

CORPORATE
STRATEGY

by Ulrike Schaede

New business strategies for the 21st century

Choose and focus

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In our excitement over China's ascent, we have forgotten to update our view of corporate Japan. This is understandable, because remnants of the "Old Japan" persist, and we have not yet trained ourselves to look for the "New Japan." But the reality is that the old keiretsu no longer exist; main banks as bailout leaders have been supplemented by new laws and actors, such as equity funds; 80% of listed Japanese firms have switched to performance promotion and pay; the manufacturing industries have globalized to a point where subcontractor relations have been turned upside down; and global competition and discount mavericks have broken open the retail industry. The most important change of all is that in many industries the household names of Old Japan are no longer among the key players.

The unifying thread behind these myriad changes is the last decade's transformation from diversification to focus. Instead of each firm like Panasonic (formerly Matsushita) producing all products, from toasters to semiconductors, they are focusing on "fewer, but better." The gestation period is still underway, but the core transformation has already occurred.

New Japan leadership

Global market share data highlight this story. As of 2005, in advanced household electronics such as flat panel displays, cell phones, DVD players, or digital cameras, the combined market share of Japanese companies for these end products was estimated at roughly 25% (data according to Japan's "White Paper on Manufacturing 2006"). This is precisely why we are led to believe that Japan must have "lost it." After all, Japanese companies used to rule that market.

But not so fast. In "midstream" products that feed into these gadgets, such as semiconductors, circuit boards, laser heads, etc.,

Japanese companies combine for roughly half of world market share. And in upstream products—advanced adhesives and resins needed for semiconductor production, the layers that differentiate a dull screen from one that can be viewed in sunlight, and the filters that produce true black—Japanese companies own more than 66% of the world market. That's why South Korea and Taiwan, the main assembly countries of these end products, have a trade deficit with Japan.

This is unequivocally a good thing, because the cost advantage that Japanese companies used to enjoy in the mass production of high-quality household products has long moved elsewhere. Margins in the assembly stage are too thin for a high-cost nation. Moving upstream, where technology leadership is less contested and margins are much higher, is the correct strategic repositioning for Japanese firms.

New ways, new firms

Japanese firms have assumed this leadership position in two ways. First, through refocusing and slimming down by large firms. Panasonic has exited the market for blow-dryers as well as that for semiconductors. The company now focuses on four business areas, of which one is high-end electronic products, under the slogan "ideas for life".

As the large firms circle in on high-end products, they need very good inputs. By exiting many component categories, they have made room for innovative, mid-sized firms to expand. This is where New Japan's core competence now lies: materials and components. Some of Old Japan's firms have moved into these segments, such as Fujifilm Holdings. But a lot of this leadership comes from smaller firms, such as JSR, Ibiden, or Nitto Denko. Larger firms have focused to compete with them, such as Shin-Etsu Chemical. These companies are not neces-

sarily new, but they have repositioned in clever ways that have turned them into world leaders.

This repositioning is by no means limited to electronic components. It is repeating itself in industry after industry, leading to new Japanese leadership in important 21st centuries, from specialty steels to green technologies (e.g., batteries) auto parts, and materials. To offer but one more example: Toray and Teijin are no longer stuffy textile companies; together, they control 70% of global market share in carbon fiber, and are leaders in a variety of membranes and pharmaceutical skin patches.

Strategic inflection

The 1990s are often referred to as Japan's "lost decade," but in reality things had gotten so bad that Japan's leading companies began to change aggressively. Reluctant reformers were pushed toward change when the non-performing loan crisis, and in particular the 2002 Financial Reform Program, made banks more aggressive in their attempts to restructure unprofitable firms. Many banks who wrote off a dud loan sold parts of a troubled firm to recuperate at least something.

In the process, the large firms became leaner, and the spun-off business units—many of which were bought by equity and turnaround funds—were by definition focused. In 1998, the "Big Bang" financial reform program brought consolidated accounting, which negated previous tricks of hiding unprofitable businesses in subsidiaries, adding further incentives for conglomerates to slim down. Just as a market for corporate assets developed, the 1998 revision of the Foreign Exchange Law removed previous limitations on foreign investments in Japan. In the 12 years between 1995 and 2007, the percentage (by value) of corporate shares owned by foreign investors climbed from about 8% to 28%. Unlike the previously dominant stable shareholders, these new investors were interested mostly in profits and the soundness of the business model.

Recall Jack Welch's strategy dictum for General Electric in the 1980s: "be No.1 or 2 [in a business], otherwise fix, sell or close." This is precisely what the leaders among Japan's largest companies decided to do in the late 1990s. The most prominent business catchphrase in Japan in the early 21st century was *sentaku to shuchu*, which I have translated as "choose and focus."

In their attempts to close down non-core

subsidiaries, sell off non-profitable businesses, or acquire spin-outs from their competitors, companies faced insurmountable restrictions in the Commercial Code. In response, between 1998 and 2006, Japan revised the Commercial Code annually—principally to facilitate reorganization and restructuring. Adjacent laws, such as the Labor Standards Law, were also revised. Dismissals are still not easy in Japan, but they are no longer impossible. Employees were also stripped of their veto right against spin-outs (which they previously blocked because wages at smaller companies tended to be lower). In 2006, the old Commercial Code was replaced by the new Corporation Law, and in 2007 Japan introduced its version of the Sarbanes-Oxley Act (called J-Sox) to increase shareholder rights commensurate with the new liberties granted to management.

These and other legal revisions contributed to a strategic inflection point in Japanese business. Among the Nikkei 500 very large firms, 75% engaged in at least one measure of reorganization—defined as exiting a business line, acquiring a business for consolidation, or changing to a new organizational structure. In comparison, during the refocusing wave in the United States in the 1980s, some 50% of Fortune 500 were estimated to have slimmed down. Japan's "choose and focus" wave was truly remarkable.

New leaders

One important result of "choose and focus" is the emergence of new industry hierarchies. Japan's leading industries used to be characterized by a stable order of large companies. But in industry after industry new firms have moved into the top tier. These new firms come in three varieties. One group includes newly merged large firms, such as Astellas (pharmaceuticals) or JFE Holdings (steel), and many of these have specialized in the process of merging. A second consists of medium-sized firms that have carved out a particular niche for themselves, as mentioned above. The third group are new firms that resulted from mergers among spun-off units of large firms. For instance, Hitachi, Toshiba and Panasonic spun out their flat panel divisions and merged them into a new company called IPS Alpha Technology. SUMCO was founded in 1999 to combine the silicon wafer divisions of previous archrivals Sumitomo Materials and

Mitsubishi Materials. Renesas is the marriage of the (non-memory) semiconductor divisions of Hitachi and Mitsubishi Electric, and Elpida of Hitachi's and NEC's DRAM operations. Not only are the parent firms more focused for having spun out these divisions, but the new companies are also focused as they operate in only one business.

Results take time

Doubters will point to the dismal performance of some of these firms (Elpida just received a government bailout), or to large laggards that refuse to downsize or claim to do so but continue to look bloated, such as Hitachi. True, for every success story, there is a failure. But this is also true in other countries. It does not negate the fact that the Japanese business setting has completely changed since the late 1980s.

Recall, also, that it took the U.S. economy more than a decade to reap the benefits of the 1980s refocusing. Research in Organizational Behavior has shown that for a company to be successful, it needs to align its critical tasks (the business model) with its formal organization, people and corporate culture. Redrawing the organization chart is a first step, but for the new incentive structure to work, Japanese companies also have to switch "people" and "culture," from being big to being profitable, from being loyal to being efficient, and from avoiding mistakes to taking risks. As pointed out by former CEO Nakamura, who led the first phase of the turnaround at Panasonic, it requires "a cultural revolution." In US firms with a deeply-embedded corporate culture, such as IBM, the realignment of tasks, structure, people and culture took about a decade. Japan's counterparts will take just as long. What's important to know is that this process is underway. Future research will reveal what processes worked best, and what companies got it right.

Japan's manufacturers were hit by a perfect storm in late 2008. Oil prices skyrocketed; the yen plunged, as did the stock market; the crystal cycle (semiconductors and flat panels) hit a record-low; and exports came to screeching halt. Factory output fell by a third. But here, too, is a silver lining. Upstream industries are hit first by a decline in orders (there is little room for channel stuffing in the global business-to-business trade), but they are also the first to receive orders when the economy revives. Thus, repositioning toward upstream and mid-

stream products made Japan more vulnerable, but also more nimble in response to the business cycle.

Moreover, unlike in the dominant strategy of 1990s of "muddling through," in early 2009, New Japan companies took immediate action in unprecedented ways. Nippon Steel and JFE Holdings shut down furnaces (an expensive thing to do), car companies closed down plants, and all reduced their workforce. The resulting stunning 36% drop in manufacturing output was portrayed in the West as a disaster. But if you think about it in strategy terms, it is exactly the right thing to do: Don't produce stuff if you can't sell it.

Thus, even as corporate Japan wrote off the first half of fiscal 2009, order inflows began to rebound in August. The world economy is still shaky, but Japan's upstream manufacturers have already cranked up production.

New Challenges

At a minimum, Japan's strategic inflection point means that differentiation among large companies has greatly increased. Whereas Panasonic and Fujitsu have actively refocused, Hitachi and others are struggling mightily. More importantly, to evaluate the competitive strength of the New Japan, one cannot simply look at end product markets, nor is it enough to look at the well-known company names. The New Japan leadership plays out in important product categories that often remain invisible unless one actively looks for them.

A new threat to ongoing change and new alignment may be the 2009 change in government. In general, businesses do not like uncertainty. In particular, some Democratic Party of Japan (DPJ) leaders have indicated a return to Old Japan, such as asking banks to offer more loans to failing or small companies.

It will be interesting to see how this plays out, but it is important to realize that Japan's strategic inflection between 1998 and 2006 was not predicated on one event; nor was it brought about by one law or one politician. It was triggered by a confluence of factors—crisis, globalization, push from within, social change—and therefore is irreversible at its core. It may take a while for Japan's leading companies to profit from it, and some laggards may remain protected for years to come. However, for competing firms to assume that corporate Japan is "the same old" could be a recipe for failure.