

Small Businesses Adapting to Structural Changes in Japanese Economy

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Adapting to Changes in Market Situation

The appreciation of the yen since September 1985 has quickly accelerated the internationalization of the Japanese economy and greatly changed its internal structure. Business enterprises have been obliged to adapt to the strong yen. In doing so, companies of all sizes have staked their very survival on cultivating demand and internationalizing their activities. These corporate initiatives in turn economy.

Today, the Japanese economy has entered a stage of growth which is pulled by domestic demand. The expansion of the home market is commonly attributed to the benefits of the strong yen and the effects of the government's fiscal policy. The strong yen, in particular, has contributed to the reduction of import prices, stabilized consumer prices and boosted corporate profits. Especially significant has been increased personal consumption.

It has to be noted, however, actualization of latent consumer demand depends on the efforts of private enterprises. I wonder why so many

economists give little attention to these corporate efforts and expect continued expansion of domestic demand to be automatic.

The demand saturation theory seems to have had some basis. Certainly, actualized demand is almost wholly satisfied. But an increase in real income resulting from the yen's appreciation does not automatically expand personal consumption, and we should not overlook corporate efforts to develop latent consumer demand in the domestic market.

Many consumers are unaware of what they want. Businesses now indispensably need the process of identifying consumers' latent desires, developing and providing products to meet those desires.

It is not easy for businesses to develop appropriate marketing strategy. A considerable effort is required to satisfy Japanese consumers. Export marketing is much easier. It was no wonder that, during the over six-year period till September 1985 when the yen was so weak that \$1 was worth well over ¥ 200, Japanese manufacturers continuously laid emphasis on export trade, mass production and an ever greater share in the market. This

pattern of corporate behavior undoubtedly was one of the factors that contributed to the appreciation of the yen.

Now, in the process of the rapid strengthening of the yen, cost reductions in export industries have further accelerated the appreciation of the yen. Not surprisingly, this resulted in the shift of corporate priority to domestic demand. Thus began the efforts of manufacturers to develop new domestic demand by trying to create products that would sell well in the home market. Today, even export-oriented companies cannot afford to do without product lines catering to domestic needs.

Consumers behavior has diversified and unique products are in demand. Businesses are required to develop emotionally appealing and functionally superior and services which will help consumers realize a richer way of life. There is a wide range of factors that could make up the richer consumers' life: they include housing, furniture and household items for daily use in addition to interesting ways to spend leisure time. Companies assert themselves and try to better communicate with consumers by directly demonstrating their products in the marketplace—particularly in big cities. Many industries now make full use of displays as a marketing tactic.

It is no exaggeration to say that businesses and consumers are working together to develop a new life style, a more sophisticated way of life.

This pattern of behavior is common to companies of all sizes. They are all restructuring to meet this new domestic demand. Never before has diversification or switching to other lines of business proceeded so quickly. An increasing number of companies are moving toward sharing managerial resources as they enlarge the scope of business activities. Such moves, moreover, are going on not only in mature industries but also in growth sectors. Creative application of the vast array of newly developed technologies has also

contributed to the development of new products. This has also led to increased merger activity. Intercorporate relationships are increasingly being organized into networks—networks organized not only locally but inter-regionally and internationally as well. Meanwhile, small businesses are engaged in stepped-up entrepreneurship in this process of network formation.

As a result of the corporate behavior so far described, industrial restructuring is proceeding rapidly. In the rest of this article, we will examine trends in industries based outside the large metropolitan areas and smaller subcontractors.

Tsubame City Has Changed

The rapid appreciation of the yen has had a severe impact on all locally-based industries. Used as they are to repeated shocks since the so-called "Nixon shock" of 1971, these industries have once again flexibly accommodated themselves to the impacts of the strong yen.

Faced with strong competition from exporters of newly industrializing economies (NIEs) in third-country markets, export-oriented local industries have no more room for cost reduction.

On the other hand, even industries that rely on domestic demand are substantially affected by the rapidly increased imports from NIEs and elsewhere, imported by major Japanese corporations in the distribution industry.

Therefore, local industries cannot sufficiently adapt themselves to the changing situation merely by developing new domestic demand. They have to develop higher value-added products and restructure themselves into gilt-edged industries that produce higher value-added goods, which are competitive even at comparatively high cost. International specialization should be actively sought between themselves and their competitors in NIEs.

Of course, what can be regarded as a new breed of local industry similar to those found in advanced countries have already achieved notable development.

At any rate, in advanced countries local industries need creative development and marketing of new products to cultivate latent consumer demand. What poses a problem here are traditional local industries that may lack the ability to adapt.

It has been said on many occasions that the history of locally-based industries is one of conversions. Is this true? Historically, many such industries failed to convert themselves and became extinct. The history of conversions is only observable among existing traditional local industries. The conversions have been made possible by utilizing local human resources for business operations. The local industries that have kept on converting themselves over the last 10-odd years have coped with the recent appreciation of the yen with some success.

For instance in Tsubame City, Niigata Prefecture, a well-known center of tableware production, diverse conversions are taking place in the processing subsector, while new products are actively being developed. In the manufacture of Western-styled tableware there, from 1975 on, products have been upgraded and production costs of regular items have been reduced through automation of the manufacturing process. As a result, the value of the local tableware output tended to gradually increase, though with minor short-term fluctuations, and surpassed ¥ 40 billion in 1984, the year preceding the recent appreciation of the yen.

The export ratio of Tsubame-made tableware in that year reached 88.2 percent in volume or 76.5 percent in value, indicating a sustained competitive strength of these products in the international market.

However, in 1987, after the yen had started to rise quickly, yearly output plummeted to ¥27.2 billion, and the export ratio also fell off to 60 percent. The strong yen had caused output to fall by 35 percent.

Moreover, there also took place a conversion from metal tableware to housewares. The yearly output of housewares, mainly comprising kitchen utensils, had been increasing despite the shocks of the dollar's depreciation and oil crises, but it took a downturn after reaching a peak of ¥ 42.7 billion in 1980, and declined to ¥ 29.7 billion in 1987. The export ratio of housewares also dropped from the previous level of over 30 percent to about 20 percent in 1987. Though domestic demand for these products increased, requirements for traditional items had run their course.

More recently, manufacturers in Tsubame have been diversifying to new lines of business beyond tableware and housewares. Utilizing the processing know how and equipment already accumulated, they are moving into new fields mainly catering to domestic demand. They are trying to make Tsubame a processing center for various metal products, including new products.

A number of product development-oriented companies have emerged and are much talked about. They include Twin Bird Industries, which has developed a wide range of including lighting equipment and outdoor items. Their slogan is "New goods for a new joy of living". Other companies include Tsubame Electrical Machinery Works whose bath water purifying system is attracting much interest; Fuji Tableware developing a pot that "speaks", and Nippon Tsusho, a manufacturer of kitchenware, developing "canned gruel" made from "Koshihikari", a choice brand of rice.

These companies are stimulating the economy of Tsubame, thereby contributing to

the creation of a new entrepreneurial climate there.

The yearly output of this new sector in Tsubame surpassed ¥ 10 billion in 1985, and reached ¥ 35 billion in 1987. It registered this remarkable growth when the yen was rapidly appreciating.

Many problems have to be solved in shifting the priority to domestic demand. Development of new products is indispensable, and marketing channels also have to be developed to secure customers. Great risks are involved, and there is a long lead time before a newly developed product can be well settled on a track of regular sales. Key factors to success include a build-up of human and financial resources.

Few Bankruptcies, Many Conversions and Closures

In not a few production areas, the structure of the social division of labor is changing in addition to diversification. The traditional structure of division of labor, which was primarily intended to reduce production costs, is being replaced by one aimed at achieving quicker production of better goods. Accordingly, regional specialization, and international sharing of specialized fields with NIEs is developing. Twin Bird Industries mentioned above is taking advantage of the strong yen by importing parts from Taiwan and elsewhere.

Table 1: Trends of Suspension of Operation, Conversion, Closure and Bankruptcy in 55 Production Centers of Export Items.

		1986	Jan.-Mar. 1987	Apr.-June. 1987	July-Sept. 1987
Suspensions		22 localities 1416 companies	21 localities 1539 companies	18 localities 1529 companies	17 localities 1588 companies
Closures	New Cases	30 localities 271 companies	17 localities 150 companies	9 localities 59 companies	11 localities 310 companies
	Cumulative	30 localities 271 companies	36 localities 421 companies	39 localities 480 companies	39 localities 790 companies
Bankruptcies	New Cases	20 localities 72 companies	11 localities 16 companies	4 localities 5 companies	3 localities 3 companies
	Cumulative	20 localities 72 companies	22 localities 88 companies	23 localities 93 companies	24 localities 96 companies
Conversions				8 localities 32 companies	7 localities 64 companies

Note: Suspensions are totaled at the end of each period closures bankruptcies and conversions are counted cumulatively for each period.

Source: Small and Medium Enterprise Agency, "A Survey of the Impact of the Appreciation of the Yen on Smaller Enterprises in Export-Oriented Production Centers."

Table 2: Proportions of Sales of Main Line Products

(in %)

Sector FY	Subsidiaries excluded			Subsidiaries included (in '86)	Average number of subsidiaries	Proportion of subsidiaries sales
	'79	'84	'86			
Food	96.1	96.8	97.0	76.6	24.3	32.0
Textile	66.3	60.3	57.1	40.2	36.8	42.9
Lumber/wood products	86.1	72.8	68.8	47.4	3.5	18.8
Pulp/paper	86.1	93.0	92.5	74.5	16.4	31.6
Publishing/printing	99.9	100.0	88.3	69.5	22.4	31.4
Chemical	88.4	88.7	84.6	65.6	30.6	35.9
Oil/coal products	99.2	99.7	99.2	83.7	13.6	19.8
Rubber products	90.0	89.6	88.5	58.5	31.3	37.7
Ceramics/stone products	75.6	76.4	71.4	64.2	24.2	25.9
Iron & steel	85.8	81.8	78.6	61.8	24.3	25.1
Nonferrous metals	89.1	67.7	60.8	47.4	28.8	38.9
Metal products	91.5	90.9	90.0	71.9	9.3	28.1
General machinery/appliances	75.9	77.9	73.1	58.9	16.3	27.0
Electrical machinery/appliances	93.3	95.3	83.6	59.2	70.3	49.2
Transport machinery/appliances	79.4	77.0	79.0	65.6	61.7	21.5
Precision machinery/appliances	59.1	45.1	37.6	32.0	13.0	35.9
Other manufacturing sectors	71.0	69.7	67.4	55.1	7.4	20.1
Average	86.7	84.5	80.2	62.1	26.5	34.1

Source: Fair Trade Commission, "On the Actual Situation of Restructuring" (February 1988)

Under these circumstances, companies lacking adaptability are increasingly going out of business either temporarily or permanently. Table 1 shows the trends in suspension of operation, conversion to some other lines of business, closure and bankruptcy in 55 localities of export-oriented industries.

The number of companies temporarily suspending operation at the end of term gradually increased, accounting for 10.7 percent of all the members of local manufacturers' associations at the end of September 1987. Companies which permanently went out of business between early 1986 and the end of September 1987 totaled 790. The number of bankruptcies during the same period, however, was relatively small, only 96. So many closed down, but not so many went bankrupt. Many would give up and close down before being driven into insolvency. Besides closures, conversions also constantly took place. It is thus seen that drastic changes are generally occurring within local industries.

Incidentally, a number of such companies sought their way to survival in overseas production, but some of them have already retreated.

De-Subcontracting Trend of Subcontractors

The strong yen dealt a heavy blow to small businesses subcontracting for export-dependent machinery industries. Parent companies demanded cost reductions, but small reductions in cost were by no means sufficient to cope with the quick and tremendous appreciation of the yen.

Now, many subcontracting companies have been attempting cost reductions through value engineering (VE) activities. They have tried to improve their products, parts, equipment, jigs, tools, processes and work procedures by using

the technique of analyzing the functions and costs of these factors and raising their values on that basis. To overcome the pressures of the tremendously strengthened yen, the parent company and its several subcontractors are required to integrate their VE activities. Such joint efforts succeeded in substantial cost reduction in many cases.

Cost reductions, however, invited a further rise in the value of the yen. Large corporations have come to restructure their business setups in a medium-to long-range perspective. According to a survey on big businesses by Fair Trade Commission, as shown in Table 2, the ratio of sales of main lines of products to total sales of the companies under review had declined from an average 86.7 percent in 1979 to 80.2 percent in 1986. This shows the progress of diversification. A similar ratio taking account of subsidiaries as well was even lower, 62.1 percent in 1986, reflecting the percent companies' diversification into new areas through their subsidiaries.

The average number of subsidiaries per parent company was 26.5, and the ratio of their contributions to the group's overall sales was as high as 34.1 percent. Moreover, the proportion of non-main line sales of both parent and subsidiaries was already over 50 percent in the precision machinery-appliance, textile and nonferrous metal industries. The corresponding proportion in the general machinery-appliance sectors was over 40 percent.

The diversification of big corporations into new sectors has resulted in loosening of their traditional ties with regular subcontractors, and at the same time motivates them to look for subcontractors in the new sectors. In their main lines of business, of course, their orders tend to go to subcontractors that offer specialized technological services. Reflecting these moves, associations of

subcontractors for a large company are increasingly being disbanded. Thus business ties in group companies have undergone liberalization.

Subcontractors are stepping up strategic moves away from their subcontracting status, as an increasing number of subcontractors are turning out products of their own. This trend has developed through the sequential phases of component processing, component production, functional component production, production of finished items on an original equipment manufacturing (OEM) basis and finally production of finished goods of their own brands. In other words, an increasing number of subcontractors are reorienting themselves to domestic demand by developing their own products.

Secondly, subcontractors are expanding their scope of business by supporting other companies entering into new fields. A subcontractor makes such an attempt in two possible ways: to offer sophisticated technology to win orders from another company going into a new area of business, and to cooperate in the development of a new product.

Another activity is multi-sectorial development of highly specialized technology. For instance, a subcontractor could apply its technology for ultrahigh-precision processing to, and seek orders from, several industries. The higher the subcontractor's technological standards, the more widely it can expand its scope of business. This kind of specialization in processing technology can be another way to step out of a subcontractor status.

Inter-corporate relations are now taking the shape of networks. Corresponding to relationships between big corporations and their subcontractors, specialized companies are linked together in new combinations. As a matter of fact, organizers are bringing subcontracting firms together

across established vertical links. Human networks are being developed in complex way with the organizers playing a key role. Also being activated thereby are strategic alliance between small businesses or between big and small businesses.

Structural Changes in Inter-corporate Relations

Now, inter-corporate relations are also developing inter-regionally and internationally. The productive functions of assembling industries (general machinery/appliances, electrical machinery/appliances, transport machinery/appliances and precision machinery/appliances) are decentralizing from the Keihin (Tokyo-Yokohama) industrial belt to the Northern Kanto, Koshu and Tohoku regions. Since the mid-1970s, increased importance has been attached to research and development, resulting in a mushrooming of research institutes, many of which are located within a 50-kilometer radius of Tokyo, at arm's length from the Tokyo headquarters of the respective companies. Productive functions, linked with research institutes, are scattered along express motorways radiating from Tokyo. Along with the high rise of land prices in the Keihin area, both big and small manufacturers have set up factories along the Tohoku, Kanetsu and Chuo expressways.

Not surprisingly a growing number of subcontracting firms are starting business in these localities. Thus, the area within a 300-kilometer radius of Tokyo has become a sphere of Tokyo-based productive activities—a huge linkage of industries. Factories in Northern Kanto and Nagano Prefecture, in particular, do not just receive orders from the Keihin district. Subcontracting complexes have been built up in these regions, where intra-regional industrial links have grown in depth.

The means of information and high-speed transit and transportation systems (especially door-to-door parcel delivery service) constitute the infrastructure for a geographical broadening of a division of labor. The East is much preferred to the West in the location of assembling factories, many of which are linked with Tokyo.

Further, procurement of parts from abroad on a develop-import basis and the establishment of overseas factories are gradually increasing; resulting in further international specialization, which is developing not just for parts but also for finished products.

Along with this inter-regional and international specialization, changes are also taking place in the intra-regional division of labor in the Keihin area, where companies excelling in soft functions are playing on increasingly important role.

Among smaller subcontracting enterprises, closures have begun to emerge though bankruptcies are relatively rare. This tendency is particularly conspicuous in the Keihin district, where land prices are sky high. Since subcontractors are

more and more called on to have soft-oriented capabilities, companies lacking in adaptability tend to give up well before they run into a real crisis. This point is well illustrated in Table 3.

The ability to develop, design and improve soft has become vitally important a factor that differentiates one business from another. Those lagging behind in this respect lose out. Of course, new businesses are begin built up on the basis of such a capability.

New Manufacturing

As we have seen, the strong yen is giving rise to new types of manufacturing industries. Against the background of an affluent society, sophisticated manufacturing industries are developing. These manufacturers constitute sectors in which advanced nations enjoy relative advantage, and they are emerging despite the hollowing out of some traditional sectors. Their characteristic features can be summarized as follows:

Table 3: Types of Subcontracting Transactions

1 Closed	}	Open (disaffiliated)
2 Customer-supplied drawings		Subcontractor-developed products (in technology)
3 Equipment-centered		Proposal-centered
4 Low value-added		High value-added
5 Processing		Finished goods
6 Price-fixed		Price-improved
7 Mass production		Non-mass production
8 Stable		Unstable

- (1) Creative activities: with high value-added products.
- (2) Customer-oriented: highly functional and emotionally appealing products are developed.
- (3) Mainly turning out a wide variety of products in small quantities: generally medium or small-sized companies.
- (4) Organized in a flexible way: engaged in business activities that are highly adaptable to changes.
- (5) More interested in profits than in increasing sales.
- (6) Customer service, especially in soft aspects, is emphasized.
- (7) This new breed of manufacturing enterprise is emerging in every industry.

The appreciation of the yen has induced every industry to switch to a pattern which is neither solely export-oriented nor import-oriented. An industry of this pattern typically would import

economy models, locally produce medium to high class goods, and import some luxury items. Accordingly, what can be successfully located in Japan are new types of industry producing high value-added products. These industries remain competitive because they can overcome the high rise of the yen and are highly likely not only to cater to domestic demand but also to begin exporting again. Goods which meet the exacting standards of Japanese consumers may well find a large market in other advanced countries. Yet, since most of these goods are high value-added items, exports will not grow quickly.

Among this new breed of manufacturers are independent smaller organizations, while others are small internal divisions or subsidiaries of big corporations. Table 2 may suggest how the latter are developing. Independent smaller companies and small units of big businesses vie with each other. The strength of the former seems to lie in their energetic entrepreneurship.