Reforming Management

By Takeuchi Hiroshi

Within a very short time, labor surplus has shifted from a state of extreme under supply to extreme oversupply. Four years ago, the active opening rate was 1.43, it fell below 1.0 the year before last, and has trended downward since, recently falling to 0.65. Moreover, the official number of unemployed has now climbed to 1.8 million. As it appears that the number of unemployed will only increase, there will be more employment problems in the future.

During the "bubble" economy, corporations concentrated on plant and equipment investment on an unprecedented scale, and also took on a huge number of young workers. Competition in hiring brought rising starting salaries and base wages, and fixed working hours decreased. Depreciation and personnel costs ballooned as a result, rising to two to three percent and 10% to 13% respectively as a percent of sales compared to the pre-bubble period. With the collapse of the bubble economy these fixed costs weighed heavily on corporate operations and many companies faced losing situations.

Businesses then decreased investment in facilities and began rigorous restructuring efforts by curtailing personnel expenses and reducing overhead. Plant and equipment investments have dropped as much as 35% in four years. Advertising, entertainment, meeting, transportation, and other overhead costs have been slashed. By reducing overtime allowances, laying off part-time workers, cutting bonuses, postponing basic wage increases, slashing new hires, and other methods, companies are continuing their efforts to cut personnel costs. The prime cost factor in deteriorating corporate operations is personnel expenditures.

Facility investments and consumption make up 80% of Japan's GNP. The economy appears ready to sink into an infernal cycle of negative GNP growth rate, continued declines in plant investments, and even further constrictions in personnel costs as full-scale restructuring proceeds.

The collapse of the bubble economy brought on great changes in corporate management strategies. During the bubble period the swelling number of nouveau rich, whose wealth was based upon land ownership, and the "windfall wealthy" took the lead in high-level, diversified consumption. The activities of property investors induced many people to sell their land, putting their hands on huge amounts of funds. The 40% increase in individual consumption around the end of the 1980s was due to outlays by the nouveau rich. Further, homeowners in major cities saw asset values inflate and the price of stocks climb. These windfall wealthy copied the nouveau rich, elevating consumption levels. The shift to higher quality and diversification in the structure of consumption led to the growth of the Japanese economy, and people believed that this trend would continue indefinitely.

In order to keep up with this trend, consumer goods manufacturers instituted management strategies that involved multiplying the number of products and frequent repetitions of model changes. Some of these did not sell and not a few products were sold below cost. Even so, it was thought that providing a full and diverse product line-up was an important means of boosting a company's image and a strategy that was suited to a society with a high standard of living.

Certainly, consumption increased rapidly during this period and consumer preferences shifted violently. Corporations echoed the slight shifts in demand observed at sales outlets with instant product development, devising functional internal systems to ensure the success of new products.

As a result, systems that could operate in unison, linking sales, product planning, development, and manufacturing, were needed. Efforts were made to create such systems for each product, requiring a tremendous amount of labor and becoming a factor in increased costs. Even so, sales grew steadily as a profusion of new products followed one after another into the market place, enabling increased costs to be absorbed by expanding profits.

But the nouveau rich and windfall wealthy disappeared with the collapse of the bubble economy, and the upgrade and diversification of the structure of consumption not only halted but slid backwards to low levels, the same as before the onset of the bubble economy. In addition, the recession deepened, income growth stopped, and the jobless rate increased. Then, consumption stagnated and luxury goods and novel new products abruptly stopped selling.

No matter how much they increased the number of products or how often they repeated the frequency of model changes, companies were unable to check falling profits. At the same time the systems formulated during the bubble economy lost their raison d'être. At that point the tremendous amount of labor that companies had invested in suddenly became superfluous.

Layoffs vs. restricting costs

The trend toward luxury products and diversification was not limited to consumer goods manufacturing—it had progressed in the distribution and service industries as well. High quality restaurants, plush hotels, and luxury goods boutiques steadily grew in number. The gourmet boom continued and restaurants offering a taste of unusual cuisines increased. Resorts were developed everywhere and wonderful vacation hotels were created.

The financial and real estate sectors were the ones that achieved eye-popping growth during the bubble period. The most fashionable professions at the time were financial or stockbroker, foreign exchange dealer, and real estate appraiser and young people flocked to these positions. During the bubble period employment in the manufacturing, financial, and distribution and service sectors increased by about 5 million. The vast majority of these were what might be referred to as surplus hires and their number closely resembles the figure for excess employment. For the majority of companies to be able to revert to conditions under which normal earnings can be obtained, wages for the equivalent of 4 million people must now be cut.

The best method for reducing the burden of personnel costs is to create an environment in which sales increases. In addition the economy must be stimulated through the expansion of public works and income tax reductions.

Unfortunately, however, these types of economic stimuli will now have an extremely minimal effect.

The effectiveness in inducing demand in the public works sector has drastically declined because property purchases now make up 30% of costs, the types of public works that would increase the efficiency of the Japanese economy and attract huge investments have decreased considerably, the political influence of vested interests is strong and there is no ability to allocate priorities to public works expenditures, and as the shift to a service economy continues it would be difficult to disseminate the benefits of public works projects across the entire spectrum of the national economy. Also, income tax cuts do not necessarily lead to an corresponding expansion in consumption in a society with a high standard of living.

Rigorous restructuring is the only option for companies in this case. Restricting personnel costs is the focus here and drastic personnel retrenchment is the most orthodox method of accomplishing this. If many companies follow this pattern, the number of jobless will increase and wage levels will decline so the burden of personnel costs, correlating to cuts in the number of persons employed, will instantly be lightened.

If the number of unemployed climbs, the government will most likely boost social security outlays in response to fears of social unrest. It will probably not be able to avoid issuing deficit bonds to achieve this.

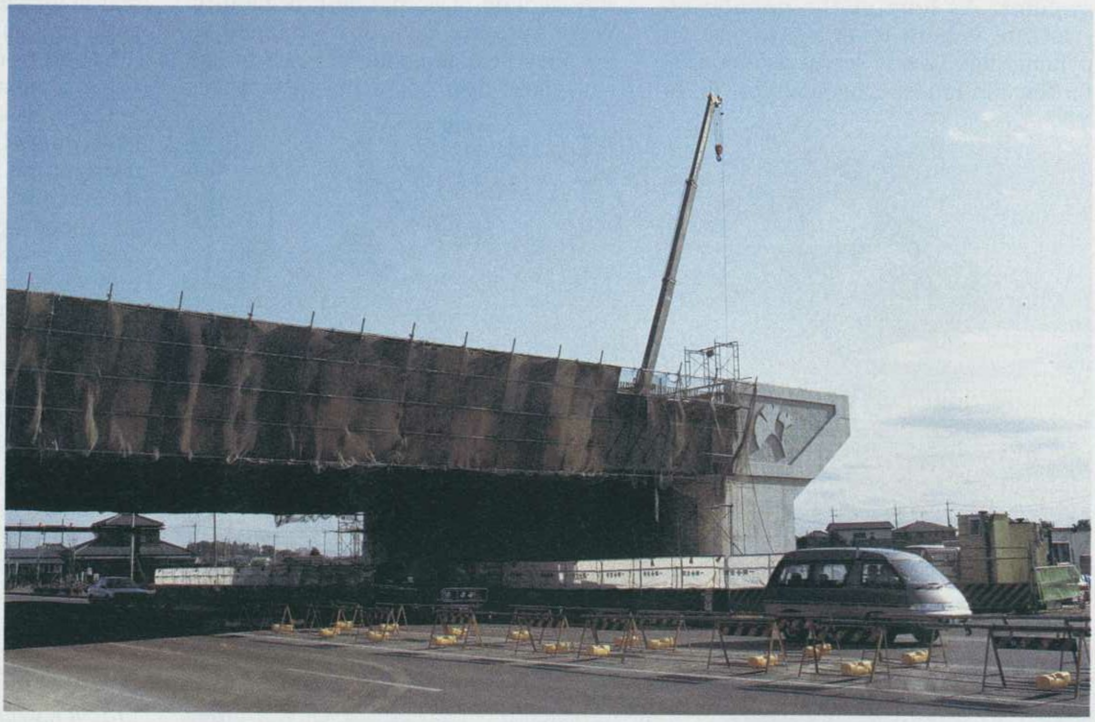
If companies recover their earning power through restructuring, there is no doubt that they will revert to positive management, expanding investment in plants and equipment, and increasing hires. In conjunction with this, the economy will rebound, companies' earnings will increase, corporate profitability will climb, and the amount of deficit bonds should rapidly decline.

The U.S. economy has recently been able to escape the quagmire through these types of methods. Facility investments have increased by about 7% on an annual basis and GNP has continued at 3% growth.

American employment fell by about 2 million during the one and one-half year period from mid-1990. About 10 years before, employment had fallen by 3 million in one year. These were appalling personnel cuts.

If Japanese corporations adopted the methods used by American companies, about 4 million excess workers would be cut, adding them to the 1.8 million wholly unemployed. There would be about 6 million jobless in this case, turning Japan into a nation with a 10% unemployment rate.

However, rough behavior of this sort is unacceptable in Japan. Companies and their employees bind their fortunes together and employees work for the same company their entire lives, giving their all for the company. This is thought to be completely correct from a moral standpoint. If a company immediately decided to make personnel cuts due to the great losses it had incurred, its employees would probably intensely question management's responsibility and public opinion would probably oppose the company's position. There is also no doubt that suspicions regarding



The once abundant public works projects of the "bubble" economy era have recently been drastically decreased.

the company would linger forever among the employees that were not let go.

As such, Japanese companies have tried overtime allowance and bonus cutbacks, reductions in new hires, and other methods which incur less resistance. When these have not sufficed, they have shifted to tapping older workers for early retirement and if a return to profitability is still not in the forecast they have sought voluntary retirements, followed by designated layoffs. More and more companies have reached this stage.

Maximal changes required

Recently, in order to alleviate wage pressures structurally, more companies have tried to shift away from a seniority-based wage system. The circumstances of a markedly declining birth rate and the rapid shift from a pyramid to bell and further to an inverted pyramid population structure have been behind this. Japan's employment practices have been based upon lifetime employment and seniority-based wage systems. As long as the population structure is built upon a broad-based pyramid this system serves as a powerful force to propel economic growth. In a society that has a pyramid-shaped population make-up, the young work force grows, individual consumption naturally continues to swell, and internal demand expands dynamically.

Because a huge number of young workers entered the labor market each year, mitigating labor supply and demand, wage increases were held back. They were protected by Japanese-style employment practices, wages rose in accordance with seniority, and they could be confident that they would be employed until they retired.

Because Japan's seniority-based wages are characterized by a quick rise after the age of 40, average wages at a company that had many young workers, corresponding to the composition of the population, would be very low. This was the secret to Japan's economic strength until the 1970s.

However, as the birth rate declined and the younger population began to shrink, consumption stopped growing. Also, average wages became very high as the make-up of employees at corporations shifted to bell-shaped or reverse pyramid structures. This led to a one-way decline in corporate profitability. Wage systems have now changed so that they peak at about 55 years of age with those over 55 seeing their wages decline drastically. This is by no means unreasonable. They own homes, their children have left the nest, and their lives should be fairly easy. It is possible that the declining curve will become even more pronounced as time goes on.

Japanese-style personnel cost reduction methods all take time before results become evident. During that time, companies must carry their excess personnel. There are many companies that launch into personnel cuts after losses have continued for about two years, but even those try to keep it to a minimum. Circumstances such as these lead to delays in a return to corporate profitability.

However, we should remember that putting a large number of people out of work so that the economic indices recover does not exactly make Japan a better nation.

For the short-term, as well as the mid- to long-term, the Japanese economy is mired in a critical situation. Corporate restructuring through large scale personnel cuts is not possible. A major relaxation of controls is also difficult. It appears that companies will shift overseas at a faster pace, leading to a steady hollowing out of the Japanese economy.

In addition there is the issue of an aging population.

The only way to overcome this crisis is to immediately change the mechanisms of the Japanese economy and halt the trends toward maturation and advanced age. In addition there is a need to restructure the old mechanisms through restrictions on private property ownership, major reform of the current tax system which places the highest property value on land, abolishment of fishing rights, water rights, leaseholds, and other vested interests, reform of multi-tiered government agencies, establishment of decentralized authority, transfer of the capitol, and a system of long-term, paid maternity leave. However, these issues are so difficult that this seems improbable. JJTI

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