Industrial Evolution

Japan's Economy Gains Steam From Manufacturing Heartland

Nagoya-Area Factories Dodge Woes of U.S. Rust Belt; Autos Lead the Recovery

'Up the Value-Added Curve'

By JATHON SAPSFORD

NAGOYA, Japan—In this Detroit-like landscape of auto plants, blast furnaces and machine shops, manufacturers have figured out how to produce something their competitors in America's Rust Belt have not: robust growth.

The economy of Central Japan's industrial heartland is booming, so much so that it is helping lift the world's second-largest economy out of 15 years of doldrums.

Property values in the provincial capital are surging. Packed restaurants are turning away customers. Tiffany, Armani and Coach have opened ritzy boutiques along its boulevards. Chauffeured sedans line up after hours waiting on executives cavorting in bars and nightclubs.

The rest of the country is now searching for the lessons to be drawn from the "Nagoya boom," which helped boost Japan's gross domestic product by 3.3% in its fiscal first quarter ended June 30. Nagoya's economic engines are the very businesses so often derided in other developed countries as "sunset industries": autos, machinery, steel, ceramics and chemicals. Yet in Nagoya, these industries are thriving in the face of low-cost global competition.

The developing world is teeming with manufacturers aiming to grab business from Japan, where costs are higher than anywhere else in Asia. Nagoya's manufacturers have kept them at bay with a maneuver now being copied by producers across Japan. They moved production of low-end products overseas, but continued to make lucrative high-end goods at home. Demand is growing for such products, which range from engines for hybrid cars to micro-robots for industrial use. To maintain its competitive edge. Nagoya spends robustly on research and development.

Other developed countries have tried this dual-track approach to manufacturing, with far less success. In the U.S., public companies have found it difficult to invest as much in research because of pressure to maintain consistent quarterly financial returns, economists say.

On Saturday, Delphi Corp., the largest U.S. auto supplier, sought Chapter 11 bankruptcy protection. The Troy, Mich.-based company, which operates plants in China, plans to shut down a substantial portion of its U.S. manufacturing operations.

Thus far, manufacturers in South Korea and China have been unable to mimic Japan's cutting-edge technologies. Some of the biggest customers for Nagoya's state-of-the-art machine shops, in fact, are other Asian manufacturers.

Richard Jerram, an economist for Macquarie Securities in Japan, attributes Nagoya's success to "moving up the value-added curve, particularly in areas like autos and machinery."

The boom is generating the kind of economic numbers not seen in Japan since before 1990, when the nation's stock market began its long slide and the economy slowed to a crawl. Shipments from Nagoya's port, now the busiest in the nation, increased 10% last year. Profits rose last year at 71% of the companies listed on the Nagoya Stock Exchange. Nagoya area manufacturers now account for half of Japan's trade surplus with the U.S. There are 1.6 jobs for every job seeker in the Nagoya region, forcing big local employers to hire migrants from China and Brazil.

For the 7.2 million people who live in the region, there is sweet vindication in this. They had long been ridiculed as provincial dullards with sing-song accents and a hankering for grilled eel on rice. During the heyday of Japan's
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"Bubble Economy," the frugality of Nagoya’s industries stood in dull contrast to the high-profile deal-making of the banks and property developers of Tokyo.

There were times when it seemed the rest of Japan was making fools of us," says Takashi Suzuki, the fourth generation president of Suzuki Violin Ltd., based in an industrial district of Nagoya. "There was once talk the bullet train— which zooms through Nagoya from Tokyo to Osaka— wouldn’t even stop in Nagoya.

Secrets of Success

Today, business consultants are talking about the region’s business practices in management seminars. Book stores are stocking quickly written titles such as "Nagoya: The Shock of the World’s Most Powerful Economy" and "The Methods of Nagoya’s All-Powerful Merchants." The fashion magazine JJ ran a spread on the matronly look of the region’s strong-willed women, under the headline “Elegant! Powerful! Appealing to Mother-in-Law!” Toy maker Takara Co. released a “Rika-chan” doll, Japan’s Barbies-equivalent, with a “Nagoya Lady” look: hairly curled, heavy eye shadow.

Manufacturing has been Nagoya’s livelihood since the 19th Century. The region, which stands between Tokyo and the ancient capital of Kyōto in the south, has long prided itself on its tradition of “monozukuri,” or craftsmanship. For centuries, the region’s hamlets competed to construct the most intricate wooden theater dolls, a custom that continues to this day.

Industries sprang up to produce everything from straw tatami mats to textile machinery. In 1937, Toyota Motor Corp. was spun out of a textile machine maker. Nagoya was targeted by Allied bombers during World War II because it produced the agile Mitsubishi “Zero” fighter planes.

Toyota, which is building a new headquarters across the street from Nagoya’s bullet train station, is one of the biggest engines of the region’s economy. Toyota is growing faster than any other major car maker in the world today. Many of the more than 500 companies that supply parts to Toyota are also thriving.

Toyota’s new president, Katsuaki Watanabe, maintains that the boom isn’t just about Toyota." About 60% of Nagoya’s industrial base is nonautomotive. Tool maker Makita Corp. and steelmaker Daido Steel Co. are both located near Nagoya, as are fax machine and printer manufacturer Brother Industries Ltd. and Yamaha Corp., one of the world’s largest makers of musical instruments. The area’s kilns turn out everything from industrial tiles to fine china from Noritake Inc. Big diversified industrial companies, including Mitsubishi Heavy Industries Inc., run their aerospace divisions out of Nagoya, which is also home to a slew of suppliers to other industries, including die-casters, paint processors, and metal pressers, molders, grinders and refiners.

Thousands of engineers and factory managers from around the world have been traveling to the region to observe. The World Expo 2005, held outside of Nagoya, drew delegations from Florida, California, New Mexico and other states. Michigan Gov. Jennifer Granholm paid a visit, despite the fact that many of her home-state constituents blame layoffs in Detroit on competition from Toyota. But Toyota is building plants across the U.S., and Michigan wants a piece. “My goal is to import jobs,” the governor explained.

The region’s success challenges some of the conventional wisdom about what went wrong with Japan’s corporations. Throughout the economic slump, government advisers and private-sector economists alike said repeatedly that long-standing Japanese customs like lifetime employment and cozy shareholder arrangements were inefficient and no longer fit for a modern corporate system.

‘There were times when Japan was making fools of us,’ Suzuki. Today, business about Nagoya’s business: and books are touting it

ent outside managers and board members, and appealed to shareholders with a U.S.-style system that rewarded managerial performance rather than seniority.

But many Nagoya businesses resisted such changes. They adhere to a staunch, conservative brand of Japanese corporate governance. Seniority is respected, shares are held by affiliates, suppliers or other loyal allies, and employees sign on for life. Companies are run exclusively by managers who work their way up the ranks.

Outsiders are rare at most corporations. Toyota doesn’t have a single non-Japanese director on its executive board, despite drawing an estimated two-thirds of its operating profits from the U.S. “We don’t want to include a foreigner or a woman just for the sake of including one,” says Mr. Watanabe, the president.

There is intense loyalty to insiders. For 86 years, Yamazaki Mazak Corp., one of the world’s largest machine-tool makers, has been run entirely by its founding family. The founder’s son is chairman. The chairman’s son is the president. A fourth generation is being groomed for the future. The family owns all shares in the company. Even when things hit a rough patch in
Nagoya’s ‘Sunset’ Industries
recent years, the company did not consider layoffs.
"Never," said Teruyuki Yamazaki, the chairman, dismissing the idea with a wave of his hand. "Employees are the biggest assets of this company. How can we cut them?"

As a closely held company, Yamazaki doesn’t disclose profits. But sales were up 35% to $15 billion in the most recent year ended March 31. In the Nagoya area, orders for machine tools rose 12% in June, the 63rd consecutive monthly increase.

Like many Nagoya manufacturers, Yamazaki has a two-pronged approach to dealing with low-cost foreign competition. It produces in Japan its most complex machine tools, so-called multitalented devices that work metals with multiple latches simultaneously. It makes less sophisticated machines at low-cost plants in China.

Likewise, Brother Industries produces high-end industrial sewing machines in Japan, but makes the bulk of its fax machines and printers in China, Malaysia and elsewhere. All told, 57% of Brother merchandise is made abroad.

Toyota churns out Corolla compacts and Camry sedans in plants all over the world. But its premium Lexus vehicles, and its popular Prius model and other hybrids that use both gasoline and electricity, are made only in Japan. Recently, it has grown comfortable enough to mass-produce the Lexus and the hybrids that it is planning to slowly roll out production overseas.

To maintain a pipeline of new high-end products for its Japanese factories to build, Nagoya-area firms spend amply on research and development. The intricate web of cross-shareholding that ties many of them together makes it easier for them to set aside capital for such long-term purposes.

Toyota, for example, holds shares of many of its suppliers. These suppliers in turn own shares of Toyota. If Toyota decides to spend money developing new products instead of reporting it as profit or returning it to shareholders as dividends, it is unlikely to hear complaints from supplier shareholders. Many of Toyota’s U.S. competitors, in contrast, focus more sharply on the quarterly bottom line to satisfy shareholders and analysts.

The Nagoya approach "doesn’t necessarily mean you don’t generate returns for shareholders," says Paul Sheard, an economist at Lehman Brothers in Tokyo. "It means you have the freedom to make the best cars, and you don’t have the capital markets breathing down your neck."

During the 1980s, many Japanese companies ran into trouble by borrowing against appreciating real estate to make trophy acquisitions, from antique cars to landmark New York real estate. When the stock and real-estate bubbles popped in the early 1990s, those loans went bad, causing a slump from which big parts of Japan have yet to recover.

While Nagoya too experienced a slump in the early 1990s, it bounced back quickly. One big reason, executives say, is its frugality, a Japanese version of New England thrift. When Nagoya recently built a new airport, it was finished two months early and nearly $1 billion under budget. In an article entitled "The DNA of Nagoya’s Almighty Prosperity," weekly news magazine AERA noted that the average Nagoya family spends $1,200 a year on entertainment, compared with a $2,100 nationwide average. Nagoyans spend less on their cell-phones, and they tend to save more than the rest of the nation.

A History of Thrift
Nagoya executives say their thrift arises from a deep-seated aversion to waste. Toyota’s president, Mr. Watanabe, recalled recently that when he joined the company 40 years ago, he was put in charge of corporate cafeterias. He studied eating habits with an eye toward eliminating waste. His breakthrough came when he noticed uneaten rice in many employee bowls. He modified the lunch line, forcing employees to fill their own bowls. "This way they could take as much as they wanted," he explained, "it reduced waste." As a result, Mr. Watanabe was selected for a team of young executives charged with finding production improvements across the company, and his career took off.

This economy now extends into the executive suite. Toyota is expanding production around the globe, but the costly investments weren’t begun until it had stooped $30 billion of cash.

A Rodin sculpture towers above the entrance to Yamazaki’s headquarters. The hall to the chairman’s office is lined with works by Picasso, Sisley and Monet. Yamazaki paid cash for all of it.

"They call us stingy," said Mr. Yamazaki, the chairman, sitting in his paneled office below a painting by 18th-century French master Francois Boucher. "And in some ways, they may be right. But we’ll spend when the time is right."