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A "NEW JAPAN"?
REAL ECONOMIC CHANGES TO A TRADITION-BOUND CULTURE

Our goal is not simply to reconstruct the Japan that existed before March 11, 2011, but to build a new Japan.

– Prime Minister Yoshihiko Noda

After struggling through the trials and tribulations of 2011, Japan, Inc., seems focused on making significant changes in the way the country's government and corporations are structured and operate. Critical attributes that made Japan, Inc., so successful in the past, namely keiretsu, kaizen *and* suriawase*, are undergoing revision, if not elimination. Japanese corporations are undertaking practices that seem contrary to those once-valued characteristics. They are: outsourcing production to replace domestic production, engaging in new international arenas, collaborating with competitors, forming national champions and changing corporate culture. Some roadblocks in the process lie ahead, but these kinds of changes could bring about a "new Japan."*

Trouble in the Factory

Bad economic news from Japan has become routine. The country's national debt has reached 215 percent of its gross domestic product (GDP), and that GDP itself declined 8 percent in the four years ending last September, all while the GDP deflator moved downward at a rate of 1 to 2 percent per year for 12 years, indicating persistent deflation. (*Financial Times*, 2/23/12; *Caixin*, 3/23/12)

And then there was the world's worst natural disaster of 2011 – a "triple whammy," as it has been called, with an earthquake measured at 9.0, a tsunami rising 128 feet above the shoreline and a nuclear meltdown with yet-to-be-determined longitudinal effects. Japanese officials underestimated the earthquake's power, miscalculated the tsunami's size and misinformed the public on the scope of the nuclear failure. This kind of bad news – of natural and human disasters exacerbated by official incompetence, if not malfeasance – combined with economic bad news to prompt calls for a reassessment of current practices, a serious rethinking of the way Japanese business and government have operated for nearly 60 years. (*Nature*, 3/8/12; *The Week*, 3/23/12; see **Special eFocus**, 5/23/11)

We have been noticing some actions in the public and private sectors that indicate substantive decisions are being made by companies and the government, decisions that could well end the constant economic bad news and bring Japanese companies back to the forefront of global business. Even as the triple whammy sent shock waves through Japanese society and awoke many leaders from what seemed like a complacent slumber, an ongoing motivation driving the Japanese to undertake significant changes can be seen in the following anomaly:

◆ In 2011, J. D. Power & Associates ranked Lexus, Honda and Acura numbers one, two and three in its annual Initial Quality Study, yet the global market share of Japanese cars has declined for three years straight. (*Nikkei Weekly*, 2/6/12)

What global markets value in an automobile has been changing, even as Japanese manufacturers have stubbornly maintained their structures and practices, attributes that in the past placed them among the most prized brand names in international business. The sophisticated, precision cars that Japanese manufacturers have produced over the years no longer attract as many buyers. South Korean, European and American cars have been expanding their market shares in the U.S., China and elsewhere. The triple whammy that paralyzed domestic manufacturing last year seems to have brought about a rethinking of what was called the Japan Model.

Japanese business leaders have come to recognize several realities of the global marketplace. Japanese workers earn 2.5 times as much as their counterparts in Seoul, 10 times that of Chinese workers in Guangzhou and a whopping 30 times the wages of Vietnamese workers in Ho Chi Minh City. Meanwhile, electricity costs for industrial users in Japan are roughly twice that of other industrialized countries, including South Korea. As Japan shutters its nuclear facilities, energy costs will likely go even higher. Last year, Japan's importation of natural gas increased 74 percent from the year earlier, and petroleum imports jumped 13 percent, both largely attributed to the Fukushima disaster. Moreover, international competition (what we have called the Effects of Large Numbers) has increased prices on critical raw materials, creating additional cost problems for Japan's manufacturing giants. These realities sent Japanese exports down an uncomfortable 8.5 percent last year compared to 2010 and down 9.3 percent in January 2012 compared to January 2011. (*Nikkei Weekly*, 3/19/12; *Atlanta Journal-Constitution*, 2/21/12; *Financial Times*, 3/9/12)

Recent revelations about the condition of Japanese companies suggest the problems they face are structural, not just temporary setbacks from last year's triple whammy.

◆In the past 12 years, Japan's six major electronics firms have lost a net $2.6 billion. Just last year, Japan's shipment of televisions fell 21 percent, a much greater decrease than any of the manufacturers anticipated, leading to massive inventory buildups of LCD panels at companies such as Sharp, whose LCD prices were not competitive with China's, the world's leading LCD maker. Prior to 2000, Japanese electronics companies dominated global markets, serving as one of Japan's two export pillars, automobiles being the other. (*Nikkei Weekly*, 2/6/12 and 2/13/12)

◆Tokyo's new energy buyback program, which will take effect this coming summer, is intended to encourage deployment of solar cells in homes, a way to reduce pressures on the electricity grid. Companies from China, Canada and Europe are planning to enter the market with solar-cell prices 70 percent below those of Japanese companies. (*Nikkei Weekly*, 12/19/12)

"Wait... I always thought taking each other for granted was a good thing!"

These are the kinds of durable, substantive challenges that Japanese companies face, and evidently that reality has finally penetrated the inner sanctums of Japan, Inc.

"We can solve our problems with a merger, a government bailout, or actually producing something worth selling."

Changing the Business Culture

The incredible success of Japanese manufacturing companies in the post-World War II era has been based on several specific structures and practices, namely *keiretsu* (interlocked groupings of corporations), *kaizen* (continuous improvement) and *suriawase* (high-precision manufacturing). The first brought together complementary corporations, interlaced their shareholdings and delivered highly desired stability. The second called for relentless pursuit of modest and ongoing changes to enhance product quality, a way to trim fat or increase productivity without revolutionary change. The third part of the structures-and-practices issue involved a corporate-wide focus on high-level, sophisticated capabilities, honed to make sophisticated products. Together, these structures and practices made Japanese companies the benchmark in technological manufacturing and provided them with a corporate structure seemingly immune to hostile takeovers.

But now, those same companies are too slow to make the kinds of significant changes that other global manufacturers are making constantly, and they seem bogged down by their traditional consensus management, unable to make leaps in quality and to compete in price in the global marketplace. That is to say, the very things that raised Japanese products to high levels of market acceptance are now standing in the way of those same Japanese companies keeping pace with the shifting needs and wants of the global marketplace.

"It probably wouldn't work."

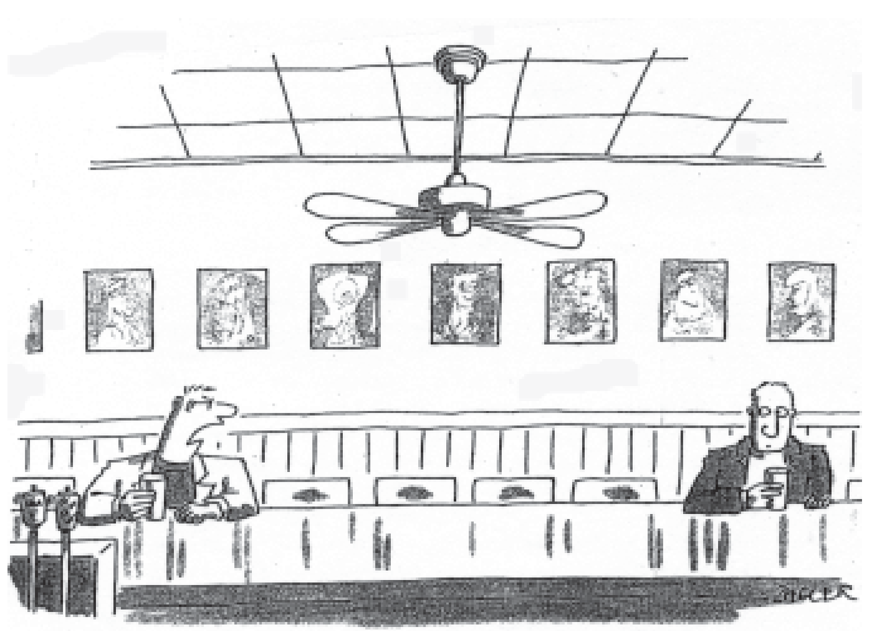
Yet, some things are changing. Several Japanese companies are taking actions that are in line with what other international companies have been doing, even though these actions are mostly new to Japan's traditional business culture.

Outsourcing production to replace domestic production – For years, Japanese companies have been dispersing production facilities around the world, but, for the most part, this internationalization has represented an extension of domestic capabilities. That is changing. Onkyo, the high-end audio-equipment manufacturer, recently announced that it would close a speaker factory in Japan, a facility that currently produces 30 percent of the company's output, and move it to China, where the company hopes to lower costs between 10 and 30 percent – that is, the dispersal of Japanese production capabilities to international sites no longer complements domestic production; international sites are now replacing domestic production. Meanwhile, in

2010, 114 Japanese companies established production facilities in Vietnam, where they hoped to exploit the significant wage advantage that the country offers; in 2011, the number of Japanese firms shifting to Vietnam rocketed to 2,008. The Japanese government is spending money to assist Japanese companies move facilities. For instance, Tokyo is providing financial support for the expansion of shipping facilities in Vietnam's Lach Huyen port in Haiphong, where more Japanese products will enter Vietnam and more Japanese-produced goods will exit Vietnam. (*Nikkei Weekly*, 1/30/12; *Financial Times*, 2/10/12)

Engaging in new international arenas – Japan is putting the finishing touches on an Islamic bond market, seeking to encourage issuers of such bonds, especially from Malaysia and Indonesia, to use the Japanese facility. The government passed a law last November that allows investors to share in profits instead of charging interest, a critical characteristic of the *sukuk*, the Islamic bond. Also, Japan has entered into an agreement with China to enable Tokyo to purchase Chinese government bonds. Japan and China announced plans to promote the use of their own currencies for bilateral trade. China is already Japan's largest trade partner, and these countries' using their own currencies, rather than constantly pricing everything through U.S. dollars, could expand the volume of their bilateral trade. (*South China Morning Post*, 12/21/11; *Nikkei Weekly*, 3/12/12; *Financial Times*, 12/28/11)

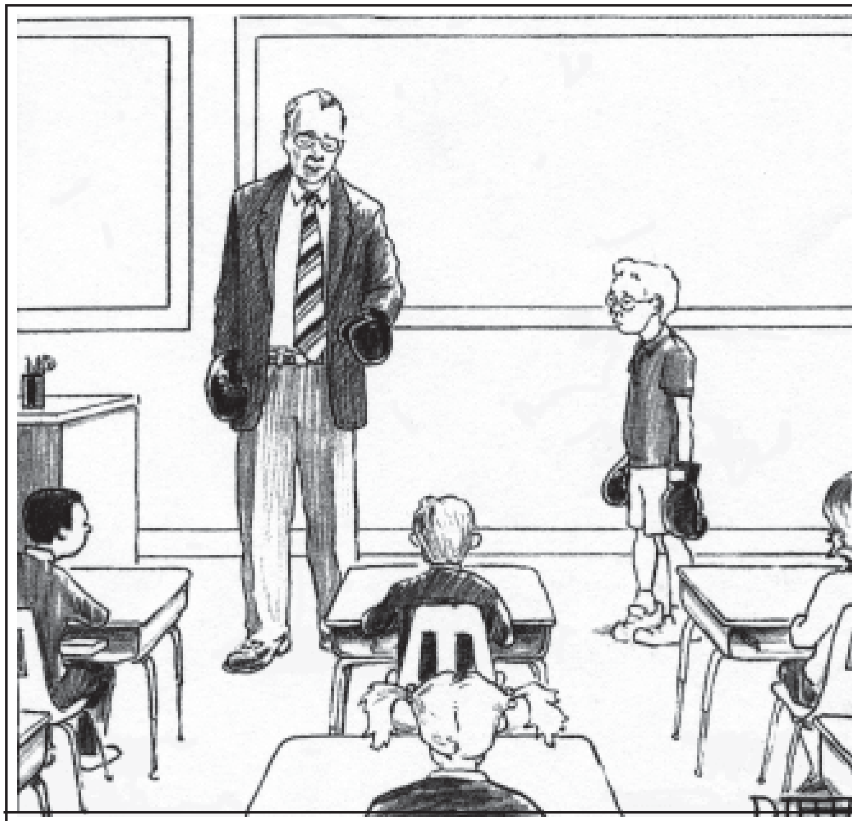
Collaborating with competitors – Panasonic's president, Fumio Otsubo, admitted that one reason for his company's poor performance was one of its basic policies, a policy shared by most *keiretsu*: "We tried to do everything on our own." The automobile industry is shifting away from that model. Toyota recently procured diesel engines from BMW rather than develop its own Japanese version. Nissan is cutting back on research-and-development costs by working on common car platforms as well as mutual-supply chains with Renault and Daimler. As Honda's president, Takanobu Ito, explained, "We are going to change our business operations and production systems in response to the globe's paradigm shift." (*Nikkei Weekly*, 2/6/12 and 2/12/12)



"Hey, you! Wanna be my best friend?"

Forming national champions – Tokyo has decided to engage in industrial development and is working to create national champions backed by the government, similar to those forged by Moscow and Beijing, as a means to make Japanese companies competitive again. The Innovation Network Corporation of Japan (INCJ) is a government-funded institution created to focus on Japan's growth opportunities, especially where inefficiencies stymie competitiveness. It brought together competitors Panasonic, Fujitsu and Renesas (itself a merger of chip businesses from Hitachi, NEC and Mitsubishi) to create new chip-making capabilities for the large-scale integrated (LSI) chip market in order to compete with the South Koreans and the Taiwanese. The INCJ also brought together liquid crystal display (LCD) units from Sony and Hitachi to form Japan Display. The government's Japan Industrial Solutions Group (JISG), which was created in 2010 specifically to help companies break free of confining *keiretsu* structures, was brought in to address the three-year run of losses at Sumco, a joint project of Mitsubishi Materials and Sumitomo Metal Industries and the country's second-largest producer of silicon semiconductor wafers. The two management teams were in constant disagreement about operations, and Sumco was suffering from a lack of action at the top. To circumvent that traditional corporate issue of being slow to make decisions, the JISG will essentially push the two corporations aside and attempt to turn around the enterprise, using funds from three large Japanese banks, Bank of Tokyo, Mitsubishi UFJ and Sumitomo Mitsui Banking Corporation. And of course, all of these activities will be aided by Tokyo's efforts to lower the price of the yen. (*Financial Times*, 2/9/12 and 2/10/12; *Nikkei Weekly*, 3/12/17)

Changing corporate culture – Honda has acknowledged that *kaizen*, the continuous improvement model, is no longer effective in global markets because changes in international markets are taking place faster than mere "improvement" can match. Instead, the company has shifted to simpler designs and fewer parts – thereby also breaking free of the high-precision manufacturing of *suriawase*. Honda has shifted strategies to imitate the Volkswagen model of cost-efficient manufacturing based on enormous economies of scale, creating cars with interchangeable parts, simpler technology and easier repair. Similarly, Toyota is working on roughly 170 major components that can be shared across several models in its fleet. More brazenly, Rakuten Ichiba, Japan's largest online marketplace, was created seemingly in opposition to traditional corporate structures and has benefited, with annual sales of $4 billion in 2010. The company's founder, Hiroshi Mikitani, is not shy in explaining how Japanese corporations are misaligned with contemporary markets. "Japanese companies cannot keep doing what they have been doing," he noted, and then added, "We need to change the mindset of every single Japanese person." As if to show the way forward, Mikitani recently switched the company's official language from Japanese to English, and in just one week in January, he decided Rakuten Ichiba should purchase Kobo, a Canadian e-reader manufacturer. Such brash and speedy corporate behavior is anathema to traditional Japanese companies. "We are going to be very aggressive," Mikitani has explained. "You need to be agile and have vision" – a very un-Japanese perspective but perhaps an intimation of the new Japan. (*Guardian Weekly*, 2/10/12; *Nikkei Weekly*, 2/6/12)



"O.K., class, today we're going to learn about survival of the fittest."

Where Does This Lead?

In the decades after the OPEC-triggered energy crisis of 1973, Japan tripled its GDP without increasing its use of energy, developing in the process some highly efficient energy-use systems. Meanwhile, Japan's companies have produced pumps, irrigation systems and water-saving devices that have made Japanese agriculture among the most efficient in the world. Given that roughly 70 percent of the world's water use goes to agriculture, the developing world, especially China, India and sections of Africa, is finding its way to Japan's doorstep. In short, Japanese technology is set to become a critical component of advancing economies in need of efficient use of water and energy. (*Nikkei Weekly*, 3/19/12)

Recently, Japan's Emperor Akihito made a controversial speech to mark the one-year anniversary of the earthquake-tsunami-meltdown triple whammy, and he noted that a "formidable task" lay ahead in dealing with radioactive contamination. The speech was broadcast live, but news outlets replaying the speech that evening cut that part of the emperor's message because it conflicted with official government statements that the problems had been solved and that the area where radioactive contamination took place was now safe. Yet just days after the Emperor's speech, Tokyo Electric Power Company admitted that a new reactor leak had sent tons of radioactive fluids into the local environment and the Pacific Ocean, and the government acknowledged that some radioactivity levels in the area of Fukushima were higher than reported earlier. (*Atlantic*, 3/12; *New York Times*, 4/6/12)

These two observations – Japanese expertise in emerging critical arenas and internal censorship – highlight contradictory pressures within Japanese culture. The Japanese have the technology that the world needs, and changes in corporate structures and practices could put them in a better position to exploit that advantage. Meanwhile, denial of the need for change and even of the need to acknowledge reality – as "censoring" the Emperor indicates – still runs through much of official Japan, another hindrance to cultural change.

Yet examples continue to surface of companies and the government circumventing structural limitations and changing traditional practices in an effort to make Japan globally competitive again. The new Japan, should it continue to emerge, could move Japanese companies back to the core of global markets and lift the country's economy out of its two-decade slump.