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Cultural Accountability for Business-Practice Differences and Beyond

A Comparative Study on Bank Loan Classification between Japan and the USA

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Abstract

The aim of this interdisciplinary essay is to demonstrate locally shared senses of values ("cultural values") as the root causes of the cross-national differences in business practice between Japan and the USA; in particular bank loan classification and its value-driven consequences. For this aim, it investigates three levels of bank lending; decision-making at an individual level, bank loan classification at an organisation level and aggregate bank loans at a national level. The essay first examines the historical debate in economic anthropology, with the focus on cultural values. The second part explores research-proven differences in individualism and collectivism. The third part investigates the bank loan classification systems at an organisation level. The fourth part examines the CME-LMC distinction (Hall and Soskice 2001) as a culturally-driven dichotomy of how differently aggregate bank loans appear at a national level. The essay concludes that global frameworks need to accommodate value differences across the world.

Keywords: culture, cultural dimensions, senses of values, individualism, collectivism, bank loan classification, BIS, FRB, Japanese FSA, liberal market economies, coordinated market economies.

Introduction

Globalisation has rapidly increased in recent years and consequently brought us merits and demerits that often stir debate on both sides. In the banking sector, international financial integration has continued to expand in the past two decades, and as a result "the shares in country banking systems of banks with sisable foreign portions have grown tremendously" (Goldberg 2009: 171). Consumers can now enjoy a wide variety of international products and services, some of which may have not been offered otherwise. In addition to these overt changes, there are invisible conflicts arising from globalisation, implied in the testimony below from the President of the National Research Foundation, South Africa:

> Much of management theory is based on the writings of 20th century Western scholars whose disciplinary orientations were heavily grounded in economics and classical sociology. Their writings depict people as being individualistic, utility maximizing, transaction-oriented. In point of fact, people are social and communal beings. Along with rationality, they are also guided by emotions. By acknowledging this, global management discourse can evolve more holistic and inclusive theories (Thomas 2002: 189).

One interpretation of the comment is not to undervalue the Western writings but instead to point out that i) individuals outside the West[1] are not as individualistic, utility-maximising or transaction-oriented; ii) some of the management theories, originated in the West and translated or introduced to other regions, may have not worked well—a matter of global applicability of theory, rather than the functionality of it in its birth place; and iii) global theories should be more holistic and inclusive to foster the differences in ways of thinking. Some of the "global theories" may have turned out non-global in reality when applied in a cross-national setting or outside their birth place.

There can be many terminologies that denote the *ways of thinking* above; for example, senses of values, morals, locally shared beliefs, preferences and norms—a system of constructs, some of which can be "correct" for one society but not for another. Broadly speaking there can be two types of value systems: one that only exist in certain societies; and the other which can be compared across societies (Hofstede 2001: 15; House et al. 2004: 19). Major research projects (Hampden-Turner and Trompenaars 1993; Hofstede 2001; House et al. 2004) investigated the latter type, focusing on the relative differences in the "correct" ways of thinking between nations, including Japan and the USA. Such locally peculiar senses of values—*cultural values* in the present essay—can be general tendencies yet become decision-making bases for corporate employees who make business decisions. Big corporate decisions usually lead the enterprises, including banks, in different directions especially in global contexts as eloquently described in case studies such as one in the Harvard Business Review. Hampden-Turner and Trompenaars (1993: 3) write "wealth creation is a moral act" and explain where the moral values come from:

> They originate in *culture*—the word actually means "to work upon," as in *agriculture*, which means "to work upon soil or ground." Cultures that work upon products originate within nations, within sects or groups therein, and increasingly within organisations deliberately incorporated by industry. The qualities of work performed by these corporations depend as much on the durable values of their work cultures as they once depended on the values of their founders. In our survey of 15,000 executives we found that culture of origin is the most important determinant of values. In any culture, a deep structure of beliefs is the invisible hand that regulates economic activity. These cultural preferences, or values, are the bedrock of national identity and the source of economic strengths—and weaknesses (Hampden-Turner and Trompenaars 1993: 4).

They describe the terminology *value*, synonymous to *belief*, *moral* and *cultural preference*. Not only does it give shape to national identity, but it also substantiates the characteristics of national economy by regulating and governing wealth creation in the business world, the major component of the economy. As such, even economic strengths and weaknesses differ according to the cultural values. In his famous work *The Clash of Civilisations and the Remaking of World Order*, Huntington argues "In the Post-Cold War world, the most important distinctions among peoples are not ideological, political, or economic"—"They are cultural" (1996/2011: 21). His definition of *culture* may not be perfectly identical to *cultural value* being referred to in the present essay, but his work has the same point of view that the differences in the "correct" ways of thinking result in different decisions and practices. In his argument, it is the dominant source of conflict between civilisations today. Babbie (2004) also stresses the point:

> Today, social theory has to do with what is, not with what should be.... This means that scientific theory —and, more broadly, science itself—cannot settle debates about values. Science cannot determine whether capitalism is better or worse than socialism.... We could determine scientifically whether capitalism or socialism most supports human dignity and freedom only if we first agreed on some measurable definitions of dignity and freedom. Our conclusions would then be limited to the meanings specified in our definitions, and they would have no general meaning beyond that. (2004: 12)

Having written many books about social research, Babbie concludes that science cannot settle conflicts between cultural values. Why not? He suggests that in the first place the definition or understanding of *human dignity* or *freedom* is not identical across the world. In other words, cultural values placed on the terminology *human dignity* or *freedom* differ between societies. Naturally one scientific conclusion can hold for certain societies but cannot for others, to which the definition of *human dignity* or *freedom* employed for the tool *science* is incongruous. This

means that one scientific theory can be meaningful to certain societies but not to others—the point raised in the comment from the President of the National Research Foundation, South Africa. In a global context, certain cultural values may agree with the conviction that capitalism is better in every single aspect than socialism, while others may not. As a matter of fact, capitalism is not operated in the same manner across the world as examined later in the present essay. Babbie's comment has a balanced viewpoint in that it accommodates disparate views—possibly one of the features of globally applicable frameworks. Indeed the first line of his comment exactly corresponds to *grounded theory* (Glaser and Strauss 1967), a widely supported concept in today's globalising social science. Aside from the capitalism-socialism discussion, one can say that values of humans, not science or scientific theory, shape our notion of correctness, which can be the bases of our social systems yet may not be uniform across nations. As a result of these invisible conflicts between cultural values, culturally one-sided social systems in a global setting do not always function well: One fact in the business sector is that more than 50% of international joint ventures and strategic alliances go out of business due mainly to cultural conflicts (Steers et al. 2010). Culture is certainly not everything, but in a value-driven context individuals' values rule "correct" practices, which shape international business, part of the world's social systems.

The aim of this interdisciplinary essay is to demonstrate cultural values as the root causes of the differences in business practice, focusing in particular on bank loan classification and its value-driven consequences. For this aim, it investigates three levels of bank lending: Decision-making at an individual level, bank loan classification at an organisation level and aggregate bank loans at a national level. At the centre of these is the theme *cultural value* with different angles of decision-making and its outcomes. The essay first revisits the historical debate in economic anthropology and presents individuals' value differences as possible root causes of the debate. To have a structured understanding of cultural values at an individual level, the second part examines the research-proven cultural values, individualism and its opposite collectivism ("I/C"), as the grounds of the differences in business practice between Japan and the USA. Introducing a government-commissioned report available only in Japanese as a case study, the third part qualitatively compares their normative approaches to bank loan classification from the perspective of lenders and regulators and brings out the cross-national difference at an organisation level. The fourth part examines the LME-CME distinction in *Varieties of Capitalism* (Hall and Soskice 2001) as a culturally-driven distinction of how aggregate bank loans appear differently at a national level. Drawing on major works and real-world evidence, the essay considers that these systematic differences are ultimately ascribed to the varying cultural values—"the bedrock of national identity and the source of economic strengths—and weaknesses." The essay concludes that global frameworks need to accommodate value differences across the world, as an optimal structure to deal with the dynamics of value-driven consequences in global settings.

Historical Value-Driven Debate in Economic Anthropology

There is an academic field called economic anthropology, which has the task, among others, of dealing with two apparently contradictory views: "While economists are concerned with how markets direct the actions of profit-maximising actors, anthropologists have been interested in exploring how actors' perceptions, social relations and obligations affect their economic decisions" (Ortiz 2005: 59). Wilk and Cliggett put it this way: "The field emerged only through debate and often heated disagreement, the polite academic equivalent of a barroom brawl" (2007: 3). The disagreements seem impossible to settle and there appears to be something which makes the two views polarised and uncompromising. Blim (2005) writes of the possible root cause in his article "Culture and Economy":

> Much depends upon our values. People have values, notions of what is good or worthy and what is bad or unworthy of human life, regarding the most fundamental questions of existence. Our choices, our actions in the world, are guided by them. They are ultimate ends against which we measure our actions (2005: 306).

Having put it forth, Blim continues "Values point towards appropriate actions" (2005: 306), suggesting that values determine how people act. This agrees with the discussions in the Introduction that cultural values can be decision

bases, and value differences can result in disparate action outcomes. In the discipline, the series of heated disagreements may be interpreted as the consequences of conflicts between basic cultural values.

Wilk and Cliggett provide a brief history of the interdisciplinary field, starting with the formalist-substantivist debate of the 1960s which was "once the centrepiece of economic anthropology" (2007: 3-5). According to them, the debate is "a variation on a much older debate about the differences among human groups"—the relativist-universalist debate (2007: 6).

> A relativist argues that cultures are so different from one another, especially primitives from moderns, that they cannot be understood with the tools of Western science, tools that are themselves fundamentally a product of modernity... [whereas] a universalist says, on the contrary, that all human experience is fundamentally the same and can be understood using objective tools that are universal (2007: 6).

From the universalist perspective, "science is not bound by a single culture and therefore can make general comparative statements" (2007: 6). Further clarification on the definition of *modernity* would help, but it appears that individuals in the West generally have cultural values that make the societies prioritise "modernisation" or minimisation of the necessary period of time (Hall 1959: 8) to attain certain "modernity;" in contrast these preferences may not be equally appealing to individuals' cultural values outside the West (Hampden-Turner and Trompenaars 1993; Hofstede 2001; House et al. 2004). If so, not all the Western tools may be universal because some of them are unsuitable for non-Western cultural values.

Isaac (2005) elaborates on this history, introducing Karl Polanyi, who made the distinction—the "specification of two root meanings of 'economic', the substantive and the formal" (2005: 15). Below is an excerpt from Polanyi (1957: 243) as Isaac notes:

> The substantive meaning of economic derives from man's dependence for his living upon nature and his fellows. It refers to the interchange with his natural and social environment, in so far as this results in supplying him with the means of material want satisfaction.
>
> The formal meaning of economic derives from the logical character of the means-ends relationship, as apparent in such words as 'economical' or 'economising'. It refers to a definite situation of choice, namely, that between the different uses of means induced by an insufficiency of those means. (2005: 15).

Isaac further quotes Polanyi, who argued that "those two meanings of the term have nothing in common" in between:

> The latter [formal meaning] derives from logic, the former [substantive meaning] from fact. The formal meaning implies a set of rules referring to choice between the alternative uses of insufficient means. The substantive meaning implies neither choice nor insufficiency of means; man's livelihood may or may not involve the necessity of choice and, if choice there be, it need not be induced by the limiting effect of a 'scarcity' of the means (2005: 15).

As Isaac notes, "The substantive meaning alone is useful for comparative economics, Polanyi argued, because 'formal economics' is applicable only to 'an economy of a definite type, namely, a market system' (Polanyi 1957: 247) in which livelihood routinely involves choice arising from an insufficiency of means (economising)" (2005: 15). One of their points is that the two meanings have nothing in common but are belived to be true in the respective parties or even societies. Wilk and Cliggett observe Polanyi this way: "Like most cultural evolutionary models, Polynyi's can be used to order all societies from the simple ('primitive') to the complex ('modern') and depicts modern society as a radical break from the past" (2007: 8). While placing it to introduce Polanyi, Wilk and Cliggett appear to disagree with the terminologies, "primitive" and "modern." In the end note, they add "We do not think they have a legitimate

use in anthropology" (2007: 28), concluding that 'substantive' and 'formal' do not represent 'primitive' and 'modern' respectively. They continue that formalists attempted to "demystify non-Western economic behaviour, to show that people really are rational" (2007: 11), which was "a critical message to get across to the government officials and policy makers, who had (as many still have) a tendency to dismiss the behaviour of poor people and ethnic minorities as 'irrational,' sunk in tradition, or just plain stupid." Their observation suggests that the 'substantive' and 'formal' debate is more evidence of the value differences between "non-West" and "West." Both sides seem to believe that they, or their cultural values, are absolutely right while making no attempt to understand each other.

As for the outcome of the debate, there seems to be no definite answer. Wilk and Cliggett write about the winner: "In some sense, then, both sides won by making their points" and "in an ultimate sense, neither side won since nobody really addressed the more fundamental assumptions being made about human nature" (2007: 14). Regarding the debate, the present essay considers that there is no need to determine which side wins, because both are normative in the respective societies. Many components of the debate can be dynamic, relative and subject to interpretation in a truly global context.

Research-Proven Value Differences in Cross-Cultural Studies

Many researchers have attempted to find cultural values that can be compared between societies. According to major cultural research outcomes (Hampden-Turner and Trompenaars 1993; Hofstede 2001; House et al. 2004), a representative set of cultural values—*cultural dimensions* in Hofstede[2]—are called individualism and its opposite, collectivism ("I/C"). Individualism is the prioritisation of individual interests over collective interests, and collectivism is the opposite (Chen et al. 2002). I/C is one of the research-proven constructs that help explain the cross-national differences in cultural values, which often function as decision-making bases for various everyday activities. House et al. (2004: 437) highlight the significance of I/C among other constructs, reporting that there are more than 1,400 articles published in the last 25 years and numerous books devoted exclusively to the I/C distinction. Chen et al. (2002: 571) note:

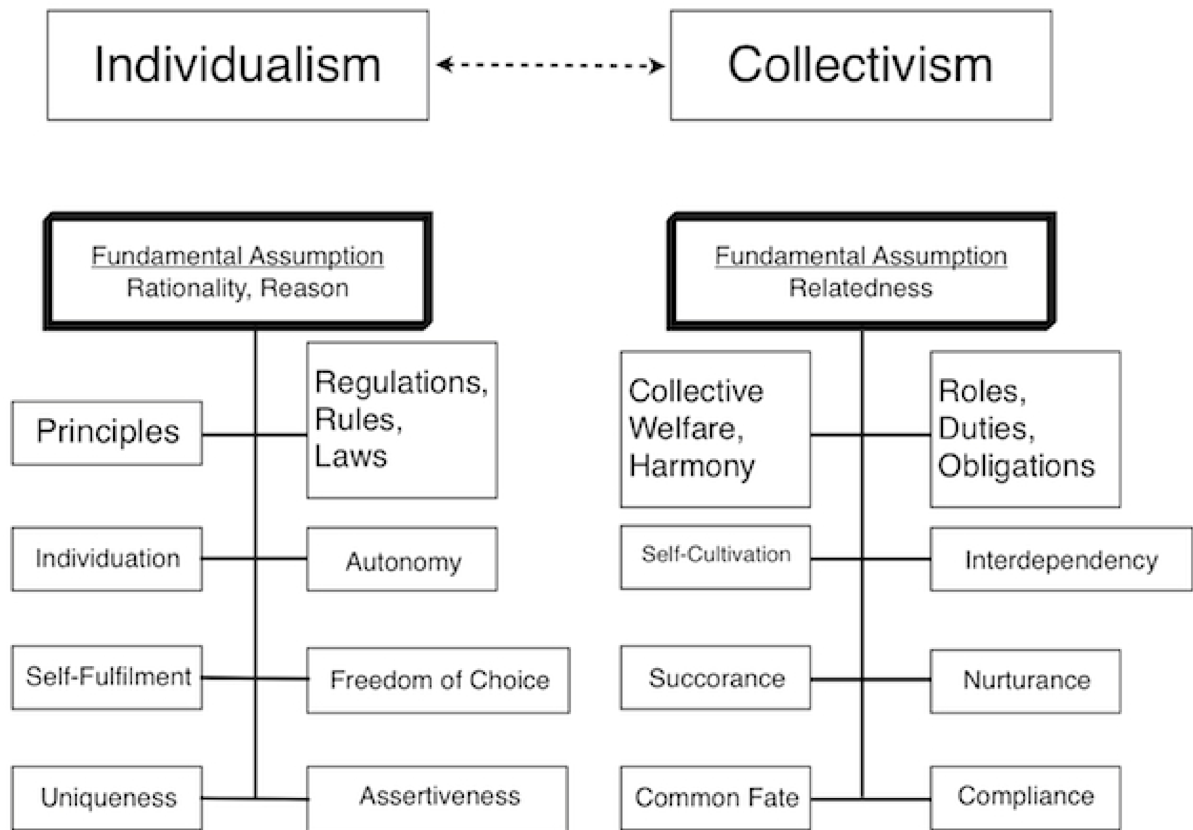
> The cultural dimension of I/C is particularly appropriate for specifying human opportunistic propensity because it offers insight into culturally conditioned views of self-identity (Markus and Kitayama 1991) and the primacy of self versus group interest seeking (Parsons and Shils 1951), both of which affect individuals' cognitive, affective, and behavioral orientations toward others (Markus and Kitayama 1991). Individuals define the self as autonomous and independent, whereas collectivists define the self as interconnected and interdependent with significant others of various groups. Furthermore, when individual and collective interests are in conflict, individual interests have the primacy in individualist cultures whereas collective interests have the primacy in collectivist cultures (Triandis 1995).

As a breakdown at the country level, "individualism is very high in the United States and generally the English-speaking countries," while "collectivism can be found in parts of Europe (e.g. southern Italy, rural Greece) and much of Africa, Asia, and Latin America" (Triandis 1994: 41), including Japan as a collective society.

I/C, among other cultural constructs reported by the major research works, appears to have much commonality with the historical debate in economic anthropology discussed in the preceding section, in the sense that locally normative specificity, which is believed to be correct in one society, is not correct in another. This can be an explanation for value-driven decision-making activities including the historical debate. Disagreements stem from the differences between their cultural values on which they base their arguments. Because certain senses of values are strongly believed, the resultant disagreement cannot be easily settled.

Figure 1 below is borrowed from Kim et al. (1994: 7, Figure 1.1, Individualism and Collectivism: An Integrated Framework) which illustrates fundamental reasoning of individualism and collectivism and compares their basic tenets:

Figure 1. Comparison of reasoning between individualistic and collective societies



Kim et al. write that rationality, which can be exemplified as regulations, rules and laws, is a fundamental assumption, since individuals have autonomy and freedom of choice in individualistic societies. In collectivistic societies, relatedness—roles, duties and obligations—is a fundamental assumption, since individuals are interdependent with the collective group and in compliance with it. The comparison is not an absolute dichotomy; for example, many regulations and laws are obviously laid out in collectivistic societies including Japan, whereas relatedness certainly plays a role in various settings in individualistic societies. The point here is that, relatively speaking, the fundamental assumptions are of high significance and can be basic reasoning constructs, driven by senses of values peculiar to the societies. Locally believed values are highly stable (Hofstede 2001: 34), as "shared motives, values, beliefs, identities, and interpretations or meanings of significant events that result from common experiences of members of collectives and are transmitted across age generations" (House et al. 2004: 57).

Value-driven social differences are easily recognisable when compared through examples. For instance, individualistic societies, including the USA, have a system called GPA (Grade Point Average), which is a trusted scale for academic achievements. While one's alma mater is important, GPA is a relatively dominant determinant of educational events in these nations. All the pertinent educational systems are aligned with the GPA system, and they function in harmony as socially-linked systems in the society. In Japan, in contrast, one's alma mater determines one's life, and GPA does not. GPA is not even calculated at many colleges and universities, because the social systems highly demand one's alma mater—one's educational identity embedded in the collective entity—for most events (Kondo 1990: 51). Globalisation may have started to force educational institutions in Japan to adopt the GPA system, but GPA will never replace alma mater as a critical determinant in this collective society. It can be argued that this relative, though not absolute, difference in measurement systems is a reflection of individualism and collectivism: In the USA, the GPA system, peculiar to the individual, is the trusted measure, whereas an alma mater, a membership of the collective entity, is most trusted in Japan. Local values and social systems are often tightly linked and usually

remain intact (Hofstede 2001: 12). Note that the focus of this essay is to provide cultural accountability for the cross-national differences by examining cultural values as the root causes of unique practices, borrowing the research-proven construct, I/C, which subsumes the categories of cultural values. The GPA and alma mater systems are intended to exemplify unique practices, not to justify the I/C distinction. I/C is a research outcome of numerous questionnaires conducted in the major research projects: For instance the GLOBE project (House et al. 2004) gathered 17,000 responses from business managers in 62 societies.

Value-Driven Differences in Bank Loan Classification

Having explored the basic concepts of cultural values at an individual level, we will qualitatively examine cross-national differences in the banking sector at an organisation level. The focus of this case study is the same as the distinction between the GPA system and alma mater in that cultural values give direction to social systems. In an attempt to present this complex topic in the easiest possible way, this section first offers an overview of bank supervision and its framework and then investigates the differences between the practices.

Bank supervison overview

According to a 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 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) and affect the bank's profits and capital ratio. The present essay focuses on bank loan classification, not provisioning.

From the perspective of lenders, one of the important goals 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 global frameworks such as the Basel Accord. The bank loan classification outcome generally represents the quality of the bank's credit portfolio.

Despite the obvious importance of loan classification, "a well-recognised international standard to which national authorities and bank supervisors may refer is unavailable" (Laurin and Majnoni 2003: v), and the amount of research on cross-national analysis of loan classification appears somewhat limited. A possible reason for the absence of a well-recognised international standard is that the notions of "perceived risk and other relevant characteristics of the loans" (Laurin and Majnoni 2003: 1) vary depending on cultural values across countries.

Bank supervison framework

In *Core Principles for Effective Banking Supervision* (2012) by the Basel Committee on Banking Supervision, the BIS 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 one of the policy descriptions pertinent to bank loan classification that BIS 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 BIS Principle can be interpreted as such: Banks should evaluate the borrower's current financial standing and repayment ability, and the loan classification system should incorporate the pertinent components, such as the outcomes of credit analysis. This framework can be generally applicable worldwide regardless of nationality. Both Japan and the USA have overall satisfactory supervisors at the national level, according to IMF (2010; 2012), the country reports of the financial sector assessment program, administered by the IMF.

Bank loan classification

As touched upon earlier, despite the obvious importance of loan classification, there is no well-recognised international standard for it. Laurin and Majnoni reveal their survey results which boil down to "the absence of international consensus on loan classification approaches," although the approaches can be broadly classified into two: "Either a management responsibility or a regulatory matter" (2003: 9). Bank loan classification is a regulatory matter for both Japan and the USA.

In the USA, the Office of the Comptroller of the Currency ("OCC") provides the definitions of bank loan classification (e.g. ChuoAoyama 2002). According to OCC's publication, 'Rating Credit Risk: Comptroller's Handbook,' OCC sets forth the following:

> **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 (OCC 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

OCC provides the definitions for each of the last four categories but not for the pass grade. In the USA, bank loan classification is a regulatory matter, and 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" (OCC 2001: 14). 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 which include guidelines for loan classification. The original manuals, such as *Inspection Manual for Deposit-Taking Institutions* in Japanese and provisional translations in English, are available on their webpage.[3] The present essay follows the originals in Japanese (JFSA 2012), since the English ones are provided as provisional translations supplementary to the originals. 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, there seems to be no agreement on their English translations between banks. Below is a summary of major banks' English terminologies:[4]

- 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 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 (i.e. borrower classification) results are verified and translated into loan classification results in four categories: Bankrupt or De Facto Bankrupt, Doubtful, Special Attention and Normal,[5] similar to the U.S. classification, although traditionally called IV, III, II and I in Japan, respectively (ChuoAoyama 2002: 20). The loan classification results are publicly released[6] 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 the cross-national differences in banking practice (ChuoAoyama 2002, available only in Japanese). They (2002: 20) report the Japan-USA differences: 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. In other words, the borrower classification is the basis of loan classification as explained also in the Japanese Bankers Association (2012). In the USA, the primary consideration for loan classification is the primary repayment source of cash (OCC 2001: 14), not borrower classification. The primary source of repayment does not necessarily equate to the credit rating of the borrower, as borrower ratings are determined with a number of factors, not only the primary source of repayment but also all the features of the balance sheet, income statement and cash flow statement. Soft information (i.e. qualitative factors) may also be incorporated into credit analysis, where it obviously drives the financial condition. Japanese banks often take notes of soft information especially on "relatedness" which would favor the borrower's business performance or continuity. The following chapter looks at several types of *relatedness*.

Highlighted in the works of ChuoAoyama and Japanese Bankers Association, borrower classification—the process of assigning credit ratings to borrowers, the collective entities—is an indispensable, valued part of the whole process of loan classification in Japan. While borrower ratings weigh against the Japanese approach in the collective society,

they are not the primary consideration for bank loan classification in the USA. Bank loan classification probably appears to be a dry and cultureless system, yet there are cross-national differences in banking practice. The following section will further examine the connection between the cultural values and resultant practices from a different angle.

Value-Driven Differences in Aggregate Bank Loans

As I quoted in the Introduction, “Today, social theory has to do with what is, not with what should be” (Babbie 2004: 12). Among the many researches to examine “what is” rather than “what should be,” *Varieties of Capitalism* (Hall and Soskice 2001) makes an important contribution highly pertinent to the present discussion, useful for verifying the connection between the three levels of banking practice. Hall and Soskice provide rich samples and discussions which elucidate how economic and political institutions are different at a national level. Their work is “actor-centred,” in which actors can be “individuals, firms, producer groups, or governments,” suggesting that economic performance is the aggregate results of firm activities (2001: 6). With that, they argue that broadly speaking there are two types of political economies, namely liberal market economies (LMEs) and coordinated market economies (CMEs) (2001: 8). In LMEs, “firms coordinate their activities primarily via hierarchies and competitive market arrangements,” and “market relationships are characterised by the arm’s-length exchange of goods or services in a context of competition and formal contracting” (2001: 6). As a result, “the equilibrium outcomes of firm behaviour are usually given by demand and supply conditions in competitive markets” (2001: 6). In contrast, “the equilibria on which firms coordinate in CMEs are more often the result of strategic interaction among firms and other actors” (2001: 6). The present essay argues that one of the root causes for “strategic interaction” is *relatedness* (Kim et al. 1994), the value normative in the CMEs, where it leads business decision makers and consequently the firms to “strategic interaction.” While cultural values do not determine every interaction, the CME-LME equilibrium difference cannot be reasonably explainable without the local values believed to be correct. Australia, Canada, Ireland, New Zealand, the UK and the USA are defined as the LMEs, and the CMEs include Japan, and continental European and Scandinavian countries (2001: 20). This country classification highly corresponds with that of the I/C distinction (Kim et al. 1994), meaning possibly that I/C is the root cause of the CME-LME distinction.

From the viewpoint of political economy, Hall and Soskice describe *how* the LMEs and the CMEs differ from each other, providing the characteristics that distinguish the economies. Economic anthropology and cross-cultural research can clarify the reason *why* the economies differ from each other: “Our choices, our actions in the world, are guided by them (values)” (Bilm 2005: 306), and “These cultural preferences, or values, are the bedrock of national identity and the source of economic strengths—and weaknesses” (Hampden-Turner and Trompenaars 1993: 4). Hall and Soskice observe that Germany, one of the CMEs including Japan, “typically provides companies with access to finance that is not entirely dependent on publicly available financial data or current returns,” and “access to this kind of ‘patient capital’ makes it possible for firms to retain a skilled workforce through economic downturns and to invest in projects generating returns only in the long run” (2001: 22-23). ‘Patient capital’ can be aggregate bank loans in the CMEs, including Japan, where bank financing is relatively predominant. As an interpretation of their CME observation, banks in collective societies tend to provide ‘patient capital’ in order to support the continued existence of companies that make long-term employment more feasible (Aoki and Dore 1994). A representative example can be Japan’s main bank system (Aoki 1995/2000) which denotes their common banking practice—the closest bank provides resolute financial support even when the borrower is not performing well. The main bank system does not guarantee unconditional support but does provide ‘patient capital’ even for borrowers not generating strong cash at present (Abegglen 2006). Why do they do that? From a cultural perspective, Japan, one of the collectivistic societies, tends not only to value “relatedness” (Kim et al. 1994) between the bank and the borrower but also to demand the continued existence of collective organisations, including profit-pursuing companies, which offer “relatedness” or even “home” (Totten 1998: 79) to individuals. Mutual stockholding (Aoki 1995/2000) between companies, including those between relationship banks and their borrowers, is also evidence to attest to this argument rooted in “relatedness” in Japan. It can be an odd business practice that violates the “correct” ways of thinking in individualistic societies. Their CME observation (Hall and Soskice 2001) overall agrees with the

comment from the President of the National Research Foundation quoted in the Introduction that individuals outside the West are not as individualistic, utility maximizing or transaction-oriented.

In the CMEs, patient capital can be aggregate bank loans that are not entirely dependent on publicly available financial data or current returns as aforementioned. From the perspective of the LMEs, this generally means that CME banks provide loans for borrowers based on opaque financial data or weak current returns relative to the "correct" LME standard. Such CME loans probably appear to have less sustainable repayment sources (OCC 2001: 14) and consequently they may be assessed as adverse in loan classification, if the bank examiners only use the "correct" LME judgment standard. Yet such CME bank loans (i.e. patient capital) are regionally normative, generally acceptable in CME banking practice. As testified in Aoki (1995/2000), CME companies tend to be financially well-off, backed by the main bank system in the case of Japan. This means that CME loans are likely to be paid back with relatively rich funding resources reinforced by the main bank system. Another CME lending practice—an incorporation of soft information (Berger and Udell 2006) as a legitimate practice at a financial institution in a collective society—may appear "not entirely dependent on publicly available financial data or current returns" to LME observers. Can one assess such regionally normative loans as less sound? Correctness is relative in the pluralistic world.

To verify the important characteristic of arm's-length pricing in the CME-LME distinction, we will examine relevant works. Sako (1992) proposes two extreme patterns of business contract relation: Arm's-length Contractual Relation (ACR) and Obligational Contractual Relation (OCR), "which represent the ends of a multi-dimensional spectrum of possible trading relationships" (1992: 9); for example, one between a manufacturer and its supplier. Below is a summary of the definitions (1992: 9-10):

Table 1: Definitions.

ACR	**OCR**
A specific, discrete economic transaction which spells out before trading commences each party's tasks and duties in every conceivable eventuality, as far as human capacity for anticipation allows.	An economic contract covering the production and trading of goods and services.
Unforeseen contingencies to be settled by resort to some universalistic legal or normative rules.	Embedded in more particularistic social relations between trading partners who entertain a sense of mutual trust.
All dealings to be conducted at arm's-length, so as to avoid undue unfamiliarity, with neither party controlled by the other.	Transactions taking place without prior agreement on all terms and conditions of trade because of the underpinning.

Identical to the terminology *arm's-length* in Hall and Soskice (2001), ACR is obviously normative in the individualistic societies including the USA, where the prioritisation of formal contracting is rooted in the "transaction-oriented" senses of value. In contrast, OCR with the prioritisation of relationship is "correct" in Japan. As a matter of fact, there are many academic works to support Sako's argument and distinction: Aoki (1984) provides *invisible handshake* and *visible handshake*, and Flynn (1999) introduces *expressive tie* and *instrumental tie*.

All discussions boil down to this: Correct senses of values and resultant business practices are relative from a global perspective. Certain notions of correctness differ across nations, because the contents of correctness or rationality are not always uniform in a global context.

Concluding Remarks

Drawing on the existing body of research, the present essay has examined the differences in bank loan classification and related topics, with the theme *cultural value* as their root cause. The notion of proper loan classification can be subject to the locally shared senses of decision determinants. From the perspective of lenders, banks in most

countries share the same goals, one of which is to minimise credit loss. Yet "correct" approaches to bank loan classification differ according to the regionally normative correctness. Japan's collectivism can help explain the real-world sample—the prioritisation of borrower classification—the collective interest in the society. In contrast, the prioritisation of collective interest is not the primary consideration for loan classification in the USA. With locally attached values, banks conduct bank loan classification, and the bank supervisors, who are likely to share the same senses of values, audit the classification outcomes in the nation. The discussions suggest that varying approaches are unlikely to converge perfectly as seen at present. From a global standpoint, there is no absolute need to converge into a single approach, as long as the approach meets the goal in the respective county. The best standard in one country does not always mean best in another or universal in the world.

Cultural differences may become shocks, hitches or even clashes (Huntington 1996/2011) yet can be a mere phrase, insignificant to those only familiar with a single culture where no cross-cultural conflict exists. Cultural difference may also sound unfamiliar to many scholars and professionals, because it tends to kick in upon decision-making, for instance in finance, loan lending based on the interpretation of financial data (i.e. computed ratios) and often other qualitative factors beyond pure mathematics—the calculation part at the initial stage of the whole decision-making process. Calculation itself is not culturally contingent, but a choice or interpretation of the critical indicators can be culturally driven in reality. Originated at an individual level, aggregate decision results come out differently all the way through a national level. With this social reality, the present essay has offered cultural reasoning to the CME-LME distinction, an important contribution from political economy.

Culture is not the sole decision-making driver, but culturally one-sided operating frameworks may be inappropriate in truly global settings. In their executive summary, the Basel Committee on Banking Supervision states "*The Core Principles for Effective Banking Supervision* (Core Principles) are the *de facto* minimum standard for sound prudential regulation and supervision of banks and banking systems" (2012: 1). The conclusion of the present essay agrees with the idea of the BIS core principles being the minimum standard as a global framework. It can be an important characteristic, as it fosters disparate values and practices seen in the globalising world—not only the differences between Japan and the USA but also all countries across the globe.

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Notes

[1] The terminology *West* is used for discussion purposes only, as the West can be further subcategorised in many ways.

[2] See Williamson (2002) for counterarguments against criticisms of Hofstede.

[3] http://www.fsa.go.jp/.

[4] Japan has three major financial groups; 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/.

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

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

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