

moneybox

Japan's Creaky Conglomerates

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Though it didn't attract too much attention here, last week was a momentous time in Japan. For the first time since the years immediately following World War II, two of the country's--and the world's--largest companies, Hitachi and Toshiba, reported losses in the fiscal year's first half. These companies are models of the Japanese-style conglomerate, diversified across nearly every industry that has anything at all to do with electronics. For almost 50 years, they've been profitable. But even they have found it impossible to ride out the Japanese recession in the black. And with the exception of Sony, these companies' peers--Mitsubishi, Matsushita, NEC, and Fujitsu--are all in similar straits, though most managed to eke out minor profits in this first half.

Much of what has happened to these companies is simply the result of the Japanese consumer's--and, by extension, the Japanese corporation's--hesitancy to buy. (In retrospect, the Japanese government's decision to increase the sales tax from 3 percent to 5 percent a year and a half ago was probably not the best idea.) Domestic TV shipments, to take only one example, have declined in 11 of the last 12 months in Japan. Industrial production was projected to fall 1.1 percent in the month just ended, and is expected to decline again in November, and corporate capital investment is dropping. While the corporate giants are true multinational companies, and while until recently they have benefited from the weak yen, the domestic market still accounts for as much as half of their sales. Not surprisingly, then, the Japanese recession has meant that these companies' revenues, as well as profits, have declined.

Nonetheless, it's also time to entertain the possibility that these companies are suffering from more than just the national malaise, and their woes reflect a problem with the strategy of conglomeration itself. While the 1980s and early 1990s saw U.S. companies divest themselves--either through sales or spin-offs--of those parts that didn't fit what became known as their "core competences," the Japanese heirs to the *zaibatsus* have blissfully continued to make everything under the sun. Hitachi, for instance, makes mainframes, semiconductors, PCs, elevators, escalators, industrial robots, power plant equipment, ceramic materials, wire, stereos, air conditioners, refrigerators, and washing machines, while also building nuclear power plants and delving into property management. Toshiba is best known here for its PCs (I actually own two) and its DRAM semiconductor business. But the company also makes, among other things, TVs, air conditioners, washing machines, and glass. (Glass?)

Now, there something's a little too easy about saying "No company can make so many different things well." In the first place, for much of this century some of the largest American companies did make many different things. In the second place, perhaps the best American company--GE--is still essentially a conglomerate. Still, GE is probably the exception that proves the rule. While a certain measure of diversification may be important to allow companies to cushion themselves from product-specific downturns, the record of the last 15 years suggests that those companies that try to do a few things well do better than those that try to own the planet. Dell Computer makes PCs and servers and that's about it. Coke makes soda. And Microsoft makes software (well, and those weird talking dolls).

What's worth keeping in mind, though, is that the superiority of the "core competence" approach is historically specific and not universally true. Corporate diversification along the lines of a Hitachi or a Matsushita actually makes sense when internal capital markets--those within the corporation--are more efficient than external capital markets, and some economists have argued that this was true in the United States until the deregulation of the financial services industry in the 1970s. In other words, if the external

capital market is not competitive, it will not be rigorous in the way it allocates capital, nor in the way it prices capital. (In other words, money will be too expensive.) Under those conditions, corporations may be better served by funding their operations internally.

Today, though, capital markets are, relatively speaking, competitive, and an investor who wants to diversify away risk can do so much more easily by buying a portfolio of many different companies rather than investing in one large, diversified company. In addition, smaller companies have easier access to outside financing, financing that has the additional virtue of disciplining poor corporate performance instead of subsidizing it. Toshiba announced last week that it would be dividing its operations among nine subsidiaries next year. But it would be worth the company's while to ask what purpose keeping those subsidiaries under one umbrella serves, and whether everyone wouldn't be better off if each of them were pushed out of the nest.

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