

JAPANESE INDUSTRIES IN THE CHANGING ENVIRONMENT: UNDER YEN APPRECIATION AND RISING PROTECTIONISM

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I. Corporate Strategy under Yen Appreciation

1. Economic Environment

In the wake of the G5 Plaza Agreement concluded in September 1985, yen value in terms of the U.S. dollar sharply appreciated from 240 (47%) to 125 (47%) by late December 1987. This hit corporations directly through decreased export earnings resulting from reduced sales prices and from increased product imports. This appreciation of the yen in the short time span involved forced revenues down by 24.1% in 1986 over 1985.

On Black Monday, October 19, 1987, the New York stock market fell 22.6% after having trebled in five years. By October 24, investors in the U.S., Japan, and Britain were more than 1 trillion dollars poorer. But the Tokyo market was hit less hard than the others. And, real economic growth is expected to continue at between 2 and 3% in most advanced countries with low inflation. OECD forecasts that if all goes well from now on ward, there will be no full-blown recession in 1988 or 1989. Still, the next two years will see a slowing of growth in all of the five largest economies, and higher unemployment in all but one of the fine. The Japanese government concluded in its economic plan for 1988 FY that real economic growth would 3.8%, higher by 0.1% than in 1987. The contribution of domestic demand would equal 4.7%, less 1.0% in external demand. And for the next two years, Japanese industry will have fewer export opportunities owing to expansion of the domestic market, yen appreciation and general world economic stagnation. Industry also understands that the exchange level of the dollar over the next few years will be weak relative to other major western

currencies, thus requiring companies to become truly global corporations in marketing and production.

2. Adjustment to the New Environment

Japanese export-oriented industries such as iron and steel, shipbuilding, automobiles and home electronics under the yen hike have witnessed both seriously depressed business results and increased production costs, particularly to in respect Asian NICs.

In past yen appreciations, Japanese corporations had the advantage of cheaper import raw material prices and could offset increased production costs by rationalization of production and increased selling prices. During 1977 and 1978, raising prices in foreign currency was fundamentally effective. For example, producers of seamless steel pipe and automobiles could fully recover increased costs by raising export prices. But in the present depressed world market absorbing increased production cost through rasing price and rationalization is all but impossible.

In terms of labor cost, Japanese corporations have no advantage over American industry. Labor costs in US manufacturing industries in 1980 was 7.5% higher than comparable Japanese figures, but by 1986 4.3% lower. In the case of the Honda Motor Corp., export costs for a Japanese plant and the production costs in the most efficient US plant were at a par at 150 yen/dollar, and at 125 yen/dollar, there are clearly limits of rationalization in each production step.

Export oriented-industries must examine overall corporate strategy in two major areas: the maintenance of the world market by further internationalization, and the reorganization of domestic production by reviewing the business base. This theme will be discussed later.

Most Japanese corporations are geared to an export-oriented industrial strategy rather than one domestic-demand related. But, despite stagnating export-oriented industry, domestic demand-based industry is booming.

II. Prosperity in Domestic Demand-Oriented Industries

1. Restructuring the Growth Base from the Export-Oriented Sector to the Domestic Demand-Oriented Sector

In the past several years, the Japanese government has examined the restructuring of the economic growth base from the export-oriented to the domestic demand-oriented as noted in the Maekawa report. And, an expansion policy toward domestic demand, starting in 1987, has held sway over Takeshita's new cabinet.

In terms of expansion of domestic demand, sound fiscal administration is changing to a more positive role and growth industries based on exports are being considered as domestic demand-related industries in a broad sense, including the automobile, home electronics and semiconductor sectors which are changing their growth area from exports to the domestic market. Newly registered Japanese cars in 1987 will number 4.3 million units, the highest sales ever recorded in Japan. Car makers forecast sales at 4.4 million units in 1988.

Domestic demand-oriented industries include construction, housing, food, pharmaceuticals, apparel, leisure, department stores, supermarkets and other service industries. These are expected to be prosperous sectors through market

expansion under the positive fiscal policy. Promotion of public works and housing construction are main thrusts of the domestic-demand expansion policy. Housing starts in 1986 FY registered 1.4 million in spite of soaring land prices in urban areas and will increase to the 1.6-million level in 1987. As reference, there were 1.13 million and 1.25 million housing starts in 1982 and 1985, respectively. This main reasons for this are considered as follows: first, reduction of loan interest by the Housing Loan Corp. to 4.2% which is the lowest in Japanese experience, second the private interest rate for housing loans declined greatly, third increased investment in rental housing for tax-saving purposes. Recent total construction of rental housing marked 53% and this trend will continue in 1988.

Public sector investment in infrastructure in 1987 was planned at 6 trillion yen or 48 billion dollars by means of the supplementary budget. Investments by the private sector also increased by 20% over that of 1986.

2. Growing Consumer Market

The Japanese consumer market increased in terms of food and pharmaceuticals, standard goods of higher quality, such as imported furniture, higher grade clothing, jewelery, precious

metals, paintings. New home electronics products, large-sized TVs, compact discs, washing machines, refrigerators and other white goods, have unexpectedly shown growth sales in two digits. These durable consumer goods show buying as renewal demand for the baby-boom generation and as extended demand in new housing investment.

As noted in the U.S. and Europe, trade frictions between Japan and those entities result

from complicated distribution channels in Japan, thus the distribution industry is being forced to undergo further rationalization and simplification through direct imports.

Therefore, the distribution industry can be expected to be a growth sector under continuing yen appreciation, assuming an appropriate strategy.

III. Adjustment of Export-Based Key Industries

1. Changing Corporate Environment

Japanese corporations have been internationalizing rapidly with increasing overseas operations including direct investments and import of processed goods. The reasons for increased overseas operations can be pointed out firstly as globalization of business activities through the development of telecommunication systems. This leads to integration of internal and external markets. Corporations can now select the most suitable sites for world-wide production and sales beyond the restrictions of national boundaries. Thus, they are tackling development of international networks for business information, planning, research, production and sales. The second reason is the diffusion of trade friction for increased numbers of countries and goods. The third is the rapid industrialization in Asian NICs. Direct overseas investment in Korea was 65.5% in terms of annual average growth during 1981 and 1985, and in Taiwan the figure was 19.5%. Thus, it cannot necessarily be said that the sharp yen appreciation is the basic reason for internationalization.

Japanese corporations are increasing outsourcing of capital and intermediate goods. MITI's survey on parts and raw material supply from overseas, conducted in January 1987, showed that 39.2% of those products came from Asia, 28.6% from the U.S. and 21.4% from Europe.

Particularly, supply from developing countries is increasing sharply and it is considered that lowered prices result from the yen appreciation and that quality and capacity have been improved.

Japanese OEM (original equipment manufacturing) exports are greatly increasing under demand by overseas customers and in terms of the expansion of the export market. Technology exchanges with developed and developing countries are progressing in the chemical industry followed by general machinery, electric machinery, transport equipment and precision instruments.

2. Increase of Overseas Production

Direct Japanese foreign investments recorded 10 billion dollars in 1984 FY and 12 billion dollars in 1985 FY, a 20.3% increase over the previous year. In 1986 FY, the figure reached 22.3 billion dollars, which is an 82.7% increase. Most companies intending expansion of overseas production plan to expand overseas production facilities now in operation without newly opening overseas plants. Caution is the watchword for new investment to avoid foreign exchange risks.

However, as a means of coping with the continuing appreciation of the yen, direct overseas investment in the U.S. and Asian NICs is rapidly growing. Direct investments in the U.S. target assembly industries, including automobile, electronics and machinery. They intend to avoid trade friction and exchange risks, and collect market information. Investment in Asian NICs is aimed at economizing production costs by lower labor costs. Improvement of quality of products and parts is an attractive element for foreign direct investments in the Asian NICs.

Recent revision concerning foreign investment earnings regulations in Asian NICs and ASEAN members are also inviting foreign investments reflecting the international thrust of deregulation and privatization. Japanese direct investment, particularly in high-tech industries, in Thailand and Malaysia have increased about two times as compared with 1986 during January to October in 1987, with a 40% increase in Indonesia. This trend can be observed in the formation of production triangles between Japan, Asian NICs and ASEAN members. In these circumstances, small and medium-sized businesses are

also increasing overseas investments for their organizational survival.

3. Variation of Production Strategies in the Automobile Industry

Most Japanese automobile companies are moving their production plants to the U.S. In 1988, such production will number about 1 million units. In 1990, Japanese automobile production in the U.S. will increase to 1.6 million and the Big Three will produce 800,000 compact cars per year. In addition to this, Korean Taiwanese, Yugoslavian, Mexican and Brazilian makers will export about 600,000 units to the US market. 1990 will be the year of the most severe auto sales competition in the US market.

Honda Motor Co. plans to produce 500,000 units in the U.S. by 1989 and during this phase, will export US-made Hondas to Japan and Europe. Some auto parts makers, which have close relations with their overseas customers, have started to move their factories overseas.

Owing to growing overseas production, there is the worry of the hollowing-out of domestic production and unemployment problems in local areas where these factories are located. In fact, Japanese overseas production is creating a total of 900,000 new jobs in the world, 700,000 within the manufacturing industry and 480,000 in Asia.

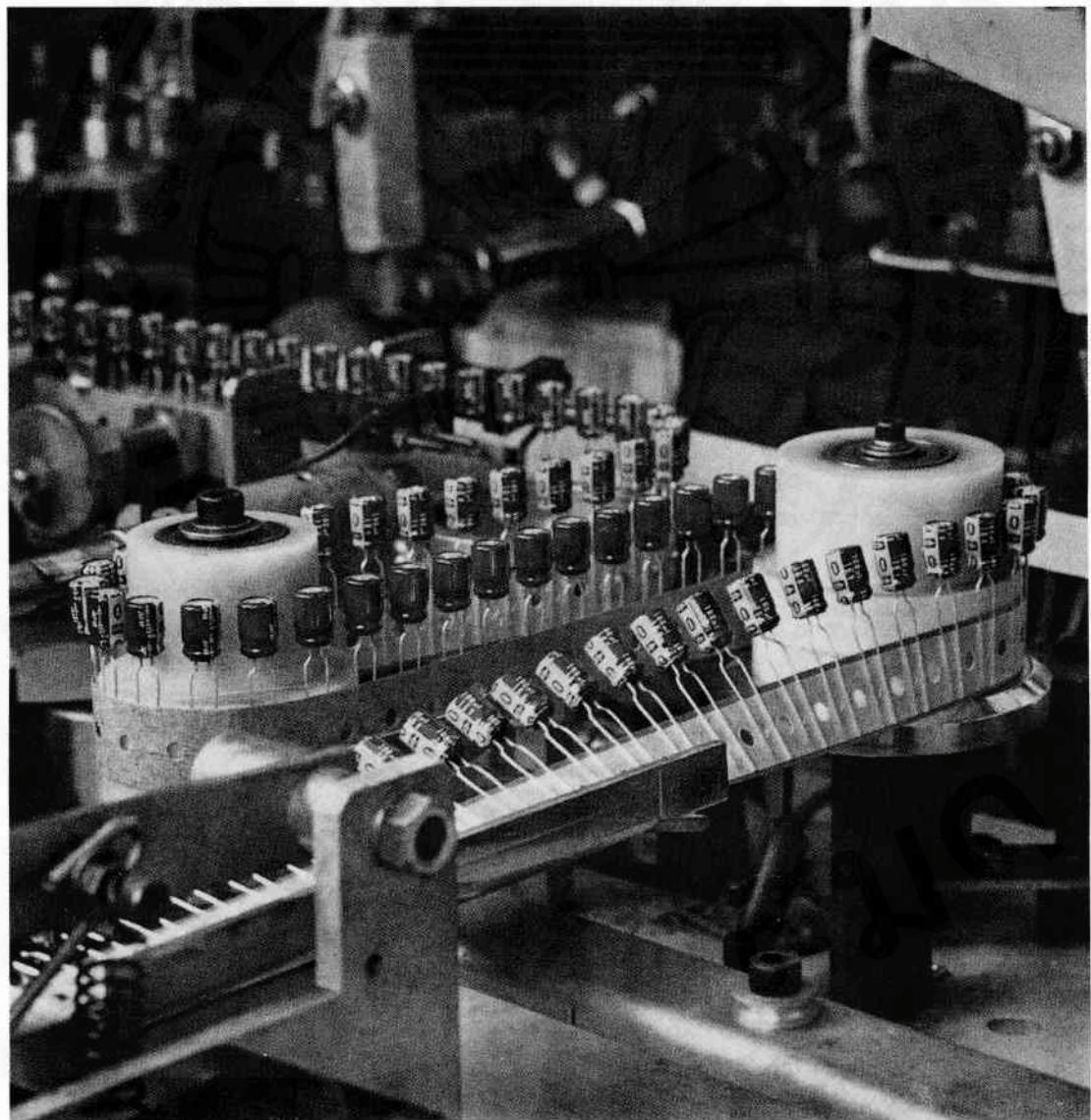
However, unemployment problems will be occur shortly after the expansion of additional overseas investment, especially in the area of small business. Japanese iron and steel and shipbuilding industries have had bitter experiences with scrap and build policies, suffering from

restructuring and shifting of unemployment to other prosperous sectors, such as high-tech and service industries.

Fortunately, domestic car sales are growing in 1987 because of booming renewal demand brought about by full model change and aggressive sales campaigns by dealers. Sales of 6 million units are expected, 43% of total production.

4. Maintenance of International Competitiveness in Electronics Industries

The Japanese semiconductor industry has 90% of the world market in 256 KDRAM and close to saturation in the 1 MEGA market.



As they have extraordinary international competitiveness in terms of production scale, quality and market share, this industry is faced with controlling exports under the Japan-US semiconductor agreement which is based on a policy of reciprocity in consideration of the trade balance plus the concern of the semiconductor industry as a basis for US national security. Japanese semiconductor makers are, under such changing market situations, shifting their products to more advanced

technological products such as 4 MEGA and moving factories overseas to be nearer to their customers for producing custom ICs. Leading electronics parts makers are expanding their U.S. and South Asian facilities in order to adjust cost increases by about 20% in terms of domestic production and for more quickly responding to customer requests. Some electronic parts, which are no longer high value-added products, such as the fixed resistor, are produced 100% overseas.

IV. Hollowing-Out of Basic Industries

The yen appreciation following the 1970's has until now been most severe on basic industries such as iron and steel, shipbuilding, coal, aluminum and other raw material industries. Consequently, agriculture, fishing and other primary industries have deteriorated. There were large work cutbacks and they have been forced

to discontinue their business or diversify their production. Depressed local areas which are dependent on such depressed industries are strongly grappling to determine their long-term planning. The government should prepare suitable labor-planning studies for the unemployment to follow the aging society later in this century.

V. Conclusion

Japanese industry is now coping with dramatic yen appreciation and increasing protectionism.

Industry has the fundamental ability to adjust to the new corporate environment by upgrading products, increasing research and development, shifting production facilities to places of lower production costs and by diversifying to entirely different fields such as computer-software communication, leisure, service and as yet unknown new industries. Japanese employers and employees generally have survival capabilities and enthusiasm for the continuation of their organization as their laudable custom, since Japan has both a

long history of isolation and the knowledge to promptly adjust to a new environment as a peripheral nation.

The economic vitality of the Asian and Pacific regions has shown in recent decades great promise toward playing the leading role in the stagnated world economy. The dynamic and diverse interactions between developed countries, NICs, and developing countries may be showing a new formula for resolution of North-South problems.

Asia-Pacific countries and Japan are working together in their desire to realize the Asia-Pacific century.