Manufacturers Face Troubles By Dozen

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Japanese manufacturers have long complained about the “six hardships” they face in trying to do business these days, but to these woes another six can be added.

The sluggish global economy is one. Japan's territorial disputes with its neighbors is another potential obstacle to deeper business relationships.

A third has to do with Japan's two-tiered labor market: Large companies were once reluctant to lay off regular employees, but after sales fell sharply following the financial crisis triggered by the collapse of Lehman Brothers in 2008, some companies had no choice but to cut payrolls.

NEC Corp. (6701) announced Aug. 28 that 2,393 domestic employees had signed up for early retirement. One of its affiliates, NEC Tokin Corp., has already eliminated 250 domestic jobs and let 2,700 of its overseas employees go. In all, more than 5,000 employees worldwide have decided to walk away from NEC.

Litany Of Complaints

Sharp Corp. (6753) announced its own voluntary retirement program the same day, which applies only to costly Japanese employees. The company expects around 2,000 employees to take the offer by December. As previously reported, Sharp plans to reduce its workforce by about 10,000, or roughly 20% of the global total.

Other manufacturers may follow the lead of NEC and Sharp, who were ultimately forced to withdraw from loss-making businesses to maintain their borrowing capacity.

The biggest reason Japan's widget-makers are struggling seems to be a lack of creativity compared with years past. But top executives prefer to blame the six well-known obstacles they face, namely, the strong yen, high corporate taxes,
rigid labor regulations, greenhouse gas reduction targets, slow progress on free trade agreements, and power shortages.

One can argue that even at today's foreign exchange rates, hourly wages and welfare costs for factory workers in Japan are comparable to those in other G-7 countries. But in the consumer electronics sector, Japanese companies' toughest rivals are South Korean giants like Samsung Electronics Co. and LG Electronics Co. The combination of the strong Japanese yen and the weak South Korean won is a strong headwind for Japanese firms.

**Double Trouble**

In addition to the six problems mentioned above, six new ones should be taken into account. First, the global economy is slowing. According to Japan's Finance Ministry, the trade deficit for July came in at 517.4 billion yen, the worst ever for the month. The European debt crisis and the slowdown of the Chinese economy pushed exports 8.1% lower on the year to 5.31 trillion yen.

Second, an insider trading scandal involving large securities firms has depressed the market for equity finance. After the "Lehman shock," loss-making large companies often floated additional shares. But their underwriters sometimes leaked information to hedge funds ahead of the official public offering announcements, which let the hedge funds sell the shares short, buy them back at lower prices and pocket the difference. That has hardly created enthusiasm for new share floatations.

Third, territorial disputes with Korea and China have flared up and may be bad for business. Many South Koreans and Chinese still harbor anti-Japanese sentiment, which makes Japanese goods and services vulnerable to consumer boycotts.

Fourth, Japanese workers who jump ship or are pushed may find a home with Korean and Chinese companies, bringing valuable know-how with them. Even now, Japan's overseas rivals are waving cash under the noses of people with advanced technical skills. This trend is likely to accelerate.

Fifth, boom and bust cycles caused by government handouts for the purchase of certain products on the one hand and the rise in the consumption tax on the
other may create instability for businesses. One reason why Sharp is in trouble is the spike in demand for LCD TVs last year. The end of analog broadcasting, together with government subsidies for the purchase of new gadgets, created huge demand for TVs. The spike may be followed by a slump lasting three years.

Sixth, an unstable political situation creates headaches for companies trying to come up with long-term strategy. Regulatory uncertainty may also stifle investment.

Whether Japanese manufacturers can overcome this "dirty dozen" obstacles will mostly depend on recapturing their lost creativity and coming up with the sorts of new, world-beating products for which they were once famous.

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