Introduction of Global Economic Standards and the Management of Japanese Companies

By Suzuki Tadao

After its defeat in World War II, Japan adopted the policy of promoting democracy and a free market economy under United States leadership. This decision meant that Japan, which had been pursuing the "Fukoku Kyohei" policy to increase its wealth (*fukoku*) and military strength (*kyohei*) to catch up with the rich industrialized nations since the Meiji Restoration, abandoned building arms (kyohei) and concentrated on the economic front (fukoku). The country's patriotic and talented corps of bureaucrats did their best to be "democratic" in reconstructing a devastated land, rebuilding industry, and improving the lives of the people. However, as regards the "free economy" part, they chose not to be blind advocates of the market mechanism, and instead carefully controlled the resources needed to rebuild the nation's industry. At the time, it was necessary to portion out the limited resources available, since Japan was still a developing country where demand far exceeded supply.

Agricultural land reforms broke up the land holdings of big landlords for division among their tenant farmers. Introduction of a property tax deprived the affluent of much of their wealth. The property and inheritance taxes were highly progressive. Together, these post-war measures helped minimize the gap between the "haves" and the "have-nots." As a result, Japan saw the birth of a society more equal than any of the socialist states. Furthermore, it enjoyed almost-miraculous economic development during the 50 years following the war, spurred by the traditional nationwide compulsory education achieving a literacy rate of almost 100%, coupled with the innate abilities and diligence of the people. The U.S.-Japan Security Treaty allowed Japan to cut military spending to a level quite low for the scale of its economy, also contributing to economic growth. If the Japanese economy, despite its huge supply-and-demand imbalance, had been completely liberalized immediately after the war, it would have suffered spiralling inflation and extreme polarization of wealth, resulting in a highly unstable and crime-ridden society. Many of the former East Bloc states including Russia are now plagued by economic and social turmoil because they made the transition to a market economy before making adequate preparations. With this in mind, Japan's bureaucrats, the majority of whom are diligent and competent, should be praised for the role they played in the nation's economic development.

Regulations drawn up by the bureaucrats and a taxation system aimed at smoothing differences in wealth were effective when the Japanese economy was relatively small and growing rapidly. The minimum taxable level was set quite high. Roads were paved and water pipes laid even in the most remote areas amid calls to balance development nationwide. Regular mail delivery reached even very isolated houses in the mountains, along with a variety of other facilities and services to enable people to live their lives in comfort. Public halls were built in many mountain villages. At the same time, agriculture, forestry and other industries unfit for international competition were protected. Banks, insurance companies and brokerage firms avoided tough competition through sheltering under the "guidance" of the Ministry of Finance.

The government, the bureaucracy and the private sector were all happy when the Japanese economy was small enough to isolate itself from foreign competition. The vested interests of private businesses were protected, as


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bureaucratic guidance and regulations enabled them to avoid real competition. They even had the time and energy to amass votes for politicians. However, times have changed. Japan's GDP has increased to the world's second largest, while its per-capita income is virtually at the top, excluding certain exceptionally small countries. Thus, it is now impossible for Japan to turn its back on global rules on economic management.

In addition, taxes and subsidies aimed at achieving income equality have raised the Japanese standard of living to top world levels, but at the same time have overburdened national finances to their limit.

Further, protection of vulnerable industries has raised prices in Japan to the world's highest, depriving the people of the opportunity to enjoy the affluence they deserve. Similarly important, high prices have prompted automakers and other companies that must compete in the global market to transfer plants overseas. While some

U.S. manufacturers have also shifted production abroad, foreign investors have injected large amounts of capital into the U.S., offsetting the loss. In the case of Japan, direct foreign investment amounts to only one fourteenth of Japanese capital invested abroad. Tight control, coupled with high prices, is apparently making Japan unattractive to foreign investors. A total of 42.3% of Japanese industries are covered by regulations of some form, compared to a mere 6.6% in the U.S.

Therefore, Japan must remove restrictions, minimize bureaucratic involvement, and introduce a market mechanism in order to reinvigorate its economy. I believe the six reforms proposed by the Cabinet of Prime Minister Hashimoto Ryutaro are basically sound and hope that they will be implemented steadily and completely. The government and the private sector are mostly in agreement regarding the changes that need to be carried out.

The problem is the expected resistance from those with vested interests. The bureaucrats will not wish to give up their authority. Many private industries are used to enjoying limited competition, aided by bureaucratic guidance and regulations that have blocked the entry of new rivals. They have long enjoyed a state wherein they have the sense of being on the same level as other people, often likened to an escorted group of ships in a convoy. Thus, they very much wish to avoid cut-throat competition under market principles that would divide them into winners and losers, based on their own responsibility.

The Japanese version of the financial "Big Bang" will most likely be carried out. The degree to which other industries are deregulated will determine whether the Japanese economy will be revitalized and whether it will become attractive enough for foreign companies to invest in Japan.

In a truly open economy, "equality of opportunity" is guaranteed, but not "equality of outcome." Thus, there will be winners and losers. Of course, the losers will have a chance to fight a return match. If Japan can abandon its policy of protecting even the most inefficient companies to ensure equality of outcome, and instead allow the market mechanism to create a more efficient economy, its prices would go down and the economy would most certainly be revitalized. If a loser is defeated again in a return match, it would be more reasonable to help it by means of social policy rather than protect it as part of economic policy.

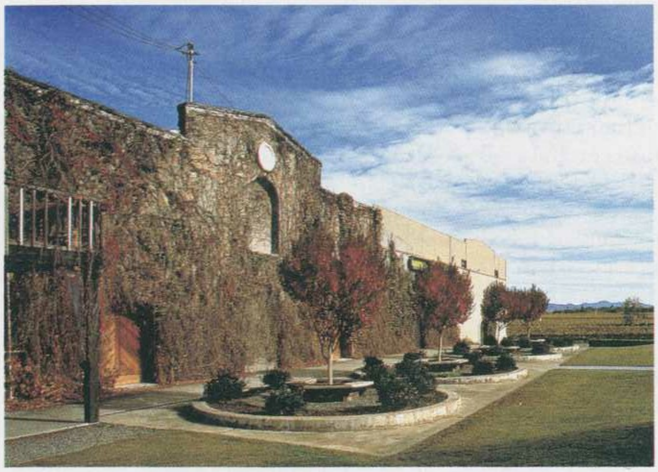
A single global standard for the market mechanism has not yet been established. Standards vary even among industrialized countries. There is a wide gap between the system of continental Europe and that of the U.S. and Britain. I personally believe the market mechanism of the "Anglo-Saxon" cultures is more predominant at the moment. The current prosperity of the U.S. and British economies owes much to the decision of former U.S. President Ronald Reagan and former British Prime Minister Margaret Thatcher to liberalize their economies and introduce the principle of self-responsibility. President Collomb of France-based Lafarge, the world's leading cement maker, once sought the advice of his international advisory board members, including myself, over his idea to change the official language used at their Paris headquarters to English. I knew that he had much pride in French and often used it in answering questions posed in English. It was enough to remind me that the present global economy is led by the English-speaking countries.

Mercian's Katsunuma winery in Yamanashi Prefecture

Similarly, Japanese CEOs must at once end practicing management which is dependent on bureaucratic regulations, protection and guidance. They should spur the economy by adopting a management style with an eye to the introduction of a free, fair and global market mechanism where everyone assumes their responsibilities.

The London financial market is humming like the New York market, as a result of the "Big Bang" financial reforms that Japan is to implement. However, many of the traditional British merchant banks have been bought and merged with U.S. and German rivals. This phenomenon is compared to Wimbledon, which attracts considerable attention and international tennis talent as one of the world's four major tennis titles, but now never has a native-born champion. Something similar may happen in Japan after its "Big Bang." Therefore, the ability to develop new products that attract investors is crucial if a bank or securities firm wants to be a winner on a global scale. However, Japanese financial institutions have long been blocked by Ministry of Finance regulations from developing new products and services, since until now, there has been no need to do so. Consequently, they are likely to face an uphill battle in the era of deregulation.

In March 1987, I resigned my position as vice-president at Ajinomoto Co., Inc. and became president of Sanraku (now called Mercian Corp.). The Japanese economy was at the height of the bubble boom at the time, symbolized by skyrocketing share prices. By contrast, business at Sanraku was dull and the mood gloomy amid concern over the impact of major liquor tax reforms expected in 1989.


Mercian's Markham Vineyards in Napa Valley, California

The decision on the reforms followed complaints from Thatcher and other EU leaders at the time that the Japanese tax system posed a non-tariff barrier to their products. They insisted that Japan immediately reduce a tax on Scotch whisky and cognac that was considerably higher than that levied on Japan's own liquors, such as second-class whisky and *shochu*. Like the highly progressive income tax, Japan after the war had a fixed liquor tax that benefitted the makers of cheap liquor drunk by the working masses, but made high-priced liquor more expensive.

Europe demanded that Japan, now that it had become one of the richest nations in the world, join the U.S. and Europe in pegging taxes on distilled liquor to the percentage of alcohol regardless of the original price. Japan already had its back to the wall due to attacks on its huge trade surpluses, and agreed to change the tax according to the European proposal from April 1, 1989.

Under the initial tax system, 20% of Sanraku's sales come from *Ocean* second-class whisky, which was accounting for an even larger percentage profit-wise. Tax changes meant that the price of a 640 milliliter bottle of *Ocean*, which was selling for ¥670, would double to ¥1,230. We anticipated that the product would disappear from the shelves, as well as more than 20% of our sales. Some even feared that the company would plunge into the red. Thus, it was only natural that at the time, the atmosphere at the company was one of depression.

In a bid to overcome the impending crisis, top managers held several meetings and decided on three measures that were to be carried out simultaneously. The company was to make uncompromising streamlining efforts to cut costs, develop a line-up of new products to replace *Ocean* second-class whisky, and boost the awareness of our employees. For a start, we determined that we would halve the number of workers at our factories, a plan tantamount to doubling productivity. Out of a total 1,500 employees, 700 were working at 10 factories. They were to be reduced to 350 in three years' time. The remaining 350 were not to be dismissed, but instead were to be shifted to new businesses or sales, in order to avoid further dampening the already downbeat corporate atmosphere. The target was achieved ahead of schedule, in two and a half years, without any major investment in plant and equipment. The success of this plan owes much to the introduction of a total productivity maintenance method which maximized the efforts and creativity of our workers. One of the new businesses launched by the former factory workers involves selling various types of liquors for use as flavoring materials by food processing companies. The business has turned out to be a huge success, generating annual sales of almost ¥10 billion just a few years after start-up.

As regards the new product line-up to replace *Ocean*, we promoted the sales of a Scotch whisky, *Glenfiddich*, and endeavored to increase the sales of a Bourbon whisky, *Old Crow*. As a wine maker, Mercian had until then focussed on domestic wine, but now decided to gain experience from foreign wineries. We purchased *Chateau Reysson* in Bordeaux, France, and *Markham Vineyards* in Napa Valley in the U.S., and bought a stake in *Mildara Blass* in Australia. Before our purchase, *Markham* was an obscure winery selling around 20,000 cases a year, with each bottle having a retail price of between $8 and $9. However, in the ensuing seven years, *Markham* raised the quality of its wine to such a level that it was given a rating of 95 points by the magazine *The Wine Spectator*. Sales grew 10-fold to 200,000 cases and prices doubled to between $18 and $19. I certainly believe that *Markham* represents a notable example of success in the open economic system of the U.S.

On the domestic front, we launched several new products. Worthy of mention is *Bon Marché*, which we put on the market three years ago at a remarkably low price of ¥500. The price was kept low by using imported wine in bulk, lowering bottle costs, and improving the distribution system. We take pride in having led the expansion of the Japanese wine market by an annual 30% in the last three years. Our workers are flush with success in having overcome the crisis described above, and with the increase achieved both in sales and profits.

I hope a glimpse into the success of Mercian will provide some useful hints on how to win the game of global competition that will intensify after the expected removal of restrictions in Japan. I believe the key to success lies in improving one's ability to develop new products that meet consumer needs, making rigorous streamlining efforts to cut costs, maintaining high worker morale, and finally, top managers providing clear guidelines for achieving these objectives. JJTI

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