Oil on Troubled Waters

Interview with Mobil Sekiyu Chairman Faneuil Adams by Roslyn Hayman

The Japanese market, it is said, is exclusionist and impenetrable. And when it comes to oil and petrochemicals, huge problems of overcapacity, slackened demand, high raw materials costs and an increasingly uncertain international energy situation have brought even Japanese firms to their knees.

Yet Mobil Sekiyu Kabushiki Kaisha, a wholly-owned Japanese subsidiary of the U.S.-based Mobil Corporation, has managed to stay afloat.

In fact, Mobil Sekiyu's American Chairman, Faneuil Adams, is optimistic. "Even though we have only 5% of the market," he says, "our sales are in the order of $4 billion annually, which is fairly large by any standard of what size you need to be to be in business."

Though incorporated in Tokyo in 1961 as the domestic sales company for two affiliated refineries, Toa Nenryo Kogyo K.K. and Kyokuto Petroleum Industries Ltd., Mobil Sekiyu's roots in Japan go back 90 years this month: to the opening of a Yokohama branch office of the Standard Oil Company, Mobil's antecedent, in May 1893.

Discussing his experience—and some of the secrets of Mobil Sekiyu's success—Faneuil Adams said he would encourage foreign firms to invest in Japan.

Question: *Despite the current easing in international oil prices, Japan's oil and petrochemicals industry has been hit seriously over recent years by a combination of low prices on the domestic market, sluggish demand, and high raw materials costs, aggravated by the low yen exchange rate. Has Mobil Sekiyu been affected as seriously as its Japanese competitors?*

Adams: Obviously the last few years have been difficult, with falling demand and violent fluctuations in the foreign exchange rate. But our marketing company and joint venture partners have managed to avoid the big losses that some of our competitors have incurred.

I think we have several advantages really. One is that, over the years, we've given considerable emphasis to the retail business: gasoline, distillate fuel, as well as lubricants. This portion of the business, in which we have a larger market share than our overall market share, has not suffered as much as the portion represented by residual fuel oil and naphtha, where demand has dropped off sharply.

Another advantage has been the state of our balance sheet. Compared with most Japanese petroleum companies today, we've managed to keep our debt down and our net worth up, so that we do not have the enormous interest burdens many of our competitors have to pay.

A third factor is that we've tended to cover our foreign exchange risks and this has helped to avoid the very large swings downward—and sometimes upward—in earnings reflected in the results of some of our competitors.

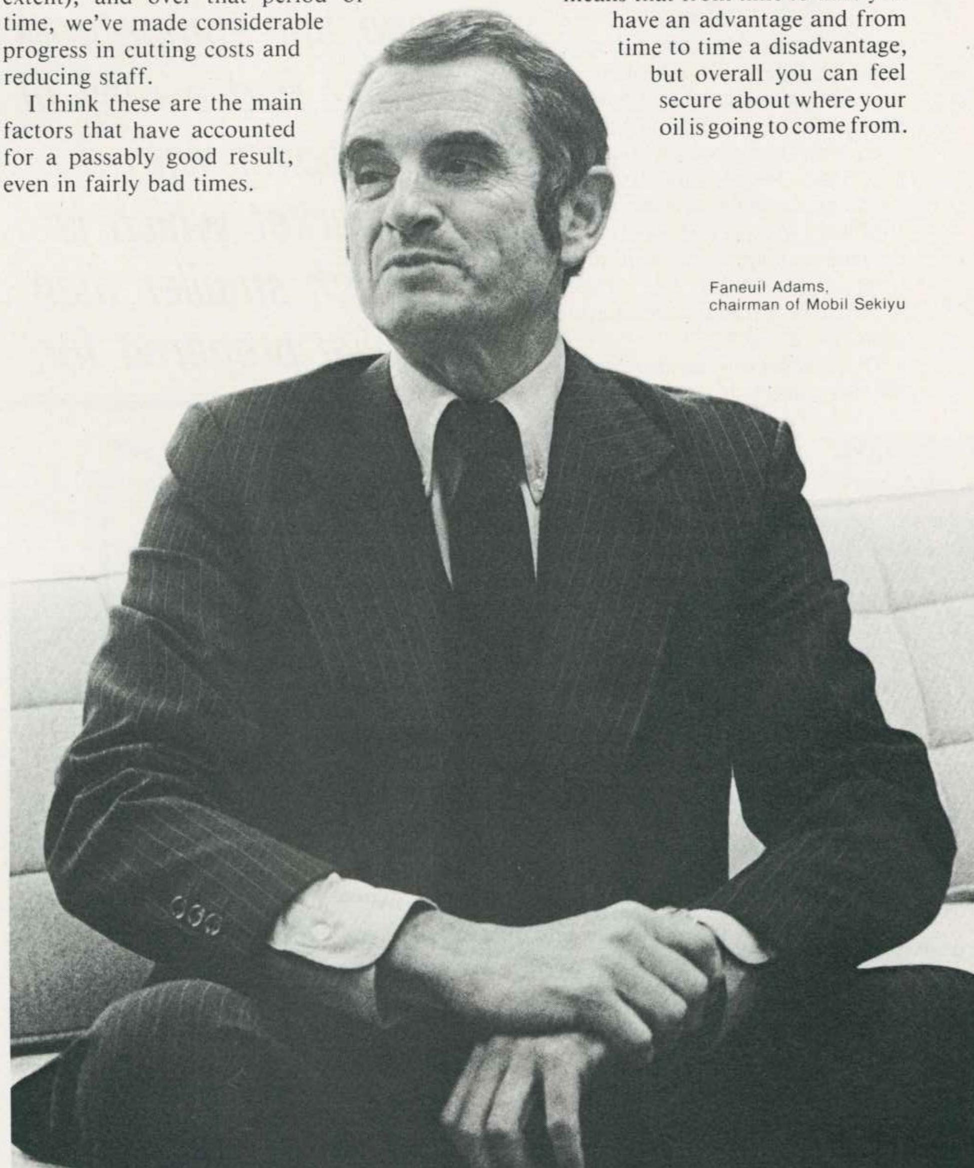
And a fourth factor is that, since 1973, the time of the oil crisis, we saw that the oil business was going to be more restricted (although we didn't see the extent), and over that period of time, we've made considerable progress in cutting costs and reducing staff.

I think these are the main factors that have accounted for a passably good result, even in fairly bad times.

Q: *Do you feel your relationship with Mobil Corporation has given you an advantage over your Japanese competitors, for example in foreign exchange or crude oil purchasing?*

Adams: So far as crude price is concerned, for a fairly long period we enjoyed the so-called Aramco advantage, when Aramco crude on the whole was cheaper than the average cost of crude coming into Japan. Over recent months, we've faced an Aramco "disadvantage," where our average cost of crude has been higher than that of our competitors.

Mobil has always placed a lot of emphasis on good relations with Saudi Arabia, feeling that in the long term, a secure supply of oil is the prime target. This means that from time to time you have an advantage and from time to time a disadvantage, but overall you can feel secure about where your oil is going to come from.



Faneuil Adams, chairman of Mobil Sekiyu

Q: *How do you see the immediate outlook for business in Japan and are you adopting any special strategies to cope with it?*

Adams: Perhaps nothing you'd call a strategy. But in recent years and with increasing emphasis, we've examined the costs and efficiency of really every aspect of our business, and our joint venture partners have been doing the same.

We believe there'll probably be no further growth in the petroleum market as a whole over the coming years, so that somehow we and our competitors must find a way of coping with a market which is much smaller than we've prepared for. In other words, we've built too many refineries, too many service stations, too many terminals, and the like.

Our most important work—not just ours, but for every company in Japan—is to see what can be done to reduce some of this excess investment in facilities and people. That's the major strategy.

But it's very difficult to reduce refining capacity. Our refiners do have excess capacity, and they are studying hard—and we're helping them to study—what can be done about it.

Some refineries have just one crude tower, and there's really no way you can make a crude tower any smaller. You can find various pieces of equipment that can be shut down, and our partners are doing that. You can find ways to upgrade products from lower value to higher value products, and they're doing that. You can find ways to save energy, and, over time, to reduce manpower, and all of these things they're doing. But a big reduction in capacity is quite a complicated thing to achieve.

Q: *How do you see the prospects, then, for the Japanese government's industry restructuring program? An estimated 40% of refining capacity is reportedly lying idle, and the Industrial Structure Council is urging the local industry to scrap excess plants, along with a program of cost-cutting, higher value-added creation, and industry grouping to consolidate purchasing and marketing arrangements.*

Adams: We have always, where it's legally permissible, worked quite closely with competitors in such areas as exchanges of product, joint use of storage terminals, joint use of vessels, etc., and for many years we've been the leading company moving in this direction in terms of a percentage of our total sales.

Not all companies have followed that policy. But now, partly under their own volition, and partly under government encouragement, more and more—really all companies—are looking at the possibilities of that kind of cooperation, and I think it will be extended somewhat.

The government and the Petroleum Deliberation Council have certainly been fostering the idea of consolidation of companies. That, unfortunately, is much easier said than done.

"...somehow we and our competitors must find a way of coping with a market which is much smaller than we've prepared for."

In the first place, many of the companies that would have to be consolidated to become efficient have enormous debt burdens, which the potential partners are not enthusiastic about assuming. Furthermore, in the case of refineries, mostly they don't need the refining capacity that would be involved. Then, as you know, in Japan it's very difficult to lay off staff. Whereas in Europe or America you may be able to consolidate companies, shut down a refinery and dismiss the staff, this normally isn't done in Japan, even in the case of a company that's close to bankrupt.

So it's quite a complicated problem. The need to consolidate is obvious. The way to do it is very obscure.

Q: *Many Japanese blame the present overcapacity in the refining industry on excessive intervention and over-optimistic demand forecasts by the Ministry of International Trade and Industry (MITI). Do you agree, and how do you feel about the level of government intervention in the industry here?*

Adams: I think in recent years their demand forecasts have been somewhat over-optimistic and currently are very over-optimistic because their forecasts are somewhat out of date. But they have their reasons. The Japanese government has to negotiate, for example, with the International Energy Agency over oil allocation, and with many local communities about the placement of nuclear plants and coal receiving facilities, etc., and if they don't show a somewhat bullish demand forecast, it makes it harder to negotiate.

But so far as the long term is concerned, and the cause of all this surplus capacity, I don't think it can be laid to government intervention. Everybody in, say, 1971-72 was forecasting continued growth of Japanese energy demand at a rate of some 10% a year. We ourselves were forecasting, for 1985, a demand of something like 14 million barrels a day. So I don't think it's fair to blame the government for that.

However, there was, in the same period, one government activity that has been somewhat criticized, and that was MITI's policy of promoting Japanese capital refining companies.

The late 60s and early 70s was the period when all these *kombinato* refineries were created, largely to produce fuel oil and naphtha to supply industrial complexes. We, of course, complained loudly in those days that we—or our joint venture partners—should have had a larger share. Looking back, it was very lucky that they didn't let us expand to the extent we wanted, because naphtha and heavy fuel demands have dropped sharply and these companies, created with the strong backing of MITI, are now in difficulty.

Photo: WWP

A typical gas price competition scene on a Japanese highway

But whether, over time, this government intervention is a good policy or a bad policy, I'm not going to make a judgment. We operate in markets that are free, we operate in markets that are regulated and somehow we have to get along in both. But I will say that over the years, we have not been treated unfairly under this system as a foreign company. Once in a while we have to go in and fight for our rights, but that's true of all oil companies in Japan, not just companies with foreign capital.

Q: *Looking at the petrochemical industry, Japan's naphtha-based refining is no longer price-competitive with ethane-based refining as carried out in the United States and Canada. And Japan's export market in Southeast Asia has been eroded by countries like Taiwan and South Korea as they achieve self-sufficiency and start turning to exports. Do you really see a future for petrochemical industries in Japan?*

Adams: Certainly general demand for petrochemicals in Japan has slowed and the export markets are pretty well gone with the big petrochemical centers coming on in the Middle East, Singapore, Taiwan, and so forth.

But that doesn't mean there's no opportunity in the petrochemical industry. There are always new products, new processes, and the company that's alert, studies its opportunities carefully, and can get hold of some technology, either by its own endeavors or by licensing from somebody else, probably can still be successful over the long term.

Q: *As a wholly-owned foreign subsidiary with a long history of operations in Japan, how have you found working here? The complexities of the Japanese distribution system, for example, are considered an obstacle to the entry of foreign products.*

Adams: The distribution system is rather expensive in terms of the cost of getting the goods to the consumer. On the other hand, it employs a lot of people. So you can argue either way about that. We may have lower costs in Europe or America, but we've got a lot of unemployed people too.

But I think it's unfair to attack the Japanese government or industry on the basis that their marketing structure is a non-tariff barrier. This market structure was mostly developed for historical and cultural reasons and is not readily changeable by government influence. It's changing gradually by market forces, as companies like Daiei and all these specialty discount houses, auto supply houses and so forth grow up. But to think it can be changed by fiat is to me very unrealistic.

And while the distribution system may be high cost, the margins generally reflect the cost. So I don't think it's necessarily

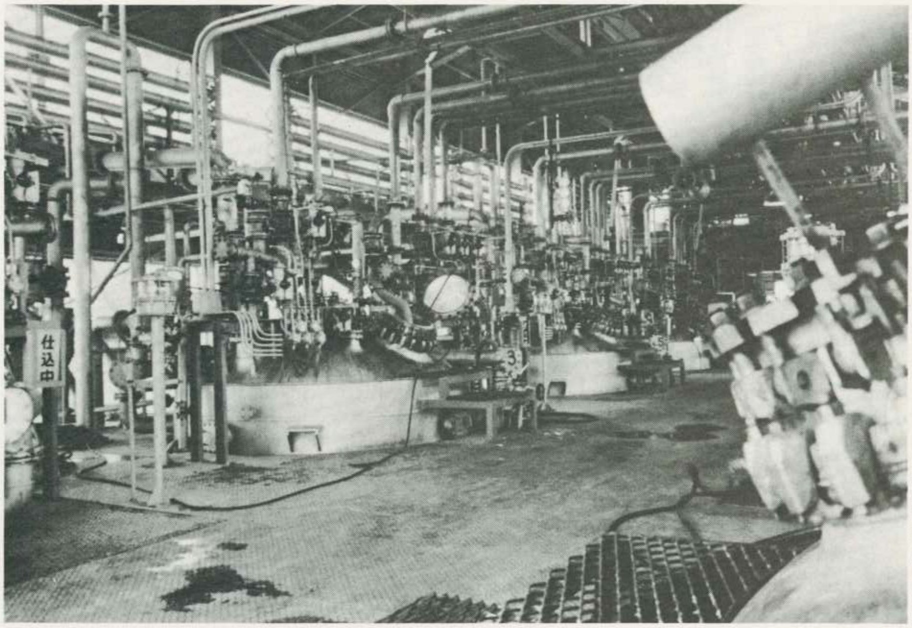


Photo: Asahi Shimbun

The oil industry is suffering from surplus production facilities due to the lingering economic slump.

"There are always new products, new processes, and the company that's alert... probably can still be successful over the long term."

related to profit one way or the other. What really matters is how unique the product is, how much competition there is in a given industry, and so on. A lot of people in Japan, both Japanese companies and foreign companies, make a lot of money—even though distribution costs may be high.

Q: *In what ways have you had to adapt to Japanese business methods, and what advice would you give other foreign firms seeking to enter the Japanese market?*

Adams: Obviously the way of marketing in Japan is different. For example, we do almost all our marketing through *dairiten* or agents. This we would not do in most other countries. But it works very successfully. Most of our agents have been loyal to us for many years, some of them for generations. Of course, they negotiate over prices and terms just like anybody else, but there is a basic family feeling between a company and its agents, in my view, that's very distinctive to Japan.

I think to deal with the market situation in Japan, you have to develop strong Japanese staff, and this takes quite a lot of time for a foreign firm. You have to convince people you're here for the long haul, that you're a desirable company to work for, and that if they join you, they're not just joining the local operation, but that they'll have opportunities in your worldwide operations, and they'll get proper education and be properly treated and properly paid.

If you keep at it, you'll get a better staff of people than you'd find anywhere in the world, in my opinion, but it doesn't come overnight.

Q: *So you don't see Japan as the closed market people make out?*

Adams: I think the reputation of the market is far worse than the realities, and there are opportunities here for foreign companies. The Japanese government has taken many steps over recent years and plans to take more in the coming year to further liberalize the market.

I would encourage foreign countries to make an effort to invest in Japan and to export to Japan. You have to prepare very carefully—no question about that—but if you do, and you have a product or a service that has some special attraction in either technology or design, or even marketing approach, this is the second largest market in the world, and it shouldn't be overlooked. ●

Roslyn Hayman is a feature writer for Japan's Kyodo News Service and Australia's Canberra Times. An Australian, she has lived in Japan for 10 years, and previously spent several years working and studying in Europe.