Japan's Identity Crisis

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Japan Inc. at the Crossroads

The outlook for Japan's economy and multinational corporations looks promising through the end of the decade.

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Japanese multination corporations (MNCs) have achieved international economic power through rapid growth, facilitating the introduction of new technology and continuous cost improvement, which promotes further growth. They recognize, though, that other countries can pursue similar strategies and that Japan is competitively vulnerable, given the appreciation of the yen and a maturing economy where many consumer needs have been satisfied. MNCs have therefore chased growth abroad, investing to access new technologies, exploit new markets, and keep costs low. An aging population and the impact of the bubble contribute to this process.

Japan's population over 65 is increasing faster than in any other country. By the first decade of the next century, it will have accomplished in one generation what has taken France and Sweden over 50 years. But this population is presently saving for retirement, not consuming, both slowing economic growth and providing resources for overseas investment. Further, when their consumption does rise, it will not be for the investment goods and consumer durables produced by the MNCs but for health care and leisure.

Similarly, helping MNCs abroad, yen appreciation, and a high savings rate increased Japan's money supply very quickly in the 1980s. This combined with financial liberalization to bid asset prices, especially stock and real estate, to astronomical levels, the so-called bubble. During this period, companies could raise capital very cheaply. While the subsequent collapse hurt financial institutions holding overvalued stock and real estate, on balance MNCs benefited from the bubble through cheap capital, access to world financial markets, and less government control.

Management's focus

Japanese management is aware that competitive development is based on growth and is concerned that new competitors will impact Japan as they did the United States. Most MNCs have developed by importing technology and selling in the high-growth Japanese market. After product and manufacturing were improved, export growth followed—first to lesser developed countries (LDCs) and then to advanced countries.

This evolution depended on aggressive pricing and investment to build volume and market share because product differentiation was difficult with several large producers using similar imported technologies. Price pressures became particularly intense once growth slowed, as each firm tried to operate at capacity. This pattern has been repeated serially in technically more sophisticated, higher value-added industries, starting with cotton textiles, then steel, ships, construction equipment, cars, and currently
computers and ICs.

Japanese firms are quick imitators and use price competitively while constantly reducing costs and improving productivity. They generally offer a full product range by being less integrated assemblers than their U.S. counterparts and using common subcontractors. Toyota has larger volume and lower costs than Mazda; but, by buying from the same firms, Mazda coattails Toyota’s scale while Toyota benefits from added volume. MNCs also source abroad from these subcontractors to maintain competitiveness, a critical factor in Japan’s growing globalization.

Since Japanese MNCs’ senior executives are employed for life, corporate survival is their principal goal. One cannot yield competitive advantage, so a key motivation is “competitive compulsion,” which affects foreign direct investment (FDI). Firms cannot risk competitors’ gaining advantage or customer access. Thus, they will offer products or services purely to protect relationships rather than make profits; they use existing business to provide cross-subsidization.

This competitive topology is characteristic of a few businesses where the main firm generates a profit and many that encircle the customer break even or lose. Resources are allocated to the core business, whereas peripheral ones are loss leaders. Core market share is substantial but for others is minimal and may be sourced from industrywide subcontractors. Core customers will be defended fiercely because of the drive for survival.

Because this paradigm describes major firms in key industries, it depicts the economy in general and its global impact. The steel industry chain—including autos, ships, machinery, and earth-moving equipment, plus the electronics industry chain—accounts for 80 percent of exports and FDI, which means it supports the rest of the economy.
Engine of Growth

- Japan's economic outlook throughout the 1990s will be defined by its large corporations.
- Borrowing in the 1980s allowed corporations easy access to cheap capital and foreign markets.
- But a maturing economy and aging population are slowing domestic growth to 2.5-3.5 percent.
- Thus, corporations will continue to seek out opportunities to increase global market share.
- Japan will maintain its lead in consumer electronics, despite the encroachment of Korea and Taiwan.
- Corporations will seek technology-sharing agreements with foreign competitors and universities.

Foreign trade

Foreign firms succeed only by offering new products or services that are not easily emulated. If they are new, they will not infringe upon core businesses. If they are not easily emulated, other firms will not offer them and therefore not threaten key customers. Foreign companies establishing and sustaining such positions can be very profitable because they need only offer their specialties.

Competition abroad is an extension of domestic competition. Managers’ experience with product cycles and with continuous cost improvement therefore provides an insight into their strategies. FDI and intragroup trade are used at a cycle's beginning to access new technologies for Japanese sales and, at its end, to preserve markets when Japanese exports are not competitive.

Once a technology is known, transfer costs decline, which aids followers like Japan. Becoming competitive, exports first went to LDCs that were not producers. These markets were cost sensitive, and aggressive pricing overcame quality or service problems. After building exports, lowering costs, and increasing quality, firms exported to more advanced countries. The industries there were mature, and price competition was again a good entry strategy.

As Japan evolved, its labor-intensive, lower value-added industries were affected similarly by followers like Korea. FDI emerged during this later export stage, sometimes involving imports from LDCs, where factories were often Japanese-owned. For example, textile producers in the 1970s used FDI as an export platform to advanced markets and for imports to Japan.

When exports became a larger part of production, political pressures from affected countries have also stimulated FDI and intragroup trade to leap protectionist barriers and preserve markets. Given these developments, managers saw markets build via imports from advanced countries, followed by domestic production, exports to LDCs and more advanced markets, and finally imports from LDCs combined with production in advanced markets.

World War II promoted this awareness by exposing current top management to product cycles in a very concentrated, rapid way across all industries. With the economy put back 20 years, management was forced to repeat these developments immediately after the war, and every manager became conscious of these evolutionary forces. They became aware, too, of cost improvements generated by high growth, market expansion, and rapid investment incorporating new technologies.

By 1970 the process was so successful that the Ministry of International Trade and Industry stated it as industrial policy: Government should upgrade the economy by promoting technically advanced industries, allowing less advanced ones to migrate. A
pragmatic program for economic recovery became a formal model. Countries like Korea adopted it, also achieving high growth and reinforcing its acceptance.

The bubble and maturation

Japanese success provided the bubble's foundation as export earnings and yen appreciation dramatically increased liquidity. The fantastic growth in Japan's financial markets mesmerized everyone. Yet, the major consequence was not market growth but financial freedom for MNCs from financial institutions and the government. Until the 1980s, companies depended on lenders for finance. Capital for overseas expansion was restricted. The bubble changed this through a massive transfer of assets from lenders to corporations, enabling MNCs to fully access world financial markets.

Changes in the Foreign Exchange Law and the Yen/Dollar Accord helped the markets expand as companies borrowed abroad by selling Eurobonds to Japanese investors. Responding to high dollar interest rates and a desire to redistribute assets, insurance companies bought foreign bonds aggressively in the
early eighties. This began a head-
long surge of financings and arbi-
trage, though bond sales ended
abruptly with the Plaza Accord
and yen appreciation.

However, the bubble's emer-
gence in the late 1980s enabled
companies to issue equity at high
valuations instead with dividends

In 15 years, the
Japanese
population will
start declining,
ultimately leading
to labor shortages.

less than 1 percent of funds
raised. Still, the bubble's effects
extend far beyond financing ben-
efits. Its aftermath represents a
watershed by fundamentally
altering financial markets and
MNCs' relationship to financial
institutions, the MOF, and the
government.

Most large firms and major
industries are now mature.
Though pursuing growth in
emerging markets abroad,
their growth is over. They
have reached the innovation
frontier for their main business-
es, and acquiring foreign tech-
ology is more difficult. Foreign
competitors know their success
in steel, automobiles, consumer
electronics, computers, and so
forth, and have become wary,
restricting access to new tech-
nologies. Thus, MNCs have few
alternatives to continuing to
invest in cost and quality im-
provements globally to increase
market share. One can term this
scale and share as opposed to
scale and scope.

Added to these industrial
and economic effects is a rapidly
aging population and a smaller
younger generation with differ-
ent attitudes toward work and
corporate commitment. By 2010,
Japan’s population proportion
over 65 will be the world's high-
est, 21 percent compared with 12
percent today.

A combined baby boom, low
prewar life expectancy now the
world's longest (men 75.9, women
81.8), and a low birthrate have
caused this. In 15 years, the
population will actually start declin-
ing. Labor shortages, increased
health costs, and rising transfer
payments are clear. As leisure,
health, and special facilities grow,
MNCs will feel more pressure to
expand abroad.

Domestic and global
outlook

Japan's economic outlook in
the 1990s will be defined by its
large corporations. Since expan-
sion will mostly be abroad,
Japan's growth will be only
2.5-3.5 percent. In fact, it must
first use the excess capacity built
in the late eighties. A slow-grow-
ing aging population will accen-
tuate this. Yet, Japan's low
growth belies greater influence
internationally, especially in key
industries where they are lead-
ers.

Their growing overseas pres-
ence will reflect FDI and sourcing
plans combined with executives’
emphasis on product cycle man-
agement, constant cost declines,
and global market share. Actions
will be a logical consequence of
each firm's evolutionary develop-
ment.

For example, Sony’s acquisi-
tion of CBS Records and
Columbia Pictures was driven by
its Betamax failure due to insuf-
cient software. To avoid another
Betamax in 1 3/4” CD or in 8mm
video, it purchased companies
with extensive libraries and
cross-licensing arrangements.
Then Matsushita responded by
acquiring MCA, since Sony might
achieve an advantage.

MNCs are still more affected
by domestic competitive heritage
than foreign competitors, and
their concerns remain protecting
global markets, maintaining low
costs, and ensuring firm survival.

Senior executives' survival
and benefits plus lifelong com-
munity to their firm, customers,
employees, suppliers, banks, and
so forth, requires this. Managers
are concerned with a continuous
wage stream, not profit maxi-
mization. To achieve this, firms
must protect against further yen
appreciation and competitive
shifts toward the NICs in addi-
tion to offsetting U.S. protection-
ism. Corporate growth will be fur-
ther complicated by an aging
labor force and low birthrates,
which will create labor shortages,
especially for technical personnel.
The Vanishing Work Ethic

Japan's younger population has been raised in affluence, never knowing the violence of the thirties or World War II's deprivation. For them, Japan has always been on top, and the security of working for the same company for life has little appeal. Further, the maturing of several industries and escalating early retirements mean lifetime employment is now only for top management in large firms, not all workers.

The young Japanese are more worldly and better educated than previous generations, but they also have greater interest in leisure. Therefore, though the shinjinru, or Japanese yuppies, do not represent the majority of young employees, their desire for a better life does. Recent surveys confirm that younger workers are less committed to working for the same firm forever or putting in the long hours and five-hour commutes that their fathers did. More young workers also seem willing to switch jobs after two or three years if their first position after leaving school does not work out as expected. As part of this trend, many bright students from outside Tokyo who used to come to the capital to work for large corporations or the government now choose instead to attend regional universities and work for regional companies.

The current economic strength of outlying regions compared to large cities like Tokyo, Osaka, and Kyoto reinforces this, compelling large corporations to expand into these areas. Toyota's big new electronics facility is located in Hokkaido, and Kyushu is benefiting from the boom in the rest of Asia.

Two other important developments among younger employees are internationalization careers who are not retiring after marriage. This has increased both the number of two-income families and the desire for shorter commutes and working hours.

While the current recession has alleviated labor shortages, the long-term demographics are compelling. For the first time, large companies are becoming concerned about attracting and retaining new employees. They are thus trying to provide an initial entry experience less like Marine boot camp that will appeal to Japan's young, well-educated international elite.

The cleavage in views between the young and previous generations does remain marked. But before one projects such developments into a kinder and gentler Japanese business environment, it must be recognized that these employees will not reach decision-making authority in the MNCs until their late 30s or early 40s, 15 years from now. They will not reach top management for at least 30 years. A lot can happen in that time. In addition, the pyramid narrows quickly at the top, with those most interested in leisure exiting first. Therefore, the strategic thrust of large Japanese companies is unlikely to change in the immediate future, even as they move to accommodate personnel policies to the new recruits and develop products and services to satisfy their rising incomes.

—W.V.R.
FDI will help manage these trends. Constantly upgrading intra-industry technology is necessary, too, given competition plus customer demands. Some upgrading will depend on access to improving world technology. This can counter some competitive shifts

Rival claims exist between government and corporate strategy and will lead to independent action on trade.

while dealing with labor cost pressures and a stronger yen. Further, because producers face similar environments and managers have similar backgrounds, “competitive compulsion” will push most to follow leading firms.

In mature markets like autos or consumer electronics in the United States and Europe, this can lead to overcapacity. But since government action usually preserves market share, being an aggressive investor and lowest cost producer remains the best strategy. Japan is saturated for established products but remains an important market to control for innovations because of demanding consumers.

However, it must be supple-mented by overseas sales. Having a global presence is thus necessary, and participation in large advanced or emerging markets is mandatory. To accomplish this, technology transfers to the NICs and LDCs must be managed even while the NICs want to emulate Japan in developing global competitors.

MNC strategies

MNCs can pursue their strategies with little domestic political interference or capital constraints because the government has few economic goals and its power has been weakened, especially outside Japan. Managing FDI and group trade is thus likely to be left to the companies, competitors, and foreign governments. The government’s development concern will be more interindustry development, while its growing problem will be transfer payments to the aged. It will continue to sponsor space exploration, supercomputers, and bioengineering, although in 20 years only two workers may exist for each transfer beneficiary, not five.

The MNCs, though, will not phase out core businesses, since this could threaten corporate existence. They will pursue intra-industry development and will resist transferring resources from established industries. So rival claims exist between the government’s and the MNCs’ strategies. Such noncongruent policies are new and will lead to independent action by MNCs on FDI and trade.

Logically, MNCs will continue managing the product cycle within which FDI, intragroup trade, and technology will form important activities as part of a system for creating and maintaining competitive advantage. For instance, by investing in U.S. steel companies and upgrading their technology and capital stock to supply Japanese auto companies, Japanese steel producers made U.S. firms and themselves less vulnerable to competition from the NICs. That is, as Japanese auto companies use better steel, U.S. auto producers must improve. Yet the product is available only from Japanese-affiliated firms. Thus, the NICs lose the market share they might have captured if the U.S. industry stagnated and its firms became less competitive.

A key FDI element is managers’ confidence in reducing costs and improving quality. Indeed, their ability to accomplish this abroad surprised many U.S. manufacturers counting on U.S. entry to level the playing field as Japanese firms became subject to similar economics. However, their postwar experience of continuous cost improvement due to scale, continued product development, worker training, improved organizational structures, more sophisticated equipment, subcontractor relations, and high investment rates was transferable, thereby benefiting firms, suppliers, and employees.

Deviation from this pattern
is improbable. If consensus decision making is established, change is particularly difficult, since anyone insisting on current practice has a veto. Thus, technology acquisition, market share, and cost reduction will continue as goals, along with a compulsion to match competitors.

Development along fairly predictable paths is therefore likely because variations are not easily accommodated in a slow-growth mature environment. Long-term supply arrangements are an example. Here FDI and intragroup trade have extended historical developments to affect future investments and global competitive interaction, as seen in the response of tire and steel companies to the strategies of the automobile manufacturers.

Even if Japan’s performance is modest, MNCs pursuing growth and share will extend Japan’s influence beyond that envisioned for the economy. FDI and intragroup trade will be key strategic elements, affecting many countries. Indeed, because they are focused in a few industries, potential impact is very large. ■

Tokyo at dusk: Can Japan make the necessary technological and managerial adjustments to remain competitive?

Additional Reading


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