Spotlight on Corporate Management

By Tsugio Ide

The Ministry of International Trade and Industry's management analysis of Japanese corporations is designed to provide reference material for use in the formulation of industrial policy. It is based on a study of developments in the Japanese economy, general trends in corporate management and sectoral trends in Japanese industry. This analysis has been carried out every year since 1950.

The analysis for fiscal 1987, which ended on March 31 last year, involved a total of 1,016 enterprises (including 653 manufacturing enterprises) capitalized at ¥1 billion or more. All enterprises were listed on the Tokyo, Osaka or Nagoya stock exchanges, but the analysis did not include enterprises in the banking, insurance and securities industries. The sales of the enterprises that were included in the analysis equaled one-fourth of total sales of Japanese enterprises for the year.

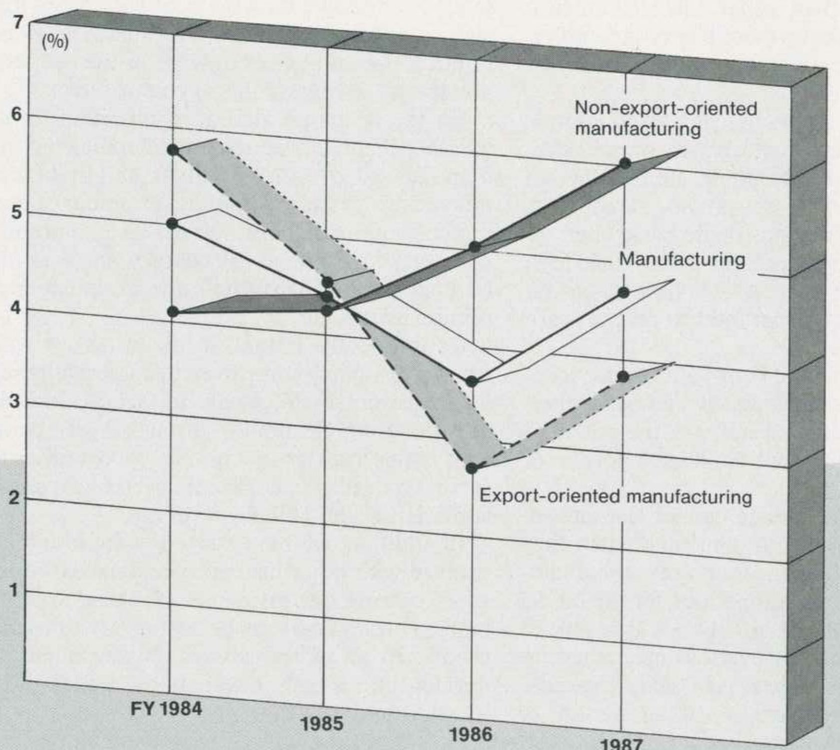
The ratio of ordinary profits to sales in the manufacturing sector increased to 4.67% in fiscal 1987 from 3.70% in fiscal 1986, when both sales and profits declined due to the appreciation of the yen. In the case of export-oriented enterprises,* the ratio of ordinary profits to sales rose to 3.71% in fiscal 1987 from 2.74% in fiscal 1986 but stayed below the peak of 5.66% reached in 1984, the year before the yen started rising in value. The profit ratio for non-export-oriented enterprises also followed an upward trend, reaching 5.92% in fiscal 1987 compared with 4.22% in fiscal 1984 (Fig. 1).

The profit surge in the manufacturing sector was due largely to the strong expansion of domestic demand induced by the yen's rapid appreciation. The export ratio to total production dropped to 18.6% in fiscal 1987 from 20.6% in fiscal 1986 (Fig. 2).

The most important factor contributing to the profit recovery in fiscal 1987 was the rapid expansion of domestic demand. The domestic economy achieved robust growth for a number of reasons, including expansionary fiscal and monetary policies and the permeation of the beneficial effects of the strong yen.

*Note: An "export-oriented enterprise" is one in which the export ratio exceeded the manufacturing sector average of 20.6% in fiscal 1986. An enterprise with an export ratio not exceeding this average is defined as "non-export-oriented."

Fig. 1 **Trend of Ratio of Ordinary Profits to Sales**



Notes: 1. Ordinary profits = Sales − cost − sales expenses − general administrative expenses + non-operating profits and losses

2. Ratio of ordinary profits to sales (%) = $\frac{\text{Ordinary profits}}{\text{Sales}} \times 100$

3. Export-oriented industries include steel, general machinery, electric machinery, transport machinery and precision machinery. Non-export-oriented industries include chemicals, ceramics and construction materials, rubber products, textiles, paper and pulp, petroleum and coal, nonferrous metals, metal products, foods and other manufacturing industries.

Fig. 2 **Export Ratio for Manufacturing Industries**

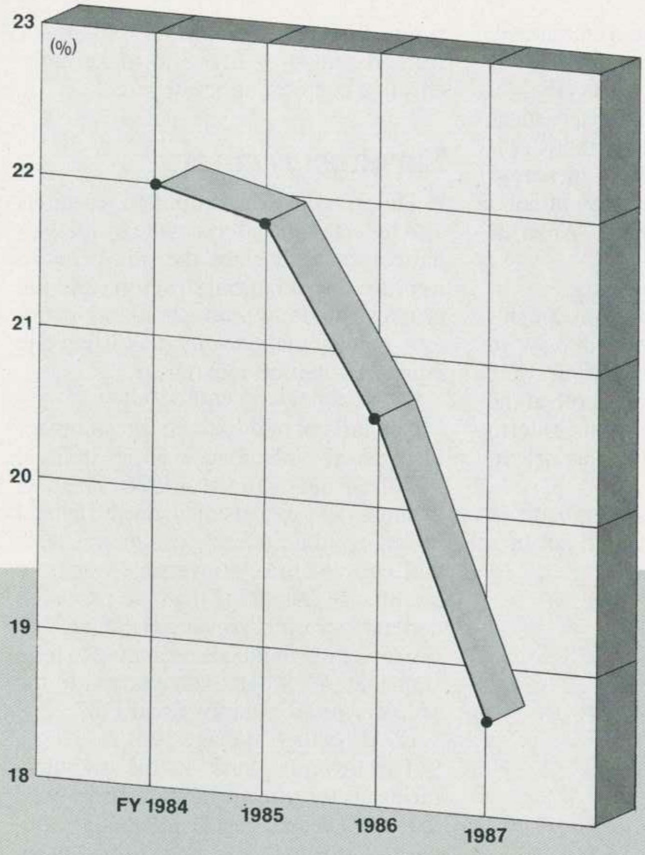
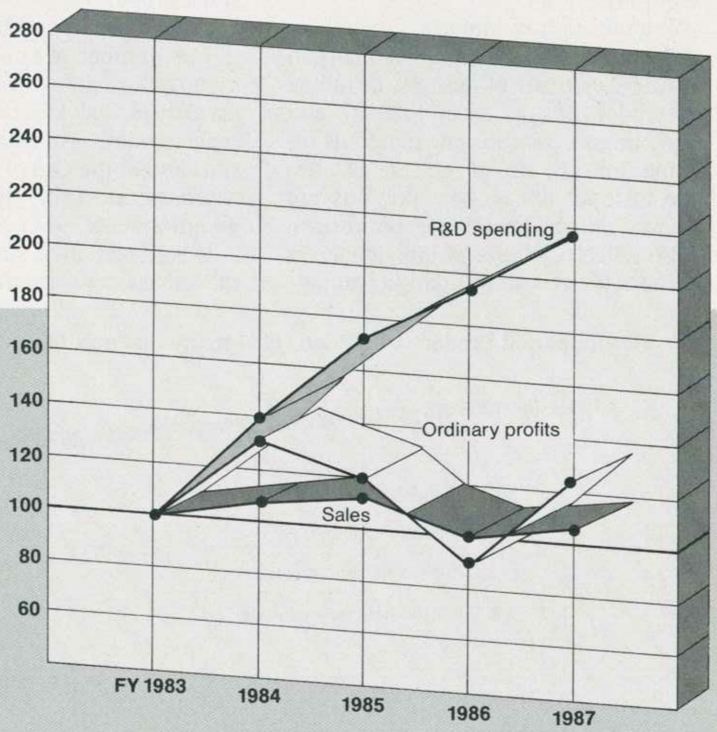


Fig. 3 **R&D Spending for Manufacturing Industry (1983 figure taken as 100)**



The analysis attempted to estimate the impact of governmental expansionary measures on domestic sales. These measures consisted of the "comprehensive economic measures" announced in the autumn of 1986, the "emergency economic measures" announced in the summer of 1987 and credit relaxation following cuts in the official discount rate since 1986. These official measures to expand domestic demand increased production value in the manufacturing sector by an estimated 3.3%. It can be said, therefore, that the growth in sales was induced substantially by government efforts to stimulate domestic demand. Had it not been for these measures, the recovery in sales and profits would have been more limited and the pace of economic expansion considerably slower than it was.

Positive responses

With the export environment deteriorating rapidly as the yen rose against foreign currencies, corporations increasingly turned their attention to the domestic market, research and development, production of high value-added merchandise and such structural adjustments as cost-cutting rationalization.

(1) Rationalization and other corporate efforts

In the manufacturing sector, the ratio of cost to sales dropped to 79.6% in fiscal 1987 from 81.2% in fiscal 1986, thanks to cost reductions and other rationalization efforts. On the other hand, the ratio of sales and general administrative expenses to sales continued to rise, from 13.5% in fiscal 1984 to 15.9% in fiscal 1987, as corporations stepped up their efforts to expand domestic sales and strengthen R&D. The cost of R&D, which is included in sales and general administrative expenses, increased steadily despite a leveling off of sales. R&D expenses in fiscal 1987 were 2.1 times the level of fiscal 1983 (Fig. 3).

Efforts to produce higher value-added products also made headway. The steel industry expanded the share of coated steel sheet in total steel production to

19.4% in fiscal 1987 from 15.4% in fiscal 1984. In the auto industry, the share of large models in total passenger car production rose to 4.1% in fiscal 1987 from 2.5% in fiscal 1986, while in the home electrical appliance industry some 52% of the VCRs produced in fiscal 1987 had a built-in hi-fi system, compared with only 18% in fiscal 1984.

(2) Utilization of imports

Input prices declined substantially in 1987 for a number of reasons, including lower oil prices in fiscal 1986–87 and falling import costs for raw materials resulting from the rise of the yen. The decline in input prices, however, was not achieved only by lowering import prices. It also reflected efforts by individual corporations to cut costs by taking advantage of the benefits of the strong yen, namely in purchasing imported parts in place of more expensive domestic parts (Fig. 4). Purchases of foreign-made parts, particularly those made in the newly industrializing economies (NIEs), have increased markedly in recent years, as have imports of intermediate goods from America and Europe.

(3) Employment adjustments

The number of employees in Japan's manufacturing sector dropped 0.3% in fiscal 1986 and 1.5% in fiscal 1987. The average number of employees both at the start and at the end of the business term was down most sharply in export-oriented enterprises.

It is notable that such adjustments in the work force were motivated, not by a compelling need to lay off redundant workers, but by a desire to make more effective use of manpower.

Earnings recovery

The recovery in corporate earnings also reflected the efforts made by individual corporations since the mid-1970s to improve their financial structure, and the progress made in production and inventory management techniques using the latest information technology.

(1) Stockholders' equity ratio

The ratio of net worth in the manufacturing sector increased to 34.5% in fiscal 1987 from 18.4% in fiscal 1976. This was because of an expansion in owned capital through public offerings of new shares and conversion of convertible bonds to equities. In fiscal 1987 the ratio exceeded dependency on borrowings (Fig. 5). The rise in net worth ratio is estimated to have contributed 0.8 percentage points to the ordinary profit ratio for fiscal 1987.

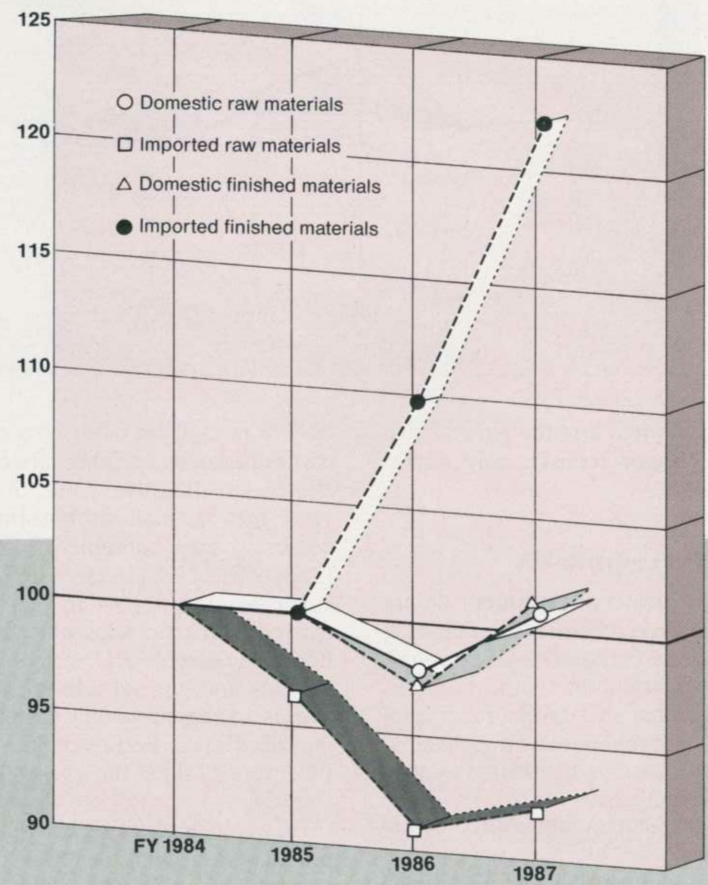
(2) Inventory management

The inventory ratio in the manufacturing sector rose to 2.6 months in fiscal 1975 as a result of the deflationary impact of the first oil crisis. It has fallen steadily since then, however, owing to the development of efficient inventory management techniques which increase efficiency in the production process. As a result, in fiscal 1987, the inventory ratio stood at a low 1.55 months. Progress in inventory management made it possible, for instance, to improve capital turnover and reduce financial costs. These two effects alone are estimated to have pushed up the ratio of profit to liabilities and net worth by 0.75 percentage points in fiscal 1987.

The various factors cited above as contributing to the profit surge in fiscal 1987 are analyzed in value terms in Table 1.

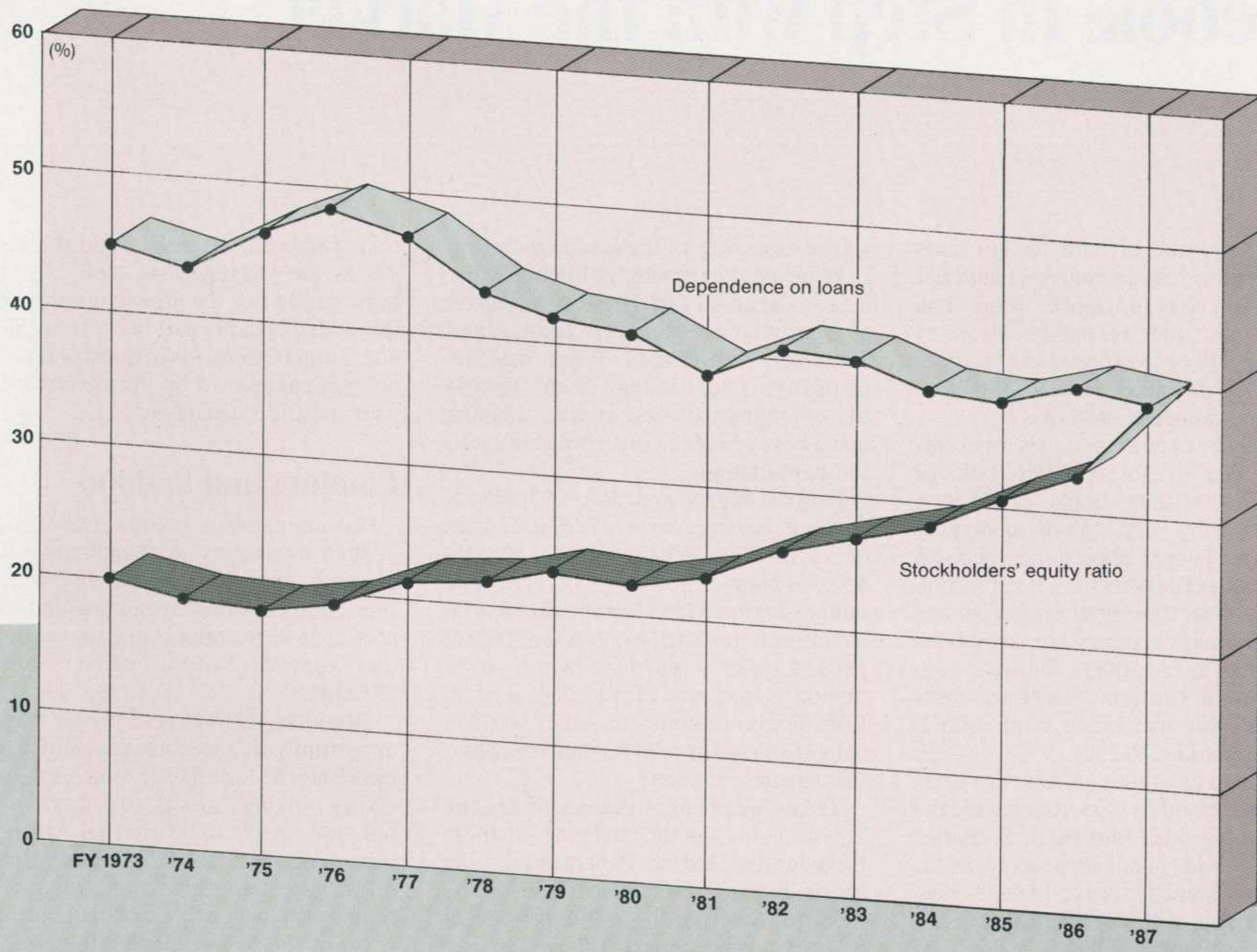
Over the longer term, Japan's corporate management needs to be put on a sounder footing. The favorable profit position achieved in fiscal 1987 should provide a basis for such extended efforts toward better management. To achieve that objective, individual enterprises need to be encouraged to promote structural reforms through the production of

Fig. 4 **How Imported Products Are Used (1984 figure taken as 100)**



Notes: 1. Based on finished materials consumption index of MITI's Monthly Industrial Statistics
2. Raw materials exclude electric power.

Fig. 5 **Stockholders' Equity Ratio and Dependence on Loans for Manufacturing Industries**



Notes: 1. Dependence on loans = $\frac{\text{Average at the beginning and end of business year (short-term loans + long-term loans + bills discounted + corporate bonds)}}{\text{Average at the beginning and end of business year (total liabilities and net worth + bills discounted)}} \times 100$

2. Stockholders' equity ratio = $\frac{\text{Capital}}{\text{Total liabilities and net worth}} \times 100$

high value-added goods and cost reductions, and to make continuing efforts in technological development and manpower training. Enterprises should also work to develop domestic demand in reponse to diversifying consumer needs and to create more "leisure" through shorter working hours. All this is desirable from the broad perspective of achieving sustainable expansion in domestic demand and a better quality of life.

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Table 1 **Factors that Affected Profits of Manufacturing Industries in Fiscal 1987** (¥ billion)

	Export-oriented industries (total of 295 companies)	Non-export-oriented industries (total of 358 companies)
Increase in pretax profits	600	500
(Main plus factors)		
Increase in volume of domestic demand	3,400	2,400
Decline in raw material prices	1,100	500
Rise in export prices	700	200
Decline in interest on debts	200	200
Decrease in number of employees	200	–
(Main minus factors)		
Exchange losses in exports	−1,600	−300
Drops in home market	−1,100	−400
Increase in volume of raw materials	−800	−500
Decline in gains from sale of securities	−200	–