Strategic Analysis of Japanese Megabanks – Financial Services Industry Analysis

Saïd Business School, University of Oxford, UK

Nicholas Burgess

nburgessx@gmail.com

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We perform a series of five strategic analyses of Japanese Megabanks. This paper is the fourth analysis in the series, where *we analyse the financial service industry dynamics to assess how Japanese Megabanks and RUFG*[1] *should best position themselves to exploit opportunities, protect against threats and maximize corporate value.*

Michael E. Porter proposes a five forces industry structure is well-suited to assess the attractiveness of important markets and industries. We perform an industry analysis for financial services, suggest what RUS should do as a result of this analysis and comment on the value and limitations of the analysis for RUS.

Industry analysis using Porter's five forces

An industry's attractiveness can be measured by assessing competitive key drivers or forces, which simplify complex industry dynamics to facilitate hard decision making. Established in 1979 by Michael E. Porter of Harvard Business School, Porter's five forces analyse an industry from a monopolistic viewpoint. High competitive forces are viewed negatively and low forces are considered favourable. Porter's five forces are:

- RIVALRY
- SUBSTITUTION THREAT
- SUPPLIER POWER
- BUYER POWER
- ENTRY THREATS

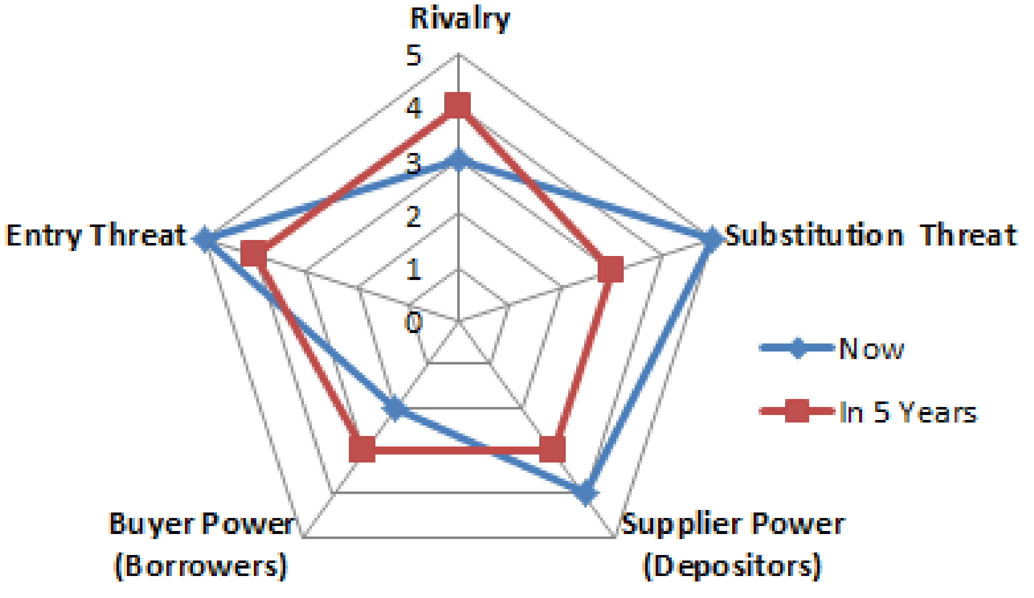
The five forces monitor industry attractiveness and how it is likely to change over a given period of time.

[1] See appendix for full case study details

Porterian Five Forces Application to Financial Services

Considering the evolution of the Porterian five forces analysis over a 5 year period and applying them to the "Financial Services" industry as per appendix A leads to the web plot visualisation below in figure 4.1, where the centre of the web 0 represents a high force and the outside of the web 5 a low force.

Figure 4.1 Porter's Five Forces Analysis for Financial Services



- Rivalry **(Decreasing)**

  Rivalry is decreasing as competitors struggle with legacy systems and technology (Burgess 2019a) to innovate and adapt quickly to market reforms (JP Morgan, 2019).

- Substitution Threats **(Increasing)**

  Fintech companies are disrupting the industry and innovating at a fraction of the cost (Refinitiv, 2019). Furthermore central clearing houses and electronic trading platforms are disrupting the industry, in a similar way to which Apple disrupted the mobile phone market (Van Alstyne, 2016). They offer standardised trading, increased liquidity, reduced credit risk and capital costs and with it reduced market share and trading margins for the banks.

- Supplier Power **(Increasing)**

  Suppliers in the financial industry are customers / depositors. Capital is in short supply with increased FRTB/Basel III regulation requiring additional capital. Consequently depositor supplier power is increasing.

- Buyer Power **(Decreasing)**

  Buyers in the financial industry are also customers / borrowers. There are less players competing in the market as banks adapt to new regulations and reforms with smaller capital reserves reducing the supply of funds. Consequently buyer power is decreasing.

- Entry Threats **(Increasing)**

  Entry threat forces are increasing. Fintech companies and central clearing houses such as LCH and CME continue to disrupt the industry, which is reducing capital requirements for cleared transactions opening up the electronic trading and hedging activities for new entrants.

Attractiveness of the industry

The Porterian five forces indicate that the financial services industry is attractive with low forces. There are 'Blue Ocean' opportunities, Libor Reform (JP Morgan, 2019), (Burgess, 2019a) offers the opportunity to gain market share, market globalisation (Ghemawat et al, 2019) presents high growth potential and there are cost saving and further market share growth opportunities presented by digital and fintech technology innovation in the industry (Refinitiv, 2019).

Market reforms, capital adequacy, technology costs and substitution threats must be carefully managed (Burgess, 2019b). However the financial industry is familiar and well poised to manage such risks and rewards.

What should my organization do?

RUS in light of the five forces analysis should look to exploit and invest in industry "Blue Ocean" opportunities and carefully monitor external threats. Furthermore RUS should look to build upon its capital strength and shore-up its technology weaknesses as outlined below.

- Capital Costs & Usage

  Capital costs are high as the company uses the basic industry capital model, inferior calculation models and analytics. The company should seek to migrate to the advanced industry model that incurs cheaper balance sheet capital costs and allows for trade netting et al. Internal synergies with corporate banking units (B) that use the advanced capital model should be explored and considered, see exhibit A.

- Alliances

  The bank should also look to form alliances with fintech companies to innovate faster and more cheaply. Innovation is extremely important as highlighted by (McGrath, 2012) and vital to keeping pace with market reforms. Furthermore (Kavadias et al 2016) highlights the importance of asset sharing and collaboration for top performing organisations looking to reduce fixed costs.

  The company trades legacy products, uses legacy technology and in-house technology innovation is slow, costly and poorly managed. Internal alliances should be sought with the Americas division to maximize synergies where cultural and political differences are favourable and CAGE (Cultural, Administrative, Geographical and Economic) distances are low, see (Ghemawat et al 2019). Alliances with Japanese divisions should be avoided since these tend to destroy value, due to cultural and political challenges, here a more arms-length knowledge and technology sharing arrangement should be employed.

- Blue Oceans

  There are opportunities to capture market share due to competitors being slow to innovate, respond to market changes and on-board new products derived from Libor reform (JP Morgan, 2019). Costs however must be carefully managed, (Burgess, 2019b). Green finance and other government initiatives (Thomas, 2019), which are overlooked by this analysis, should also be explored since such opportunities are highly lucrative.

Comment on the value and limits of the analysis

The analysis is valuable however collaborative and political forces are overlooked by Porter's five forces. Porter himself acknowledges and compensates for this by introducing 6^{th} and 7^{th} forces for collaborative and political forces respectively. Porter's analysis is monopolistic, transactional and based on value competition, whereas top performing companies are shown to be more collaborative and asset share (Kavadias et al, 2016).

Consequently government forces and Green public finance opportunities are not visible. Furthermore collaboration forces and disruptor effects from platform and digital innovation is overlooked as they were when Apple disrupted the mobile phone market and numerous other disruptors such as Airbnb, Über et al. captured significant market share form their industries (Van Alstyne et al 2016).

Despite the above limitations Porter's five forces analysis applies itself reasonably well to the financial services industry. The analysis provides useful high level oversight, but additional analysis may be required to identify gaps. The macro PESTEL scenario analysis performed in analysis 1 (Burgess, 2020a) compliments this industry analysis well and helps manage the political and regulatory uncertainty facing the industry (Ramirez et al 2017).

Appendix Case Study

Organization: Rainbow & Unicorn Securities, London (RUS)
Industry: Financial Services
Sector: UK Corporate Lending & Project Finance

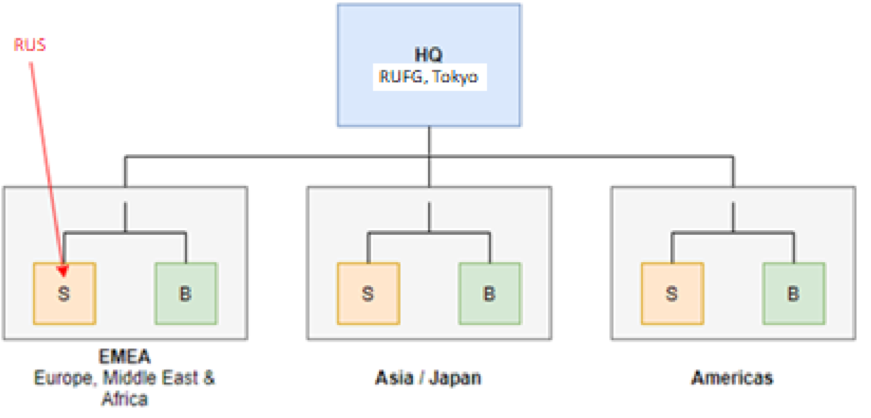
RUS provide financial services, trading expertise and risk management solutions within the interest rate, fixed income and credit markets. It specialises amongst other things in corporate lending and project finance within the UK and also Europe, Middle-East and Africa (EMEA).

RUS is fully owned by Rainbow & Unicorn Financial Group Tokyo (RUFG), which has a sizable balance sheet, predominantly due to large Japanese deposits. Japanese investors are extremely risk-averse with many business relationships based on trust, reputation and long-term track formed over decades!

RUFG is one of three 'Japanese Megabanks' that dominate the financial services industry in Japan with combined deposits exceeding USD 10 trillion (Piece-of-Japan, n.d.). RUFG itself has assets of USD 20 billion and employs 50,000 staff with 500 offices worldwide.

RUFG has 3 regional hubs to provide concentrated coverage in Europe & EMEA, Asia & Japan and the Americas. RUFG subsidiaries are siloed with Corporate Banking (B) ring-fenced and Investment & Securities (S) businesses separated to satisfy legal and regulatory requirements.

Figure A1: RUFG Organization Chart



Corporate Banking subsidiaries (B) have large balance sheets, good access to capital but poor legacy systems & infrastructure. Investment & Securities (S) businesses however have good technology and systems, but small balance sheets and little access to capital.

This case study is fictional, yet inspired by adapted from real-world industry practice and first-hand experience.

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