Five Surprising Facts

- In April 2008, Japan marked 73 months of economic growth.
- In March 2008, Japan’s current account balance surplus increased for the 6th straight year. It reached its highest level since 1985 (¥24.6 trillion).
- For FY 2007, Japanese listed firms posted record combined pretax profits for the 6th year in a row.
- Between January 2003 and 2007, the Nikkei 225 stock market index increased by 100%.
- Leaders behind this growth include companies such as JSR, Nitto Denko, Teijin, Softbank, Astellas.

Strategic Inflection Point

- "A point in time when industry dynamics are altered so profoundly that there is a fundamental change in what it takes to win." (Burgelman/Grove)
- An irreversible change in the competitive environment so that the balance of forces shifts away from previous ways of doing business to new ones.
- Examples in business history: the arrival of telephony, mechanical refrigeration (shipping), the semiconductor, the internet, ....
1998-2006: Japan’s Strategic Inflection Point

- Banking crisis
- Globalization ("hollowing out"); imports reach Japanese markets
- Political entrepreneurship ("Leave it to the Market")
- Social distress (crime, suicides, homelessness)

In 1998, Japan reached a tipping point.

- Irreversible change in laws, processes of regulation, and markets 1998-2006
- New strategic context for Japanese firms
- New industrial architecture

Strategic Inflection Point 1998-2006

- Banking Crisis
  - Switch to direct disposals of bad loans (sell off assets).
- "Sunshine" rules, 2000
  - New accounting rules (consolidated balance sheets)
  - New disclosure requirements (e.g., quarterly earnings reports)
  - New laws on bankruptcies, corporate reorganization, stocks, mergers, acquisitions, hostile takeovers, etc.
  - Annual revisions of 所会法 2000
  - Internal oversight committees: directors are liable
  - New disclosure requirements (e.g., quarterly earnings reports)
  - Stricter prosecution of corporate wrongdoings
  - Undoing of cross-shareholdings, influx of foreign investors

New Demand for Law

- From "ex ante regulation" (Civil Law-type) ...
  - Judges only "interpret" the law.
  - Markets don’t have access to lawmaking (to introduce a new process, lawmakers must write the law first).
  - People have limited access to courts, which are slow; i.e. very little precedent, no developed legal doctrine.
- …to “postremedy regulation” (Common Law-type)
  - Everything that is not prohibited is o.k.; problems legislated in the courts.
  - Courts make law in reaction to market initiative.
  - Access to courts is assured through lower fees, more attorneys, better court processes, more judges.
  ⇒ Greater managerial flexibility, but also legal liability
  ⇒ Supervisory agencies instead of informal regulation

A market for rules and regulations.

What Foreigners “Know” about Postwar Japanese Business

- Business groups
- Main bank system
- Internal processes of corporate governance
- Subcontracting hierarchies
- Lifetime employment
- Restricted distribution system and relational pricing Industrial policy
- Difficult entry for (foreign) competitors

The strategic logic underlying these has changed.
The Challenge is …

- People in the U.S. have not looked at Japan since the late 1980s/early 1990s.
- Business interest has shifted to China.
- If you ask: “What do you know about Japan?” they repeat “wisdom” of the 20th century.
- Limited awareness of the New Japan.

Strategic Drivers in the Postwar Period (1950s-1980s)

- Bank strategies
  - regulated interest rates → volume
  - risk exposure → diversification
- Companies
  - Large firms’ DER: over 600 → stability
    - business groups
    - steady sales revenues to pay interest
- Lifetime employment
  - Exit difficult → diversification
  - Promotion of special talent under seniority pay

High Leverage, High Risk

- Buy insurance through stable owners
  - cross-shareholdings
- Buy insurance through preferential trades
  - intermarket groups
- Buy insurance through a main bank
  - access to credit, rescue
- Diversify into many markets

⇒ Steady process of conglomeration

Diversification vs. Unbundling

- Diversification
  - Reduces risk of corporate failure
  - Increases profits if “related”
  - Decreases profits if “unrelated”
- Optimal point differs
  by company.
  In Japan, coupled with sales priority.
⇒ decline in performance over time
- Bubble period excesses
  (exuberant diversification)
Refocusing: From unwieldy goliaths to nimble competitors

- "Choose and Focus" (選択と集中)
  - Exit: spin-offs, M&As, MBOs (focus on core business)
  - Reorganization: "company system", holding company structure (implement new goals through incentives, promotions, accountability)
  - Consolidation: purchase competitors (choose core businesses and dominate in those)

- From sales focus to profitability focus
  - From "stability" to "winning"
Was this a sectoral phenomenon?

Is this a lot or a little?

- U.S. refocusing of the 1980s:
  - At least 20%, but more likely about 50% of U.S. Fortune 500 firms restructured in the 1980s (Markides 1995)
- Compare to Japan:
  - 36% of firms have divested, 75% have restructured
- A truly remarkable episode in global business history.

Japan’s Changing Industrial Architecture

- Business groups (keiretsu) : Repositioning or Dissolving
  - Horizontal (inter-market); vertical (subcontractors)
- Main bank system : Gone (for large firms)
  - Deregulation; loans no longer cheaper
  - Bankruptcy rules vs. informal bailouts
- Internal processes of corporate governance
  - Externalized through M&As, hostile takeovers, new laws
- Lifetime employment:
  - Towards performance pay, wage by job category, individual career paths, labor mobility
  - Externalization of labor: 35% non-regular work force
- Industrial Policy
  - Government reorganization and laws: "Leave it to the Market"
- Difficult entry for (foreign) competitors
  - Market opening through price competition.

Implications for Japan

1. New Market Dynamics
   - New industrial architecture
   - New business organization
   - Labor shortage
   - New complexity in HR management
3. New Leadership Style