Sogo bankruptcy may signal new era in Japanese finances

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The decision by the Mori government to abandon its plans to bail out the debt-ridden retailer, Sogo Co Ltd, is being widely interpreted as a turning point in Japanese financial affairs, opening the way for similar liquidations of corporate bad debt.

The government's proposed bailout of Sogo, which collapsed last month under the weight of 1.87 trillion yen ($17.3 billion) in debts, attracted criticism both from international money markets and from within Japan. But it might have gone ahead had it not been for a new factor in the financial equation—one of Sogo's debtors was foreign owned.

The Japanese banks were reportedly prepared to go along with the bailout in line with the so-called convoy system under which Japanese corporations have propped each other up in the event of financial difficulties. However the Shinsei Bank, owned by the US firm Ripplewood Holdings after it purchased the defunct Long Term Credit Bank of Japan, would not participate and the deal collapsed.

The $9.5 million sale of LTCB to the Ripplewood group, involving General Electric Capital, Mellon Bank, Paine Webber, ABN Amro Bank, Deutsche Bank and Citicorp Unit Travelers Insurance, was the first sale of a Japanese bank to foreign interests. It may have far reaching consequences.

According to a comment published in the London-based *Financial Times*, “some local businessmen and politicians are critical of Shinsei's ‘American-style' lending approach.”

Pointing to the longer-term implications, it concluded: “Ultimately, the Sogo tale suggests the ‘bottom up' pressure for reform is building. Letting foreign investors, such as Ripplewood, into the Japanese banking sector has started a chain reaction with consequences that extend well beyond banking: many politicians may prefer to see business as usual but it will not be easy to stuff the reform genie back in the bottle.”

Similar views were expressed in an article in the *Australian Financial Review*, which held out the hope that the collapse of Sogo was opening the door for foreign investment in the Japanese economy and for the restructuring demanded by international markets.

“The collapse of a major business has rarely been greeted with such euphoria as that which met the decision by Sogo Co ... to apply for bankruptcy protection,” it declared.

It went on to point out that the Sogo collapse had “encouraged investors and the public to believe that finally the mess of Japan's bubble years of the late ‘80s might really start to be cleaned up, not swept under the carpet. ‘Creative destruction' is the popular phrase and in this case it is apt. It is a very Western concept, alien in Japan where traditionally nothing failed and no one lost face.”

The comment concluded by noting: “The influence of globalisation and market forces are becoming irresistible in Japan and it is fitting that another Western vulture fund, Cerebus—the dog at the gates of Hell—is the first to have stuck its hand up as interested in the remnants of Sogo.”

The *Financial Times* said the decision of the government not to proceed with the bailout “shocked the markets, even in a country used to dizzingly high debts” but that what was more surprising was the manner of Sogo's demise. Most investors had assumed that Sogo would be “saved” either by the government or the banking sector. “Bailouts are a common feature of Japanese corporate culture and the business community had no reason to believe Sogo would break the tradition. But Sogo's collapse has shown that reform pressures are slowly building in Japan. What is particularly intriguing is that they have been partly sparked by the arrival of foreign banks."

And the Sogo collapse will by no means by the last, and perhaps not the biggest. Last week, Seiyo Corporation, a real estate unit of Seibu Department Store Ltd, filed for special liquidation with debts totaling 517.5 billion yen ($4.79 billion).

Media reports and business analysts said the collapse was a fresh reminder of the instability of Japan's corporate sector, particularly in "old economy" sectors such as real estate and retailing which accumulated huge debts during the period of expansion in Japan's "bubble economy" a decade ago.

In the words of Miki Shimogori, Tokyo correspondent for Reuters: "Like Sogo and Seiyo, many of the companies fueling Japan's rising bankruptcy levels are firms that built up a huge exposure to property values a decade ago such as retail, construction and real estate companies. Some analysts fear that with a halving in property prices since a peak in the late 1980s when Japan's asset price bubble burst, more of these companies will seek protection."

And that will in turn hit the banks, which lent these firms money on the basis of vastly over-priced assets.

The latest figures show that Japanese bankruptcies have increased for the eighth consecutive month. According to Teikoku Databank, Japanese corporate bankruptcies in June rose 21.2 percent to 1,560 cases compared to 1,287 cases in June 1999, topping the 1,500 mark for the fourth month in a row.

Kimitaka Kuze, head of Japan's Financial Reconstruction Commission, reported last week that debts left behind by insolvent companies in June grew 1.8 percent to $17.27 billion compared to $17 billion the year before.

The Sogo and Seiyo collapses will add to the worsening employment and social conditions of the Japanese working class.

No official estimates of the Sogo job losses have been released, but they will have a flown-on effect throughout the economy. The company employs nearly 10,000 people and if part-time workers and the families of full-time employees are taken into account about 50,000 will be directly affected. Then there is the impact on the 10,000 or so companies which have a connection with Sogo, often as suppliers, and a host of other companies which have an indirect connection with the department store chain.

But the corporations, banks and international markets are looking to the gains to be reaped from the new orientation. In the words of the *Financial Times*: "There will be short-term difficulties: jobs will be lost and taxpayers will have to pick up the irrecoverable loans. But the benefits will more than compensate. Japanese banks, besieged by requests to waive corporate debts, can stiffen their resolve to resist. The restructuring of the Japanese corporate sector can continue."

But it will not be without political consequences. The Mori government and subsequent regimes will face an increasingly difficult balancing act as they confront the growing hostility of working people on the one hand and increasing pressure from international finance capital for "restructuring" of the economy on the other.