Deadbeat Days
It's Japan's Paradox:
Troubled Banks Buoy
Their Ailing Borrowers
Mr. Suzuki Has Come to Rely
On Lenders to Lighten
His Machine Shop's Load
‘Go Ahead and Foreclose’

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TOKYO - Debt and recession are hammering Takao Suzuki's machine shop, but his bankers won't let him fail, And in that regard, he isn't unique: His is only one among thousands of businesses, big and small, that Japan insists on keeping afloat - at great economic expense.

Mr. Suzuki and his company, Suzuko Kogyo K.K., owe five banks a total of nearly $2 million, more than 10 times the revenue he expects this year. Yet his banks keep rolling over his debt and lowering his interest rates even though he is having trouble paying back his old debts. “Without that,” Mr. Suzuki says, “I would have gone under by now.”

That's easy to believe. Business has never been worse for the 61-year-old Mr. Suzuki. In one corner of his shop, his 56-year-old sister, one of three employees, slumps over and kicks a foot-operated press that curls aluminum into covers for little motors. The technology, Mr. Suzuki says, is a century old. The other two machines in his shop are more modern, but profit margins have collapsed for the heat-treated aluminum bars they produce.

“I can't invest in new technology,” he says, “It's tough now. Very tough.”

This lament isn't particularly surprising, coming from Tokyo's Ohta Ward. Here, six thousand or so family-run machine shops bang out goods from stamped metal to high-tech components for products bearing names like Hitachi and Mitsubishi. Dozens of these businesses fail each year, What is surprising, at least to the non-Japanese eye, is how few are failing especially as Japan confronts its worst recession since World War II and tries to cope with banks that are so bad off they need public funds to survive.

“Most companies here still get money when they need it,” says Shinichi Matsumoto, an officer with a local-government fund that helps finance Mr. Suzuki. The government continues to lend money in Ohta, as do friends and customers. Banks are still lending, too, because the bizarre economics of Japan’s bad-loan problem make it rational to keep financing companies like Mr. Suzuki's.

True, much of corporate Japan remains financially sound. And the government recently surprised everyone by cutting off funds to Yamaichi Securities Co. and other weak companies and letting them fail - a trend that will probably grow. But a vast swath of the economy is kept alive with injections of cheap capital, including many businesses, large and small, that are ailing because of promiscuous borrowing that began in the mid-1980s.

Japan's refusal to let a lot of companies fail is a big reason behind the nation's banking
woes. By refinancing deadbeats, banks are able to keep loans out of their bad-debt columns. That’s why, when Japan’s top nine banks were forced recently to disclose more of their portfolios, bad loans jumped by $30 billion to $90 billion.

In essence, the bailout habit subsidizes uncompetitive companies to the detriment of stronger companies, stunting the survival-of-the-fittest principle that is a key element of the market economy. So despite reports of a ruinous credit crunch, companies such as Mr. Suzuki's keep rolling over their loans - even as business sours and the debts pile up.

Mr. Suzuki has so many loans he can't keep them straight. “Which loan is this?” he asks his wife, Yoriko, 58, at their home. He picks up a bank statement from a pile on the tatami-mat floor and passes it across a low table to her. It is from Johnan Shinkin Bank, one of the Suzukis' five lenders. The loan is for about $150,000 - not too big for Mr. Suzuki - but more than he expects his business to earn in operating profit this year.

Mrs. Suzuki, who handles the finances, will take this statement to the bank in a few days and ask its loan officers to cut the interest rate. They have already cut it twice. “They'll lower it,” she says. “I'm sure they will. You watch.”

Mr. Suzuki secures his loans with what ever he can: His home, his rental property, his land. A $1.2 million loan from Bank of Tokyo-Mitsubishi, Mr. Suzuki's biggest lender is backed by a claim on a building on which three other banks also have claims. But the property’s value has plummeted, so foreclosure would mean losses that the bank can ill-afford to absorb.

“We’re in a very tight spot right now,” says a Tokyo-Mitsubishi official. The Suzukis have their bankers over a barrel because the banks can’t afford more losses. “I’ve never defaulted on a debt,” Mr. Suzuki says later. “I’m not a bad loan.” Technically, he’s right: As long as he pays even part of the original interest on his loans, the banks won’t put him on their bad-loan ledgers.

Ohta Ward isn’t a special case. For all its talk of letting markets choose the winners and losers, Japan keeps lending to the weak along with the strong. The government's new $120 billion economic-stimulus package includes a fund to finance small businesses. The Ministry of International Trade and Industry has its own small-business-support program that often lends to debt-laden companies. City halls, country seats and ward offices across the country have emergency services that keep others afloat with new loans.

Cultural factors also play into the willingness to tend. Corporate debt carries little of the stigma in Japan that it does in the U.S. In the years after the war, bank debt was seen as the conservative way to raise capital; bond markets barely existed and stock markets were deemed unseemly and were closed to most companies anyway. Also, Japan encourages high debt by taxing corporate equity heavily. “Japanese businesses run on debt,” says Kiyohiko Kawahara, manager of a Johnan Shinkin branch in Ohta Ward who has lent to Mr. Suzuki for three decades. “Debt is the way we do things here.”

Sometimes Mr. Suzuki borrowed just to develop a relationship with a banker. “You have to have a track record even if you don't really need the money,” he says. That view is part of a deeply rooted fear of a funding crunch, born of a long history of capital shortages and unsavory lenders. In 1921, when Mr. Suzuki's father founded Suzuko Kogyo and began producing gears and ball bearings, bankers wouldn't lend to him. He turned to loan sharks who charged rates as high as 100%.

In 1966, Mr. Suzuki's father passed the business to his son. Japan was entering its high-growth period. Suzuko Kogyo grew with it, making motor coils and car parts. The company got its first large bank loan that year from a government-run bank, the People’s Finance Corp. It
lent the Suzukis $3,500 to extract themselves from money lenders. “It felt like we had finally made it,” Mr. Suzuki says. “I began borrowing money whenever I could.”

Suzuko Kogyo’s fortunes soared in the 1970s as it settled on making aluminum noise reducers for cassette-player motors. Annual sales topped $1 million, and total borrowings from two banks hovered at $120,000. “That capital meant we could grow,” Mr. Suzuki says.

Then came the period that ultimately would define Japan’s rise and fall - and that would enlist Mr. Suzuki into his small role in Japan’s bad-loan mess. In the summer of 1986, the dollar fell to 150 yen from 260 yen in only a few months. Suddenly, Japanese exports were less competitive, and Mr. Suzuki’s clients began dropping him for cheaper Asian suppliers. Sales slid to about $300,000 in 1987 from nearly $1 million in 1985.

The Bank of Japan lowered interest rates to sustain growth. Bank lending grew by double digits each year, property values soared, and the stock market was off on a long bull run. Meanwhile, Mr. Suzuki needed to invest in technology that his Asian competitors couldn’t undercut, and Mrs. Suzuki was worried about college funds for their two sons. “We needed money,” she says. “Lots of money.”

Between 1987 and 1990, Suzuko Kogyo’s debt at People’s Finance jumped to about $400,000. Mr. Suzuki borrowed an additional $500,000 from the government-run Japan Finance Corp. for Small Business. From Johnan Shinkin, their borrowing would peak at roughly $700,000, including money spent on college fees for their sons and back taxes. On the eve of the 1990s, the Suzuki’s borrowings exceeded $3 million.

During the late 1980s, banks were fighting to outlend one another. Regulations dictated funding costs and lending rates, so the only way to compete was through volume. “Bank of Tokyo-Mitsubishi - back then it was Mitsubishi Bank - came around and begged us to take out a loan,” offering $1.2 million, Mr. Suzuki says. “I said, ‘What would I use that money for?’” Mr. Suzuki recalls. “The man said, ‘Buy stocks’ So I did.”

Lenders weren’t looking at Mr. Suzuki’s cash flow. Even before his borrowing peaked, Suzuko Kogyo’s revenue had fallen to $250,000 a year. Then Tokyo stocks plummeted. The Suzukis soon felt the weight of their interest payments. They sold their stocks at a sharp loss. “We began to lose sleep,” Mrs. Suzuki says. “We wondered how we would survive.”

The answer lay in still more debt, freely proffered. In 1990, Mr. Suzuki began tapping Ohta Ward's informal capital network. A machine-shop cooperative borrowed on his behalf. The Ohta Ward office extended him an emergency loan in 1992. Tsuyoshi Nakayama, a factory owner who often slips extra contracts to Mr. Suzuki, chipped in with two emergency loans of about $100,000. “The economy was slowing, and we had to help each other,” he says.

The banking crisis worsened, Mitsubishi Bank threatened to foreclose. Mrs. Suzuki remembers a meeting at the bank. “I cried and cried,” she says. “But I told them, ‘Go ahead and foreclose. You have the fourth mortgage on our property. You won't get anything after you pay off the other banks.’”

The bank won’t comment, but the numbers back up Mrs. Suzuki. Property values in their neighborhood have fallen an estimated 60% to 80% from the day in 1989 when Mitsubishi Bank first lent them money. The mortgage document shows the bank was the last to lend on the property, meaning it would collect whatever is left after the other lenders exercise their claims. Mr. Suzuki says the bank originally lent to him at 8% but then rolled the loan over - and over again; he says it cut his interest rate to 5.6% in 1993 and then to 3% in 1995. “They'll lower it again later this year,” he says. “I'm sure they will.”

About a month ago, Tokyo-Mitsubishi reported about $6.5 billion in losses for the year
ended March 31 as a result of bad-loan write-offs. Its capital has eroded dangerously close to levels at which it would have to rein in lending. “If a bank doesn't want to take more losses,” says Akiyoshi Inoue, president of Sanyo Systems K.K., a property-appraisal company, “it has no choice but nurse a troubled landowner back to health.”

It is Mrs. Suzuki's job to exploit that largess. One day in May, she walks into the local branch of Johnan Shinkin and greets friends and tellers. “I'm going to need your help today,” she says cheerily to a loan officer. She walks, uninvited, into a conference room; the loan officer rolls his eyes and follows. Mrs. Suzuki later reports that the loan officer cut the Suzukis' rates on the condition that one of her sons open a certificate of deposit. “We're not too worried,” says Mr. Kawahara, the branch’s manager. “The sons are both doctors.”

At the current pace, it will take Mr. Suzuki at least 15 years to pay off his creditors, and that’s only if sales stay steady. “What we fear more than anything else is putting a burden on our children,” he says. The one conclusion he never reaches is that his company may not survive. After all, the loans keep flowing. “I promise not to die,” he says, “until I pay it back.”