The Changing Corporate Climate in Japan

•Corporate mergers taking place beyond the boundaries of traditional corporate groupings
•The gate is now open for foreign companies
•The outmoded political system stands in the way of Japan's economic rebirth

By Ito Shuichi

Will 1999, the last year of the millennium, go down in history as the beginning of Japan's economic rebirth? Or will it be discussed by historians as the beginning of the decline of a major economic power? There is no doubt that 1999 was a milestone year in the industrial history of postwar Japan, with entrenched conventional beliefs being replaced by new values at an unimaginable speed. Changes are accompanied by sacrifices. But we must make the pain worthwhile and sustain the momentum of the change. Then, into what economic society shall we change Japan? The Japanese people's thoughts and choices are at stake.

The collapse of two major financial institutions - Yamaichi Securities Co., one of the Big Four securities houses, and Hokkaido Takushoku Bank, one of Japan's 10 major commercial banks with a nationwide branch network - that occurred in November 1997 was the beginning of a drama that has continued until today. The following year, two major financial institutions that had long supported Japan's industrial finance - the Long-Term Credit Bank of Japan and Nippon Credit Bank - went bankrupt in quick succession, disproving the conventional wisdom of the financial world that these banks were too big to fail.

These moves were dwarfed by even bigger events that shook the financial world in 1999 - an announcement by Dai-Ichi Kangyo Bank, Fuji Bank and the Industrial Bank of Japan in August that they would establish a joint holding company in 2000 as part of their plan to create a full-scale business alliance; and a merger agreement reached between Sumitomo and Sakura Banks in October. Japanese financial institutions are saddled with massive amounts of bad loans and find themselves hard-pressed to survive alone amidst global competition. But mergers of conservative-minded major Japanese banks were unthinkable until recently. Now, they had to cross the Rubicon by merging beyond the "keiretsu" boundary.

Nissan Motor Co.'s tie-up with Renault of France was another historical event of the year. Nissan was in dire financial straits. Even so, it was quite epoch-making for such a prestigious company representing Japanese industry to come under the umbrella of a foreign entity. Perhaps no foreigner became so famous in Japan as Carlos Ghosn, Nissan's chief operating officer sent by Renault. After only six months into his job at Nissan, Ghosn launched a drastic restructuring that nobody had ever before dared in Japan: closing five factories and slashing 21,000 jobs. Ghosn, together with Philippe Troussier, manager of the Japanese World Cup soccer team who led the team to win a ticket to the 2000 Olympics in Sydney, has changed Japanese people's image of the French as being holiday-loving people. Japanese youths tended to stay away from foreign companies when job hunting until only a few years ago. But the rate of Japanese youths preferring to work in foreign companies is on the rise. Foreign companies are steadily gaining ground in Japan.

Japan's industrial reorganization is progressing in departure from conventional wisdom, as the industrial structure, corporate society and political system that had supported Japan's postwar economic growth are being forced to change. Japan is now being required to liquidate the so-called "Three Surpluses" that flared into the open following the collapse of the bubble economy: bad debts, surplus equipment and surplus workers. In addition, Japanese companies are being urged to rethink their business strategies in response to globalization and the acceleration of the economy and to create a suitable decision-making system.

Nippon Oil Co. and Mitsubishi Oil Co. merged in April to create the nation's top oil distributor under the name of Nippon Mitsubishi Oil Co., and six months later, the new company agreed to form a wide-ranging business tie-up with Cosmo Oil Co. When the alliance between Nippon Mitsubishi and Cosmo was announced, Nippon Mitsubishi President Osawa Hidejiro (a former president of Nippon Oil) commented, "The fusion of Nippon Oil and Mitsubishi Oil advanced at a faster tempo than had been expected. But oil companies are being urged to act more speedily." His remark was underscored by an announcement one month later by Japan Energy Co. and Showa Shell Sekiyu K.K. of their comprehensive alliance. The industrial landscape is changing fast in Japan.

Handshakes between rivals are not limited to the oil industry. NEC Corp. and Hitachi Ltd. have agreed to unify their general purpose semiconductor memory businesses. Mitsubishi Chemical Corp. and Sumitomo Bakelite Co. will consolidate their vinyl chloride resin processing units. Nippon Steel Corp. and Sumitomo Metal Industries, Ltd. will market their H-shaped steel on an OEM basis. There is something in common in these mega-alliances: they are aimed at raising the efficiency of their operations and spinning off non-profitable sectors.

The corporate order of the postwar Japanese business world was maintained by the interlocking financial groupings (keiretsu) and by bureaucrat-led industrial policy. Maintenance of keiretsu-based exclusive marketing zones and business deals focusing more on keiretsu relations than profitability typified the postwar business order. Such a mechanism produced profits on a stable basis during the growth period but resulted in overcapacity and eroded the competitiveness of Japanese companies in the global market after the bursting of the asset-inflated bubble. Oil refining costs were twice those in South Korea. Mitsubishi Chemical Corp.'s sales were only a third of Du Pont's. In the words of a top official of Nippon Mitsubishi Oil Corp., Japanese companies can hardly compete with their foreign counterparts if they try to crack the Japanese market in earnest. The recent relentless mega-mergers beyond the keiretsu boundary in Japan reflect the fact that Japanese corporate leaders are finally awakening to the crises they face.

Massive budget deficits and the outmoded political system could impede the industrial resurrection. With an eye to general elections to be called some time in 2000, the three-way coalition government, made up of the Liberal Democratic Party, the Komeito party and the Liberal Party, teamed up with the Finance Ministry to compile the second fiscal 1999 supplementary budget and the fiscal 2000 budget heavily dependent on bond issues, and at the same time postponed until after fiscal 2000 the introduction of a consolidated taxation system sought by the business world. With the combined long-term debts owed by the government and local entities expected to total about 650 trillion yen in March 2000, outpacing the nation's gross domestic product, Japan is being urged to maintain sustained growth through the acceleration of structural reform. But the Japanese political system seems to be too inactive to achieve the target.

A consolidated taxation system, widespread in Western countries, is aimed at balancing profits and losses of a parent company and its affiliates in an attempt to lessen corporate tax burdens. The Finance Ministry feared that the introduction of such a system could reduce tax revenues and aggravate the budget deficits. The ruling coalition, for its part, wished to boost spending on public works projects to win voters' support. Their calculations agreed. Business leaders are disappointed at the current political system that is incapable of promoting structural reform. An executive of a major electric company criticized the failure to introduce the consolidated taxation system for pouring cold water on corporate eagerness to establish holding companies and other structural reforms.

Japanese companies continue their restructuring efforts through manpower reductions. The jobless rate in June and July rose to a record 4.9%, topping that in the U.S. The rate dipped somewhat to 4.6% in September, but the curbing of hiring of new college graduates mainly by major corporations could result in massive youth unemployment. Some economists are expressing bearish views that the economy will slacken again. Yamada Hisashi, a senior analyst with Japan Research Institute projected the jobless rate in early spring at more than 5%.

Labor Minister Makino Takamori personally called on the headquarters of the Japan Federation of Employers' Associations (*Nikkeiren*) in November to ask Nikkeiren Chairman Okuda Hiroshi for Nikkeiren's cooperation in providing jobs to young people graduating from college next spring. Makino's action followed an announcement that the rate of college students graduating next spring who have already found work sagged to a record low. But Makino's request received a cool response from Okuda, who said the government should realize that Japanese companies had a surplus of white collar workers.

According to a Labor Ministry survey, 41 major companies each plan to slash more than 1,000 jobs, with 140,000 workers to be eliminated altogether. Sumitomo and Sakura will cut one in three workers upon their merger in a restructuring more severe than originally anticipated. Senior employes are surprised at the severity of the proposed restructuring, which is expected to make most senior workers redundant. Some companies even go out of the way to confine employes targeted for dismissal to small rooms in what amounts to forced retirement.

A survey of junior clerical workers with 10 years of work experience by the Japan Labor Research Organization showed that 74% of them expected to be in the same company five years later. The rate represented a decline of 8 points from the previous survey conducted six years ago, indicating that salary earners are aware of the severity of the employment situation. The corporate order based on life-time employment and seniority is collapsing fast.

Under such circumstances, there have emerged in Japan young entrepreneurs who venture to start their own businesses relying on speed and a new concept, instead of basking in the euphoria of life-time employment.

Ozeki Shigeo, a 24-year-old Tokyo businessman, is one example. He graduated from university in the spring of 1999, and after a stint at several Internet companies, established in October an Internet company of his own, named "Acusive Dotcom," in Shibuya, downtown Tokyo, which bustles with young shoppers and pleasure seekers. Clad in jeans, Ozeki makes the rounds of banks and big companies seeking their help for finance.

He was already a successful entrepreneur in his college days. In the spring of 1998, he established with friends an Internet advertising company. In the autumn of that year, he left the company, which would develop within a year into an entity worth 1 billion yen a year. He joined another Internet company to start up an Internet car marketing service in February 1999. He then sold that company to Softbank for several hundred million yen after only two months to start the business he now operates.

Speed and ideas are the keys to success in the Internet world. A new idea that made a hit today becomes outmoded in half a month. "I take pleasure in starting a new business. I'm not interested in growing a company with time," he says.

Ozeki is not the only young entrepreneur in Shibuya. Men and women in their 20s and 30s, not a few of them graduates of prestigious universities, are setting up venture businesses one after another. Shibuya attracts young people because of its convenient geographical location and low rents. In March 1999, more than 300 venture businesses started by the new generation of entrepreneurs in Shibuya issued a declaration that the area would be called "Bit Valley," patterned after Silicon Valley, the mecca of venture businesses in the United States. The word is a play on the reading of the Chinese characters of Shibuya, which literally means Bitter Valley. Their aim was to challenge the hegemony of California's Silicon Valley.

A new way of doing business, completely different from the traditional Japanese business style, is taking root in Bit Valley. The young entrepreneurs there are not interested in expanding as conventional Japanese companies do, instead placing priority on speed and a free flow of people. The venture business in Shibuya is referred to by some pundits as the "Shibuya economy," in contrast with the "Otemachi economy," which means big businesses concentrated in the Otemachi area of central Tokyo. Investment analysts with foreign securities companies say a new generation capable of responding to the speed of the information revolution has finally emerged in Japan. They predict that soon they will hardly talk about the Japanese economy without mentioning Shibuya's Bit Valley.

Meanwhile, there are signs that Japan's industrial reorganization will continue without interruption. Sumitomo Metal Industries Co. and Kobe Steel Co. may play a key role in the shake-up of the steel industry. In the automobile sector, the moves of Mitsubishi Motor Co. and Honda Motor Co. are to be reckoned with. Analysts point to the possibility of a financial restructuring involving such leading companies as Sanwa Bank, Mitsubishi Bank, Nomura Securities Co. and Nippon Life Insurance Co. Uncertainty about unemployment persists as industrial restructuring continues.

On the social side, Japan must seriously consider immigration of foreign workers to make up for the decrease in the number of children and the aging of the population. Likely to emerge as an immediate policy issue is whether to allow an estimated 280,000 foreigners working without permits to permanently settle in Japan.

Japan will have to look for a way to resurrect itself while somehow coping with its multitude of problems. It will be a challenge the country will have to face up to as it works out its own destiny in pursuit of an affluent society in the new century.

Interview with Nishimuro Taizo, the president of Toshiba Corp.

Q: During the 1990s, the U.S. industrial sector turned its fortunes around to become the success it is today through drastic restructuring. Can Japan also restructure its industries?

A: I am convinced that the Japanese economy will change for the better, though it will follow a different path from the U.S. This is because Japanese labor practices will become a major factor in the process. U.S. companies curtailed their workforces through layoffs and other measures and subsequently hired new workers, a measure called "C-curb," and thus achieved a strong recovery. While Japan will find itself hard-pressed to take such dramatic restructuring measures, industrial rehabilitation will still be possible without such drastic measures. Japan has the ability to achieve rehabilitation though it will be at a slower pace than in the U.S. I am very sure that Japan's industrial sector will regain its strength.

Japan will see its information technology industry grow as fast as in the U.S., even though venture businesses in the two countries are different in terms of the volume and quality of ideas. Everywhere in the U.S., opportunities for investing venture capital are overwhelming prospective investors, whereas in Japan applications for venture capital are rare. We have to admit that Japan drastically lacks such venture spirit. This is partly due to education, a problem that cannot be addressed in a short time.

This suggests that Japanese companies will not be rehabilitated unless major companies, which underpin the Japanese economy, promote restructuring with a clear sense of purpose and have it gain momentum.

Asian countries recovered from the regional economic meltdown not because new companies entered the field but because companies worthy of survival survived while those unworthy of survival folded. In the process of economic recovery, Asian countries were very tolerant of accepting foreign capital, quite a departure from the past. Japan will be able to gain additional momentum for its rehabilitation if it follows the pattern of the Asian economic recovery.

Q. Will Japan's labor practices drastically change?

A. Lifetime employment gives a very negative impression because it is so identified with seniority-based systems. But long-term stability of employment is not a bad thing. Even so, companies undoubtedly cannot survive if they stick to the age-based pay raise system. Companies must shift their wage systems to one based on merit and results. But stability of employment will be important for companies of a certain size. While younger generations will accept such a proposal, the problem lies with employes in their 40s and 50s who are treated better than their worth.

South Korean companies resorted to drastic restructuring during the rehabilitation process. Samsung Electronics, for example, slashed its workforce from 53,000 to 35,000. Except for members of the board, only 10 employees above the age of 50 and 150 above 45 remained on the payroll. Restructuring implemented in such a drastic way can change the seniority-based wage system. In Japan, however, companies will not be able to resort to such a drastic approach and will have to change the seniority-based wage system without eliminating workers above 45. Even unions are well aware of the necessity of overhauling the seniority-based wage system. The important thing is how soon we can do the job.

Long-term stability of employment is as important as the transfer of workers. We must pay attention to "knowledge base management," a catch-phrase in the business sector. Knowledge is embodied in humans. It will be important for corporate management to think of how to make use of human knowledge.

Q: Toshiba introduced its in-house company system in April, 1999, and spun off some its businesses. Were positive results achieved?

A: The introduction of the in-house company system made employees realize the importance of cash flow management, which helped add 70 billion yen to our cash flow in the first half of 1999 alone. Downsizing also made it easier for us to monitor the performance of each company, not only in numerical terms but also in terms of the capabilities of top managers because they were given greater responsibilities. If they were indecisive or cannot control subordinates, they must be replaced. Toshiba introduced a self-paying system for affiliates in 1971, but the headquarters still retained its excessively huge power and gave affiliates detailed instructions. With the launching of the in-house company system, the headquarters relegated its responsibilities to the management of each group company and curtailed the authority of the headquarters.

The divestiture of its ATM business to Oki Electric Co. had a great impact on Toshiba employees. It may sound derogatory to Oki Electric, but Toshiba employees regarded Oki as having a lower status than Toshiba. Staff members of the ATM division were shocked when they were informed of their transfer to Oki. They wondered why they had to move to a lower-ranked company. As far as the share of the ATM business market was concerned, Oki had outranked Toshiba 30% to 12% for many years.

Photo : Toshiba Co.

Nishimuro Taizo : the president of Toshiba Co.

Therefore, it was better for Toshiba's ATM division to combine with Oki to become the market leader and post profits than remain a money loser constantly criticized within the Toshiba group. The ATM staff members were all capable persons and well aware of this. But they were still hesitant to move to a company with lower status. This was a symbolic example of success in arousing a sense of crisis throughout the company. In carrying out in-house reform, it is important to create, with certain awareness, a symbol which could create momentum. Toshiba joined Kadokawa Publishing Co. to bid for an equity stake in Recruit Co. Toshiba's investment would total as much as 50 billion yen. But since Recruit's operations are attractive, the purchase of Recruit stakes serves as an in-house message that a good proposal would induce investment from outside.

Q: How far has Japan's industrial realignment advanced? Financial institutions are merging by crossing over the boundaries of their respective groupings. Will such mergers affect the financial sector?

A: It is only the beginning of a story. Many unforeseeable things could happen in the future. The upheavals in the banking and financial sectors will trigger similar moves in other business sectors. Not only mergers and acquisitions but also splits could occur. If funds are to be raised through the placement of equities, companies will find it more advisable to split them into units. Companies that embrace both profitable and unprofitable divisions will not be able to survive. These companies will find it more convenient to exist as separate entities. These companies must first be transformed into holding companies. The biggest question is how each unit can introduce promotion and wage systems, under which they can compete in markets. Toshiba will not be affected by the merger of Sakura Bank and Sumitomo Bank. The impact of the merger will not be felt in markets in the electric machinery sector.

Q: What do you think of Prime Minister Obuchi's commitment to economic rebirth?

A: The legal system constitutes the basis of the economic system. The government should reform the Commercial Law and tax laws in an appropriate way. The introduction of a consolidated taxation system and tax deductions on corporate transfers should be considered from a long-range viewpoint. Anything that stands in the way of Japanese companies' competition in the global market should be removed. The Fair Trade Commission is becoming more flexible these days, yet we are worried about the commission's preoccupation with domestic standards. For example, the commission instructs a company ranking only fifth or sixth in the world to submit vast amounts of documents for inquiries into possible monopoly shares of the domestic market. Such an inflexible approach by the commission will adversely affect companies's performance.

(Nishimuro joined Toshiba in 1961 after graduating from the faculty of economics of Keio University and studied at British Columbia University while he was a student at Keio. He is a marketing specialist and served in the U.S. for more than 10 years. He was appointed Toshiba president from managing director in 1996 over eight senior executives. He is the first Toshiba president to have no experience in the heavy electric machinery division.) JJTI

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