussions, there is a well-balanced work which observes both sides in a fair manner. De Geus writes:

> There are in fact two different types of commercial companies in existence today, distinguished by their primary reason for being in business. The first type is run for a purely "economic" purpose: to produce maximum results with minimum resources. This sort of "economic company" is managed primarily for profit… The economic company is not a work community. It is a corporate machine. Its sole purpose is the production of wealth for a small inner group of managers and investors. It feels no responsibility to the membership as a whole… The second type of company, by contrast, is organised around the purpose of perpetuating itself as an ongoing community…. Return on investment remains important. But managers regard the optimization of capital as a complement to the optimisation of people. The company itself is primarily a community (1997/2002:100-103).

This discussion supports the preceding discussions on the Friedman doctrine and Japan's formula. While maximising results with minimum resources is most important in certain societies, it is not for others. The two types of parent behaviour in the present research's findings correspond to the definitions of the two types of commercial companies respectively. The findings and literature seem to corroborate each other.

While De Geus offers a useful clarification, the notion of a "work community" or a "community" may require an additional explanation because individuals, who are only familiar with the first type (of economic company, "E-type" hereafter), may not be familiar with the second type ("C-type"). The preceding quote reads that any C-type company can be a community "with the purpose of perpetuating itself as an ongoing community" ("C-type purpose"). This C-type purpose however applies to various social structures besides a company: For example, a keiretsu group may also be a "community". The terminology *keiretsu* refers to corporate groups in Japan, but it distinctively differs from strategic alliances in the Western sense (Miyashita and Russell 1994:208). *Keiretsu* groups are organised around the C-type purpose, while Western strategic alliances are not. The Mitsui group[16] and the Sumitomo group,[17] the oldest *keiretsu* groups in Japan, have a 300-year history. The Mitsubishi group has existed for roughly 150 years.[18] Their longevity appears to mirror the C-type purpose. Miyashita and Russell write from a Western viewpoint "The word *keiretsu* does not translate neatly into English, and that is the beginning of the problem" (1994:7). It is problematic in a cross-national setting because the C-type purpose embedded in the word is incomprehensible to Western observers, who are only familiar with the E-type purpose. Good international banking supervision may require a good cross-cultural understanding beyond banking.

One reason for borrower classification being the primary consideration for the Japanese loan classification, or the shared ways of thinking, can relate to the idea of community-thinking in the Japan's formula and the second type of company in De Geus's argument. From the banks' standpoint, knowing how likely the parent company's consolidated operations, including its US subsidiary, are to continue in existence as a perpetuating business community is more important than knowing whether a short-term loan is paid back, because the business community is quasi-eternal with the purpose of perpetuating itself, according to the Japanese ways of thinking. The significance of the primary repayment source of cash can be less for Japanese banks, because the repayment of a short-term loan can really be an insignificant event for the ever-lasting business community, which includes the parent company and its consolidated subsidiaries across the world. The subsidiary and the bank may reside outside Japan, but geographical location does not matter because the Japanese with the same ways of thinking make big corporate decisions on their large investments for the perpetuation of the international community. The primacy of perpetuating the community in “communal” or community-thinking society outweighs economic rationality, which is more prioritised than any purpose in the English-speaking countries (cf. Wilk and Cliggett 2007). In the USA, the parent company must maximise profits with their way of thinking for the primary purpose of wealth production by not providing financial support for the poorly performing subsidiary, which should be sold unless it promptly returns to profitability. With this way of thinking, knowing whether a loan is repaid can be vitally important for banking professionals, since parent support is not taken for granted and the loan may become delinquent in a short period of time; in which case the management will be judged by the bank.

Then the question is, which way of loan classification is correct? Perhaps there is no definitive answer to this, because both sides make a correct classification decision according to the institutional rules and the decision makers’ rationale, which perhaps includes the contents of the education that they have had. Some of those decision bases differ between the countries. It is impossible to standardise them, and perhaps there is no legitimate need for forced standardisation. In reality, the final decision can be made based on the most influential factors, such as the power ratio in cross-national settings, though it may differ from the real loan quality. One can however at least say that the best standard in one country does not always mean the best in another, or a “universal” in the world.

Concluding remarks

This essay has presented the different classification assessment outcomes and relevant ways of thinking behind the outcomes. The first sample has described a favoured Japanese loan, and the second is a disfavoured Japanese loan in the USA, according to the different premises for bank loan classification. The findings suggest that the major reason for the discrepancy of the premises is highly human: It is ascribed to the different ways of thinking about whether or not the parent company in Japan abandons its poorly performing US subsidiary, shaping the perceived risks associated with the unsecured loan. Their normative parent-company behaviour appeared to be a reflection of their ways of thinking in each country.

Although there are discrepancies of loan classification approaches between the countries, each country’s primary consideration appeared to be a fair and accurate representation of normative business practices with their primary reason for being in business. The shared ways of perceiving the risks in each country seem to suit their primary consideration for bank loan classification, part of the country’s banking rules set forth by the banking supervisor. Business professionals’ decisions, including those made at a bank, drive regionally normative business practices. Educators or researchers conduct research on regional business practices and introduce them as correct practices at educational institutions. The graduates then become the business decision-makers, following the content of their education and the institutional rules laid out at the work place. The whole chain of social activities is carried over by generations. Regionally shared ways of thinking deserve attention in today’s globalising banking world especially in cross-national settings.

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Notes

[1] This essay is a continuation of Kitamura (2014), which evolved from ongoing PhD research with the same subject. This essay adds original research results from the draft dissertation chapters to the previous essay. Some of the discussion contents overlap Kitamura (2014) for explanatory purposes.

[2] The July 2005 note explains the risk parameters:

- PD per rating grade, which gives the average percentage of obligors that default in this rating grade in the course of one year
- EAD, which gives an estimate of the amount outstanding (drawn amounts plus likely future drawdowns of yet undrawn lines) in case the borrower defaults
- LGD, which gives the percentage of exposure the bank might lose in case the borrower defaults. These losses are usually shown as a percentage of EAD, and depend, amongst others, on the type and amount of collateral as well as the type of borrower and the expected proceeds from the work-out of the assets.

[3] See the capital requirement formulas in the July 2005 note.

[4] The original manuals, such as *Inspection Manual for Deposit-Taking Institutions* in Japanese and provisional translations in English, are available at http://www.fsa.go.jp. The present paper follows the originals in Japanese (JFSA 2012), since the English ones are provided as provisional translations supplementary to the originals.

[5] Japan has three major financial groups (so-called megabanks); Mizuho Financial Group ("MHFG"), Mitsubishi UFJ Financial Group ("MUFG") and Sumitomo Mitsui Financial Group ("SMFG"), each of which has its core commercial bank. The English terminologies are available in their annual reports posted on their webpages; http://www.mizuho-fg.co.jp/english/, http://www.mufg.jp/english/ and http://www.smbcgroup.com/.

[6] Loan classification terminologies in English available at http://www.fsa.go.jp/en.

[7] Also available at http://www.fsa.go.jp/en.

[8] The researcher transcribed and translated the Japanese data into English.

[9] "Japanese loan" in this essay means a corporate bank loan which involves a lender and a borrower, both of which have Japanese management personnel as their decision makers for originating the loan on the lender side and borrowing the loan on the borrower side, regardless of their geographical location.

[10] (Comment) above is a supplementary description in accordance with the context for ease of reading.

[11] US corporate banking: Lending practice which involves a lender and a borrower, both of which have American management personnel as their decision makers, regardless of their geographical location.

[12] Japanese corporate banking: Lending practice which involves a lender and a borrower, both of which have Japanese management personnel as their decision makers, regardless of their geographical location.

[13] [Comment] denotes the interviewer's reflective question or comment.

[14] The terminology *Western or West* is used for discussion purposes only, as it can be further subcategorised in many ways. Refer to the J-system (the Japanese corporate system) vs. the W-system (the corporate system found in the West) in Aoki and Dore (1994:33) with the same connotation.

[15] The original is published in Japanese. Above is an English translation, approved by Dr. Totten for the present author's on-going PhD work.

[16] Source: http://www.mitsuipr.com/en/history/index.html (accessed 3 April 5, 2016).

[17] Source: http://www.sumitomo.gr.jp/english/history/history/index.html (accessed 3 April 5, 2016).

[18] Source: https://www.mitsubishi.com/e/history/index.html (accessed 3 April 5, 2016).

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