
Monthly Blog

# PM's Perspectives

**April 2021**

## Corporate losses spur the upgrading of industrial structures

I wrote a report titled "Why do we invest in Japan where the population is declining"[*1] in 2017. What I meant there was industries advance by going through industrial development, economic downturns and development through the process of de-industrialisation. I concluded the essay with the hope that Japan would undergo further development in the 2020s through de-industrialisation now that the country was ready to accept capital and talents after corporate governance reforms and the relaxation of visa regulations in the 2010s. Today, I would like to review how these reforms have made progress in terms of corporate earnings and management policies, rather than in terms of macroeconomic policies such as Abenomics.

**Upgrading of Industrial Structures in each country:**

| Era | UK | US | Japan | China |
|---|---|---|---|---|
| 1940 | Industrial development | Industrial development | War defeat | Planned economy |
| 1950 | Industrial development | Industrial development | Reconstruction | Planned economy |
| 1960 | British disease | Industrial development | Industrial development | Planned economy |
| 1970 | British disease | Inflation | Industrial development | Planned economy |
| 1980 | Thatcherism | Reaganomics | Industrial development | Reform and opening-up by Deng Xiaoping |
| 1990 | Development through deindustrialization | Development through deindustrialization | Lost two decades | Industrial development |
| 2000 | Development through deindustrialization | Development through deindustrialization | Lost two decades | Industrial development |
| 2010 | Development through deindustrialization | Development through deindustrialization | Abenomics | Industrial development |
| 2020 | Protectionism ? | Protectionism ? | Development through deindustrialization? | Economic stagnation? |

Source: SMDAM, created April 2021. Data taken from various resources.

In the 2020s, manufacturers started to enter into non-manufacturing industries. For example, **Sony Group** transformed itself from being a maker of electronics (such as home appliances) to the entertainment company that provides online network games, movies and music as well as the financial company under the helm of Mr Yoshida. The chemical company, **JSR**, announced at their latest management policy briefing that it will cut down its traditional petrochemical unit significantly and focus on life sciences including contract drug development as well as semiconductor materials.

These companies decided to reshape themselves because they didn't have hope for future earnings growth in their loss-making manufacturing units. Big losses in the TV unit business due to the rise of South Korea and China led Sony to a change of business structure, while a series of plant expansions abroad including in China by competitors produced persistent losses in JSR's elastomer unit, leading to the cutback of the unit.


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As noted above, the manufacturing industry usually falls into the red due to the rise of newly industrialised countries. Manufacturers in the Western economies, including the UK and the US, lost its competitive edge from the 1960s to the 1980s when Japan emerged as a manufacturer of products including home appliances, which prompted the Western economies to reshape their industrial structures through de-industrialisation. The similar restructuring was repeated again from the 1990s to 2010s when home appliances/ petrochemical businesses in Japan suffered losses due to the rise of new industrialised economies such as Korea and China.

When a company falls into the red, a reformist tends to take up the post of the top manager. We can list many examples in addition to the above-mentioned Mr Yoshida of Sony and Mr Johnson, the first foreign manager of JSR. In the materials industry, Mr Hashimoto, the CEO of **Nippon Steel,** is shutting down domestic production facilities for general-purpose products. While he is planning to focus on high-value-added steel production, the company may transform itself to a non-manufacturer with CO2 reduction technologies, IT services, engineering work and so on as core businesses. In the chemicals industry, **Mitsubishi Chemical Holdings** is expected to significantly reduce its general-purpose chemicals business under it first foreign and outside CEO, Mr Gilson.

Companies are often operating in the red with decrepit facilities, which fuels managers' enthusiasm for reforms. Plants that were built during a period of industrial development become useless with an increasing number of malfunctions and rising repairs costs when the company enters into the period of reform about 40 years later. Given that the life of plants is limited, top managers have to decide whether to pour JPY10 billion plus to build new plants or invest the same amount of money in some new business areas. This review serves as a chance to transform their business portfolios.

ESG also propels the progress of reforms. The materials industry began to reduce the ratio of businesses that generate huge quantities of emissions amid increased its awareness of the environment (E), while companies have been encouraged to close loss-making units, lift the ratio of variable compensations for management, raise the ROE, increases the number of outside directors and establish a nominating committee amid increased awareness of governance (G). This didn't happened in the past.

What I wanted to communicate in this report is that there are a couple of factors behind the development through de-industrialisation, such as losses the manufacturing sector in addition to policy props. When companies are operating in losses, they may be forced to do something new under a reformist leader given new entrants abroad and decrepit facilities at home. In recent years, ESG is also providing a boost to new reforms.

Reference:

[1] Original report written by Takuya KAMIISHI, SMDAM. Data correct as at 10 November 2017.
https://www.smd-am.co.uk/wp-content/uploads/2021/05/PMs-Perspectives-10-November-2017.pdf

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Mr KAMIISHI joined Daiwa SB Investments in 2009 and covered US & European equities as a strategist from 2010 to 2013. He moved to Hong Kong in 2013 as an analyst for the auto & industrials sector in Asia Pacific ex-Japan equity. In 2015, he returned to Japan and covered the IT & services sector as a Japan equity analyst. In 2016, he became a portfolio manager in the Value + Alpha group.

Mr KAMIISHI obtained a BA degree in Economics from Keio University (2009) in Japan.

Note: Daiwa SB Investments Ltd. (DSBI) merged with Sumitomo Mitsui Asset Management Company, Limited (SMAM) on 1 April 2019.

## Disclosures



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