

■ Highlights of Fiscal 2000

Diversifying Sources of Funds

Small and medium-sized enterprises (SMEs) are actively diversifying their sources of funds to include increasingly sophisticated mechanisms, such as private bond placements, equity finance, and the factoring of trade receivables. As an integrated financial institution, the Shoko Chukin Bank is working in various ways to respond to its customers' efforts to diversify their financing arrangements through the use of these new methods.

Private Placement Trustee Services

With the growth and development of capital markets in recent years, more and more SMEs are taking their first steps into the direct financing arena by using private bond placements to raise long-term funds. The Shoko Chukin Bank recognizes the importance of these financing methods to SMEs and actively provides underwriting services.

In April 2000 the Shoko Chukin Bank began to handle private bond subscriptions under special bond guarantee systems established by Credit Guarantee Associations. The Credit Guarantee Associations guarantee 90% of the value of bonds issued by SMEs and the Bank is now working actively in this area.

In fiscal 2000 the Shoko Chukin Bank underwrote private bond placements amounting to ¥31.3 billion, including ¥27.2 billion in guaranteed bonds.

Equity Finance

SMEs are increasingly eager to improve their equity structures and financial positions by using equity issues to raise funds. Moreover, the easing of OTC registration criteria and pre-float rules and the establishment of markets for emerging companies, such as Mothers and NASDAQ, have allowed a growing number of SMEs to raise funds directly from the market. The Shoko Chukin Bank is responding to growing demand for this type of finance in the SME sector. At the end of fiscal 2000, the balance of shares acquired amounted to ¥23.1 billion.

Factoring of Trade Receivables

In recent years there is a growing need in the SME sector for the liquidation of assets so that they can be taken off balance sheets or turned into funds.

The Shoko Chukin Bank is responding to this need by providing funds through the conversion of trade bills and receivables into trust beneficiary rights, which it then acquires. In fiscal 2000, the Shoko Chukin Bank acquired trust beneficiary rights amounting to ¥14 billion relating to the trade receivables of SMEs. In February 2001, the Bank signed a trust agency contract with six trust banks covering monetary claim trusts.

Investment Syndicates

In December 2000, the Shoko Chukin Bank and the Japan Institute of Commerce, Industry & Economics, Ltd. jointly formed the first Shochu Investment Syndicate. In fiscal 2000 the Syndicate handled nine investments worth a total of ¥170 million. It was established to meet the equity and bond underwriting needs of SMEs, which are increasingly turning to equity issues as a way of raising the funds needed to expand their business operations by providing highly original products and services.

Additional Government Subscription

For several years the Shoko Chukin Bank has implemented a special loan system to facilitate access to operating funds for financing for SMEs affected by the credit crunch. The economic policy package announced by the government in October 2000 provided for the expansion of this system through the introduction of "safety net" loans to meet emergency stabilization needs. The package also included measures to increase the flexibility of collateral requirements under the disaster loan system. In December 2000 the government provided an additional subscription of ¥16.1 billion to cover the cost of these measures.

New President

On June 20, 2001, Yukiharu Kodama stepped down as President. His successor, Tadashi Ezaki, took office on June 21 as the 13th President of the Shoko Chukin Bank. Mr. Ezaki was head of the Industry Policy Bureau of the former Ministry of International Trade and Industry (MITI).

The new President, together with the directors and staff of the Shoko Chukin Bank, will continue their efforts to provide the best possible services. We look forward to the continuing support of our customers.

■ Overview of Fiscal 2000

The Economic Environment

The U.S. economy, which had previously remained strong, began to decelerate in the second half of fiscal 2000. Although there was some concern about the impact of a slower U.S. economy, the European and Asian economies mostly remained on a firm expansion trend throughout fiscal 2000.

The Japanese economy followed a gradual recovery trend through most of the fiscal year. The recovery was led by trends in the corporate sector, including a dramatic improvement in business earnings on the back of increased capital investment driven by export growth and the expansion of IT demand. Early in 2001, however, the economic outlook began to appear less certain because of factors that included slower export growth due to the deceleration of the U.S. economy. At the final demand level, there was little evidence of a recovery in consumer spending due to the lack of any significant improvement in household finances. After a period of robust growth leading up to the end of 2000, exports began to decelerate. And there were also indications that capital investment was about to lose momentum. Overall, there were clear signs of a slowdown in the performance of the corporate sector, which had previously led the growth trend.

These demand trends affected industrial production, which had previously followed a sustained upward trend. By autumn the pace of growth was slowing and stocks of production goods were rising, indicating that the growth trend had peaked. The employment situation remained difficult as well. Continuing corporate restructuring and other factors were reflected in the full unemployment rate, which reached a record high in December.

On the financial front, the Bank of Japan responded to signs of economic recovery by removing its zero interest rate policy, which had remained in place for approximately 18 months. The Bank of Japan took this step in August 2000, but the economic recovery subsequently showed signs of levelling off, and in February 2001 the central bank was forced to cut the official discount rate twice. In March it

restored the zero interest policy. Short-term interest rates rose after the removal of the zero interest policy, but by March they had returned to the level that prevailed under the policy. Long-term rates shifted to a downward trend in autumn due to concern about the economic outlook. By March the secondary market yield on new 10-year government bonds had fallen to around 1%, reflecting the shift in the Bank of Japan's policy stance. The sustained stability of the yen gave way in late 2000 to a steepening downward curve in the value of the Japanese unit against the U.S. dollar. The closing rate in the Tokyo market at the end of the fiscal year was ¥125.27. Share prices continued to lose ground because of uncertainty about the economic outlook in Japan and the downward shift in U.S. stock prices. At one point the Nikkei descended to its lowest ebb of the post-bubble period. It ended the fiscal year at ¥12,999.

The performance of the SME sector during the first half of fiscal 2000 generally followed a sustained recovery trend. In particular, there was a marked improvement in net sales, led by manufacturers. However, there were subsequently indications that business performance was beginning to falter, including production cutbacks necessitated by slower export growth and other factors. Statistics in the Shoko Chukin Bank's "Monthly Survey of the Condition of SMEs" show that the business outlook judgment index peaked at 49.8 in September and then fell in each of the next six months. There was no alleviation of the downward trending selling prices, which put a severe squeeze on the profit margins of SMEs.

The Japanese economy is going through major structural changes, including adaptation to information technology and the increased fluidity of employment. In the business sector, this process of change has been accompanied by continuing balance sheet adjustments, creating a very difficult business environment for SMEs. That is why the government stepped up its efforts to help SMEs build a solid base for growth by facilitating their access to funds and providing increased support for their adaptation to the IT revolution.

Summary of Results

• **Loans** Loans outstanding declined by ¥282.7 billion during fiscal 2000 from the previous fiscal year's level, due to a downturn in the demand for funds in the SME sector. The total balance of loans outstanding was ¥10,886.5 billion at the end of the fiscal year. The balance of loans through agencies, including credit cooperatives, at the end of fiscal 2000 was ¥87.3 billion. There were 240 agencies as of March 31, 2001.

• **Debentures** Interest-bearing debentures declined by ¥391.5 billion, but there was a ¥33.6 billion increase in discount debentures, making a total decline for the year of ¥357.9 billion. The balance at the end of fiscal 2000 was ¥10,170.6 billion, including ¥311.1 billion in debentures underwritten by the government.

• **Deposits and Negotiable Certificates of Deposit** The balance of deposits at the end of fiscal 2000 was ¥2,389.1 billion, an increase of ¥151.3 billion over the previous year's level. Negotiable certificates of deposit increased by ¥28.9 billion, and the balance at the end of fiscal 2000 was ¥40.5 billion.

• **Securities** Over-the-counter sales of government bonds and other securities amounted to ¥2.4 billion. Dealing in government bonds and other securities totaled ¥60.2 billion. The balance of trading securities at the end of fiscal 2000 was ¥12.6 billion.

• **Domestic and Foreign Exchange** Domestic

exchange transactions in fiscal 2000 totaled ¥23,974.8 billion. Foreign exchange transactions amounted to US\$12,603 million.

• **Income and Expenditure** Total operating income totaled ¥305.6 billion, while operating expenses amounted to ¥324.8 billion, leaving an operating loss of ¥19.2 billion. The loss reflects the fact that operating expenses include ¥91.2 billion in bad loans written off. Reasons for the bad loans include the worsening business performance of some customers due to prolonged economic stagnation, and the additional write-offs relating to loans already covered by reserves, due to falling land prices. Another factor was the emergence of new non-performing loans resulting from bankruptcies, due in part to the effects of the Civil Rehabilitation Law. The Shoko Chukin Bank disposed of these non-performing loans appropriately.

Other gains amounted to ¥3.6 billion, while other losses totaled ¥0.4 billion. Corporate taxes, residents' taxes and enterprise taxes amounted to ¥0.3 billion, and there was a ¥3.5 billion adjustment relating to corporate taxes and other taxes. This left a net loss for the year of ¥12.8 billion.

Under the Special Ordinance Concerning Special Exceptions under the Criteria for the Levying of Enterprise Taxes on Banks, etc., in Osaka Prefecture (promulgated and enacted on June 9, 2000), deferred tax assets amounted to ¥1.0 billion. The net loss was increased by this amount.

