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A value co-creation model of community-based finance for revitalizing regional economies

—Case study on initiatives of regional financial institutions—

Abstract

In 2003, the second section of the Financial Subcommittee indicated the necessity for regional financial institutions to strengthen relationship banking functions aimed at facilitating finance to regional companies and revitalizing regional economies, with the aim of resolving the problem of non-performing loans at regional financial institutions. Further, the Financial Services Agency (following, FSA) indicated the "Strengthening of Relationship Banking Functions" program from FY2003 to FY2004 and the "Action Program on Strengthening Community-Based Finance Functions" from FY2005 to FY2006. Various efforts were made by regional financial institutions to strengthen the functions of relationship banking (community-based finance). Since 2007, relationship banking (community-based finance) initiatives have been positioned as a permanent framework, and regional financial institutions have been required to continue their activities to revitalize regional economies. After that, following an emergency financial response at Lehman shock, these efforts coincided with a trend toward economic recovery. In 2015, the FSA laid out the financial administration policy for fiscal year 2015, in which they stated that regional financial institutions should revise their loan policies not to rely on collateral and guarantee and aim to increase the discriminatory power of business partners and contribute to regional revitalization (FSA 2015). In addition, the financial administration policy for fiscal year 2016 states that regional financial institutions should work on improving the quality of financial intermediation functions by "creating shared value" with customers (providing high-quality customer-oriented financial services and helping companies improve productivity, etc., so that regional financial institutions themselves secure a stable customer base and profits) (FSA 2016b). Amid such efforts, the FSA report (FSA 2018b) shows that the majority of regional and secondary regional banks are in the red, and the number of banks with two or more consecutive periods in the red have been increasing every year. If no efforts are made to build a sustainable business model in regional financial institutions, they will be unable to secure regular profits and stability in the future, and as a result, they will be unable to provide sufficient financial intermediation functions in their regions. As pointed out in the report, this could

have a huge adverse effect on regional economies and users.

The idea of “creating shared value” with customers presented in the fiscal year 2016 financial administration policy is a closed version of “creating shared value” between regional financial institutions and regional company customers. It is strictly different from Porter and Kramer’s (2011) “creating shared value”, which creates social value, and subsequently economic value, by addressing the needs and problems of society. A closed response, in which regional financial institutions produce revenues by providing financial services that address the direct needs and problems of the regional companies that are its customers, is not enough to create social value for the local community to which the regional financial institutions and regional companies belong. To contribute to the revitalization of regional economies, in addition to “exercising consulting functions for customer companies” (which the FSA has stated in the comprehensive supervisory guidelines for small and medium-sized financial institutions (FSA 2018a)), it is also important to work on “active participation in regional regeneration”. In other words, regional financial institutions can create economic value by contributing to business among regional companies and create social value by revitalizing regional economies, thereby realizing the original goal of “creating shared value”. The purpose of this research is to clarify the value co-creation model of regional finance based on a case study of regional financial institutions' activities in revitalizing regional economies. First, this research clarifies the characteristics of regional finance that are not limited to the closed idea of “creating shared value” that the government has sought, but the original concept of simultaneously creating social value by revitalizing regional economies while generating economic value through contribution to the profits of the regional financial institutions themselves. Second, it highlights the practical elements of regional financial institutions, which play an important role in continuously driving the cycle of value co-creation, such as regional financial institutions' support for the management of regional companies and the revitalization of regional economies. Finally, it proposes a value co-creation model of community-based finance for revitalizing regional economies.

The results of this study make clear that, unlike the academic, relationship banking in which information about customers accumulates through long-term transactions and is then used to provide financial services studied by Boot (2000) and Berger and Udell (2002) in the United States, in Japan, the regional financing aimed at revitalizing regional economies in the research by Muramoto (2005), Uchida (2008) and Tago et al. (2011) and required by the administration through the FSA's supervisory guidelines and financial administration policies, has been based on “exercising consulting functions for customer companies” and “active participation in regional regeneration” while complementing relationship banking with transaction banking.

Next, this paper organizes the value co-creation flow between the regional financial institutions and the local community through the use of secondary information and primary information obtained through interviews regarding the community-based finance efforts of the Kagoshima Bank and the Hokkoku Bank, and shows that the regional finance for revitalizing regional economies in practice is different from that which the government sought. There are two differences between what was sought and what exists in practice. The first difference is that, while the government method for producing information on customer companies is through the relationship banking method complemented by the transaction banking method, in regional finance practice, the method for producing information on customer companies is through the relationship banking method and is provided through ICT systems supporting customer business activities. As for the second difference, the government approach to revitalizing regional economies places more emphasis on "exercising consulting functions for customer companies" than on "active participation in regional regeneration". However, in regional finance practice, each regional financial institution has decided whether to place more focus on "exercising consulting functions to customer companies" or "active participation in regional revitalization".

In addition, this research conceptualized common points between the Kagoshima Bank and the Hokkoku Bank's approach to community-based finance and derived a value co-creation model for regional financial institutions. In regional finance aimed at revitalizing regional economies in practice, sales representatives visit customer companies and collect and accumulate information while building relationships through dialogue, as has long been done by many regional financial institutions. In addition, business status information is collected and accumulated in a timely manner through ICT systems that support customer business activities. Not only do regional financial institutions help regional companies improve their business by utilizing the information collected and accumulated through these ICT systems, but through "exercising consulting functions for customer companies" and "active participation in regional regeneration", regional financial institutions provide regional companies with management support through a variety of financial services beyond financing, as well as support for value chain collaboration between regional companies in the local community, contributing to the revitalization of regional economies. In addition, through systematic monitoring within regional financial institutions, a series of value co-creation processes, from regional financial institutions' production of information on regional companies to improvement of regional companies' management and strengthening of value chain linkages, are repeatedly performed, making

possible a continuous cycle of value co-creation.

Keywords: relationship banking, community-based finance, regional economic revitalization, value co-creation, CSV, creating shared value