

**JAPANESE CORPORATE STRATEGY  
IN CRISIS**

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## Japanese Corporate Strategies in Crisis

Through my past experiences with McKinsey and Co. as well as associations with a number of countries, particularly in the Asia Pacific, I have learned a great deal about the global economy and the efforts of other countries to become part of it. I have also had the opportunity to reflect on my own country Japan; due to a run of dumb luck over the past one and a half decades, the country became very prosperous--but neither Japanese companies nor the government were well prepared to face the issues of the time.

The so-called Japan Inc. of the 1980s was driven by three different elements: the corporate sector, the bureaucracy, and the politicians. First, it is important to understand that politicians don't actually make laws in Japan; bureaucrats make laws. The main job of Japanese politicians is similar to the role played by American lobbyists, which is to negotiate on certain issues and to bring money back to their hometown. Only in this way can they be assured of reelection. Bureaucrats, for their part, were busy figuring out how many institutions they could create outside of their own bureaus, so that they might be able to descend onto them in post-retirement at the age of 55. There are tons of these institutions today. And because of the enormous success of American scholars in promoting the image of Japanese success in business, much of the corporate sector thought that *Japan As Number One* meant that Japan actually was number one; they took their luck in business for granted.

Because the supply of land was limited, people expected property prices to go up and because everyone speculated, property prices did shoot up five-fold during the 1980s. This is now reflected on the asset side of the corporate balance sheet and therefore, it is argued, must be reflected in the stock market, thus explaining Japan's very high price-to-earnings ratio.

Consequently, it was no surprise when NTT issued its initial placement at a price-to-earnings ratio of 200. Even though NTT had a market value higher than that of the entire German stock market, nobody really worried because property prices were going up. In December 1989 the property price of Tokyo alone was worth twice as much as that of the entire U.S. I was a bit surprised by this, so I calculated the price of the Imperial Palace, which I discovered was worth the state of California. But everyone thought Japan's high price-to-earnings ratio was to be expected because Japan had such a large concentration of information, technology, hardworking people, and successful companies all in this small land.

With prices hovering at approximately 80 times earnings, if a Japanese company wanted to raise capital, the cost to the company was zero or sometimes negative. Therefore, Japanese companies became very bold and purchased places like Rockefeller Center, MCA, Columbia Pictures, and even Pebble Beach golf course, all of which turned out to be very bad deals--amounting to some half trillion dollars which now must be written off the books.

Also during this time our obedient government bureaucrats agreed to finance as much as a third of the entire American budget deficit. On top of this, because of the combined outcry from American industry and the U.S. Federal Reserve over the weakening of the American dollar, the Bank of Japan agreed to support the dollar at the tune of a hundred billion dollars, and that's getting sour now too. So we have many casualties on the Pacific coast, but still Japanese companies, bureaucrats and politicians don't want to recognize the problem. Of course, when we actually earn back the money that we have invested in the United States we will have to book the losses, but so far we haven't done this. This is because the Japanese Ministry of Finance (MOF) keeps changing its rather peculiar accounting rules. For example, the rule stating that loans out for more than half a year without interest

being paid are to be classified as nonperforming loans and written off was changed when the nonperforming portion became so huge--some 200 billion dollars--that Japanese banks could not possibly write them off. Well, never mind, because if everyone has this problem, then why don't we change the rule? In Japan, since everyone is in the gutter, we simply call that the main road.

So today we do not know the net position of Japanese financial institutions in terms of nonperforming loans, delinquent payments, and investments in the United States which must necessarily entail an enormous amount of currency loss. Nor do we know our net position with respect to U.S. Treasury bills through which the Bank of Japan supports the dollar. Since no one else in the United States wants to buy them, Japan is one of the largest owners of U.S. Treasury bills. This creates a problem which is not confined to Japan. The United States and Japan are so interlinked in this financial and corporate world that if Japan suddenly decides to become honest and goes back to its original rules, paying the penalties for these outlandish gains, this will create a massive capital flight out of the United States. And as Japanese financial institutions are forced to pull billions of dollars out of the United States, the U.S. bond market will have to go up, forcing major adjustments in both countries. I do not think that Clinton and Murayama will have the ability or the will to face these issues.

At a time when taxpayer revenue is going down, the Japanese government continues to spend more. Apparently the American syndrome in the early 1980s of borrowing from the future has made its way to Japan where we have been borrowing as much as 30 years into the future from our children. And now the most recent innovation is to borrow from our grandchildren by issuing 60-year bonds. Thanks to Al Gore's grand idea of an information superhighway and Japan's own competitive instinct, we now find it necessary to install fiber

optics throughout the country. Therefore we can borrow 60 years into the future since it is to the benefit of our grandchildren. This kind of bad habit which developed in the 1980s is still forming the basis of our problems today.

Due to their streak of good luck in the 1980s, Japanese corporations have never really had to improve their management techniques. Certainly good Japanese companies from the 1980s are still good, and there are a few of them. But trying to explain Japanese corporate behavior on the basis of so-called Japanese techniques such as company songs, suggestion boxes or TQM is not adequate. Even at Japan's economic peak, only some 13 percent of the Japanese working population was engaged in internationally competitive industries, including automobiles, consumer electronics, cameras, office automation equipment, mass produced semiconductors, shipbuilding and steel. What about the other 87 percent of Japan's working population? Well, luckily they were either in industries not exposed to international competition, such as agriculture or retail, or in industries such as cement, construction materials, and chemicals which formed cartels to block tough foreign competition. So an honest performance scorecard for Japan in the 1980s would rank only one in ten companies as top performers, four or five as not even in competition with the outside, and four or five as so weak that they were protected with rich taxpayers' money.

In today's economy Japan's strong industries are not really troubled but they have changed their basic configuration. The weak industries are as weak as ever; they have not improved their productivity because governmental subsidies have helped the weak get weaker. Those industries that were not exposed to international competition are now faced with a deregulatory environment in Japan for the first time. But it will not take the USTR to revolutionize Japanese distribution; it will take only one or two mavericks in Japan to

challenge the status quo of the rigid Japanese system. A few such mavericks have already emerged, such as Mr. Higuchi, who has set up a chain of liquor outlets which sell imported whiskeys at reduced prices, and Aoyama Shoji and Aoki International, who discount men's suits. The previous law and order is being challenged even in housing. One company in Japan is now offering American housing at less than 50 percent the cost of Japanese housing. Anything is possible in today's Japan.

What about the competitive industries which have earned all the money for Japan and have paid all the taxes to keep Japan's troubled engines going? Thanks to very clever American tactics, two and a half million units per year of North American automobile production is by Japanese companies. This does not include the 128 Japanese automobile component companies transferred to the United States over the past ten years which are producing state of the art auto components, not only for the Japanese transplants but for the Detroit Big Three as well. Now, due to the revival of the American Big Three automakers, the maximum number of units that Japanese companies can sell in the United States is 2.5 million units, which means that our capacity has to be reduced at home by the same amount that we produce in North America. But Japanese managers do not know how to lay off the union, and union leaders do not know how to call a strike. For 35 years our docile unions have never had to strike. Every month a portion of their check goes to the union strike fund, but it has never been used. Hypnotized by foreign scholars who say that Japanese management and labor talk, they have to talk. But they are not facing the real issues. This is the problem in Japan.

In consumer electronics, Japan has transferred most of its capacity to Southeast Asia. Americans still buy Japanese consumer electronics products, but they are no longer made in

Japan. For the first time last year, Japan became a net importer of color TVs. This comes just ten years after America negotiated a quota with Japan on the export of color TVs. Similarly, shortly after Nixon and the Japanese agreed on the textile deal, Japan lost its ability to export textile products. Now the Japanese are pushing for barriers against the Korean and Chinese textile industries, just as the Americans did against Japan.

Many of Japan's most competitive industries are either moving out of Japan or no longer have a volume large enough to sustain the past pattern of success. Korea now produces on behalf of Hitachi and then exports to the United States; PC companies in Taiwan make motherboards, etc. for Japanese companies. In fact, Taiwan and Korea outproduce Japan in the area of mass-produced high-tech products, and the United States controls most of the intelligent high-tech products. But rather than recognize these problems, Japanese companies blame the depressed economy. What they don't realize is that even if domestic demand recovers in Japan there will still be a negative 5 percent return on sales since the price level in Japan has come down so much. Companies have lost approximately a 20 percent margin from the bubble peak in 1989. Industries are now pressuring the government to stimulate the economy, saying it is not spending enough money. But this is completely wrong. We have spent 300 billion dollars on emergency spending simply for the sake of spending. We build highways in Hokkaido and bridges in Okinawa all to no avail--the economy is still depressed. Americans are also putting pressure on Japan to spend, as if this will be good for America too despite the fact that there has been zero correlation between the Japanese economy and U.S. prosperity. So Japan has pledged six trillion dollars for public spending.

What about the Japanese currency? Even if the exchange rate returns to 110 yen to

the dollar, there will be neutral impact on the Japanese economy because we import (8 percent of GNP) almost as much as we export (9 percent of GNP). Therefore even a 10 percent difference in the currency will have an impact of only 0.1 percent. This will not enable the Japanese to recover corporate profitability. In fact, it is precisely because the Japanese economy in general is almost currency neutral that Japan was able to survive the sharp appreciation of the yen. The exchange rate is simply not a big problem for the Japanese economy as a whole.

On the other hand, price erosion is a major problem. In the current restructuring and deregulatory environment, prices are coming down across the board--telephones, food, clothing, housing and just about everything else. The only growth industry in Japan is public services: Tokyo metropolitan tolls, stamps, etc. are going up.

Will the Japanese corporate world be able to revive even if they recognize these problems? I don't think so, because the Japanese became global without globalizing their psychology and management. After Reagan, the United States went through a very difficult period of management modernization during which a lot of white-collar jobs were lost. As a result of this move from traditional management to a network society which relies heavily on answer phones, PCs, internet, etc., American companies now have much better (digital) technology and much better access to consumers. Most Japanese companies, on the other hand, still do not have direct line answer phones, voice mail, e-mail or network workstations, and many large companies still use traditional mainframe computers. And unlike other people in Asia, Japanese have not improved their ability to speak English over the past ten years. Arrogant about our own success throughout this decade, we have become very inward looking and have made very little progress in terms of our ability to communicate with the rest of the



world, even with our Asian neighbors. In an internet world, the ability to communicate in English is essential because that's how you get information. The ability to be interlinked with the rest of the world is crucial because this is where the money will be in the future.

The Bank of Japan and the Ministry of Finance made a critical mistake in 1989 when they introduced tax measures to deflate the rising property prices and also banned the transaction of properties for one and a half years. Although these actions stopped property inflation, they also froze the property market at its peak level. Concerned that falling property prices would negatively affect the Japanese stock price and indeed the entire world economy, the Japanese government began a "pricekeeping" operation which introduced public funds such as postal savings and pension funds into the stock market. So today if we try to introduce the market mechanism into the property market, the bottom will fall out of not only the Japanese stock market but also the U.S. bond market, and ultimately the U.S. stock market as well. Therefore, the Japanese government has decided to give this bill to the consumer. Our people have about ten trillion dollars of savings. The government has lowered the interest paid to these depositors while at the same time keeping interest on loans high, with the result that the spread is at an all-time high. This is why the Japanese economy is depressed. Because the market prices are now so low, adjusting property prices to the real value of the market will force property taxes, inheritance taxes, land taxes, and everything else including the stock market to go down. Sweden was hit by a similar problem in November 1992. In response, the government exposed all the national assets and overnight developed emergency measures to rescue those banks that were in trouble. We have to do exactly the same thing.

In conclusion, the story of Japan today is one of management in crisis. Corporations,

politicians and bureaucrats are still working together to hide the problems. The same triad from the 1980s is now faced with a set of new challenges which they have no idea how to solve, so they continue to use taxpayer money, redistribute wealth which they don't have, and borrow from the future. We need to recognize that the lower property prices, particularly in Tokyo and Osaka, are good for Japan because for the first time the majority of the people can afford to buy a large piece of land at reasonable cost and to build large homes at a reasonable price. Having signed the Uruguay Round, Japan has freed up 60 percent of the land previously used for rice patties and agriculture within a 50 kilometer radius of Tokyo. We should put our ten trillion dollars of savings to good use and allow individuals to buy these properties, or else Japan's economy will not recover.

Clearly we have a deep valley in front of us, and we need the courage to go through it. The traditional 1980s approach of making secret deals to remove the pain will not work. We will be punished by a crash of the market and by the rest of the world market as well. Japan must have the courage to move forward with the market mechanism, even though the process will be painful, and to bring a better quality of life at a lower cost of living to the majority of the Japanese. In addition, in order to fill the large homes and live well, the Japanese will have to buy more from the United States, Canada, Australia and others; thus, this process will be good for the rest of the world as well. That is why I have decided to dedicate the rest of my life to make this happen, and I need your help in achieving the goals stated in the Reform of Heisei. Together we must believe that the solution exists, and that the end result will be good not only for us but for the rest of the world. After all, the interdependence of economy will become the source of security in the post Cold War regime.