PREFACE

In 1982, U.S. presidential candidate Walter Mondale asked, "What do we want our kids to do? Sweep up around Japanese computers?" At the time, Americans feared a rising Japan, which had recovered from the ruins of World War II and looked set to challenge American economic hegemony. Two decades later, Japan's economic bubble had burst, wiping out US\$10 trillion in value from its stock and real estate markets. Japan then entered what pundits would later call the Lost Decade—so named for the country's anemic growth, deflation, bad debt, and poor corporate performance.

The new millennium brought little relief. From 2000 to 2007, nominal GDP fell from \$4.9 to \$4.5 trillion, and Japan-watchers began referring to the period as the Second Lost Decade.² After the 2008 global financial crisis, just as things began to turn around, the country suffered one of its worst disasters in history with the 2011 Tohoku earthquake and tsunami. And just the year before, China had surpassed Japan as the world's second largest economy.³ As China continued to rise, Japan continued to struggle with deflation. Today, while China is a frequent topic of conversation for many international businesspeople, economists, and political scientists, few are talking about Japan.

Yet look closer, and it becomes clear that Japan still matters. Japan is the third largest economy in the world. It also ranks third, behind the United States and China, in terms of manufacturing output and number of Global Fortune 500 companies—even though it has a much smaller population, and its workforce of 65 million is roughly the size of China's three largest cities. What is more, Japanese companies have adjusted to the rise of China and the emergence of global supply chains by reinventing their strategies, operations, and financial markets. In this book, I argue that there are three key reasons why Japan is once again important. First, as a result of their reinvention, Japanese companies now anchor global supply chains by dominating world

markets in a large number of critical input components and materials, meaning global manufacturing has become dependent on Japanese inputs. This has increased Japan's economic power, in particular within Asia. Second, Japan's business reinvention is creating new, lucrative markets for financial and consumer products within Japan. And third, Japan continues to uphold its alternative model of balanced capitalism in an economic system that moderates inequality and values social stability while pursuing economic success. This may prove informative in the ongoing discussion in the United States of the social responsibility of the corporation.

Despite years of sluggish growth and bad press, and in the face of two supposedly lost decades, Japan is a highly developed, stable democracy with high levels of productivity and low levels of corruption and crime. This story—how the headlines can be deceiving—is also part of the closer look. Japan never threatened the United States, as Mondale and many Americans in the 1980s feared. But, unlike the United States, Japan has universal healthcare, one of the highest life expectancies in the world, and a top tier primary and secondary education system. It is the safest of any large industrialized country, with just 0.28 homicides per 100,000 inhabitants in 2016 (18 times lower than the U.S. rate). Japanese cities are famously clean and in great repair; it is rare to find a piece of trash or graffiti in Tokyo, a mega-metropolis of over 14 million. There are an estimated 13,000 homeless people in all of Japan, which is fewer than in New York City. 4 The country is also a center of culture, technology, and innovation. In the early 2000s, as the Lost Decade dragged into the Lost Score, a British Member of Parliament visited Tokyo, and upon seeing the bustling activity and bright lights of Ginza, he said: "If this is what recession looks like, I want one."5

How has Japan managed to maintain stability in the face of economic stagnation and business reorganization? My core argument is as follows: In response to the rise of China and the new competitive dynamic in Northeast Asia, Japanese companies have reinvented their business operations and built deep-technology competencies in critical components, inputs, and materials, while maintaining core strengths in manufacturing and systems engineering. While many of these products are small niches, in the aggregate they result in a sizable business portfolio that anchors Asian supply chains. This reinvention is managed within Japan's tight business culture setting—a framework introduced later in this book. As a result, change is proceeding in ways and at speeds very different from what an American observer would expect, which makes it easy to misinterpret or miss entirely. And this means that Japan's business system

continues to function differently from the U.S. system. Even with globalization and financial market pressures, Japanese companies still operate within an alternative, more balanced model of capitalism, one that is characterized by social stability and slow change.

Japan's new approach to global competition is what I call an *aggregate niche strategy*. For the managers of large Japanese companies, this translates into two separate assignments as they lead the reinvention:

- Strategic repositioning: Choose a set of core businesses and focus on upgrading those, and carve out or sell off non-core units and subsidiaries. At the same time, explore and invest in future businesses to compete in the digital economy.
- Organizational renewal: Build new internal processes and a new corporate
 culture that foster the coexistence of mature and new businesses and are
 conducive to creativity and deep-technology innovations.

The New Japan company has vacated lower value-added markets, such as basic electronics, and moved upstream into high-technology materials, components, and production machineries. While these inputs do not carry a "Japan Inside" label, there is a fairly high probability that you are using products containing critical parts from Japan on a daily basis. No matter the brand, Japan is inside your car, TV, headphones, computer, smartphone, watch, kitchen gadgets, router, printer, scanner, camera, and perhaps even your electric toothbrush. From Tesla's car batteries, Hewlett-Packard's printers, and Boeing's airplane fuselage materials, to any Apple product, Japanese technology is fundamental.

As Japan's corporate leaders are managing this transformation, they are guided by the behavioral norms of Japanese business, which shape expectations of appropriate behavior and set the proper pace of change. Because business norms are socially created, not innate, they can be changed. The management essence of Japan's business reinvention is to nudge employees to embrace a new, shared understanding of what constitutes appropriate workplace behavior, in order to compete globally. The ways in which Japan's senior managers are rolling out this change process is also part of this story.

You may wonder who or what "Japan" is in this description: who or what is the mastermind behind this business reinvention? The answer is that there is no central actor. Rather, the results are an integration of the discourse between reformists and guardians from a cross-section of business, government, and society. They disagree on most matters, yet they all share a set of common values and norms. As you will see later in this book, these norms prescribe that whatever path Japanese managers take, changes have to be made in ways that are, or at least are presented as, considerate of all interests and polite and respectful to all parts of society. This balancing act has allowed significant corporate reorganization while preserving social stability.

Japan's business reinvention carries important implications for the United States and Asia. As Americans search for new ways to balance corporate profits with social prosperity, Japan's process of change can be informative. The outcomes of the reinvention are also significant because Japan is an economic powerhouse and Japanese companies are deeply embedded in the U.S. economy—as suppliers, producers, and employers. What is more, Japanese companies are positioning to compete in the digital economy—with its 5G-based internet of things (IoT), artificial intelligence, and cloud-based, data-driven information sharing and connectivity—in ways that differ markedly from the U.S. and Chinese approaches, and that may afford them a long-term advantage in digital manufacturing. Quietly, some Japanese companies—such as SoftBank, Toyota, and Recruit—have extended their business models into the new economy, in ways that may come as a surprise.

Some readers will be skeptical of the positive tone of this book. They may say that I am overstating the amount of change that is actually happening, and point to Japanese firms, small and large, that are hopelessly mired in unproductive approaches to business. They may point out that I have not discussed the budget deficit, debt levels, the aging society, regional poverty, or the root causes of low economic growth. It's fine if Japan builds the critical sensors and robots, they might say, but the money is in big data and artificial intelligence, and Japan will simply not be an economic factor if it cannot play in the cloud.

I disagree and look forward to this discourse. While we cannot be sure what the future will be bring, as of the time of this writing in 2019, my initial responses will be along the following lines.

This book puts a spotlight on the changes in Japanese companies and their business strategies. It highlights important new developments in cutting-edge markets that are relevant to global business, and shows how these approaches aim to maintain stability first and growth second. I challenge the naysayers by pointing out that they have probably not taken a deep and unbiased look at Japan for a long time. But if you step back and ask, "What is Japan trying to accomplish with these gradual reforms?" you will realize that Japan is making

choices and tradeoffs that are different from those of most Western economies. And as much as everybody in Japan enjoys higher economic growth rates, there are other considerations—first and foremost social stability—that are even more important than growth. The danger is that by dismissing Japan for its alleged stagnation, you will miss out on something rather exciting that is happening in Japan right now. And by the way, who says that Japanese companies cannot play in the cloud? Although the spotlight of the digital transformation is currently on the United States and China, we should not dismiss what is quietly happening in other parts of the world. Ignore Japan at your own peril.

Acknowledgments

Over the past three decades, I have lived and worked in Japan for a total of more than nine years—as a student, a professor, and a resident scholar at Hitotsubashi University, the Bank of Japan, the Ministry of Finance, the Ministry of Economy, Trade and Industry, and the Development Bank of Japan. The people at these institutions allowed me to become part of their daily life and work, and shared their thoughts and insights in many lunch and dinner conversations. Through these observations, I developed a sense of the different office dynamics and workplace rules in Japan. I have had many, repeated, and long conversations with CEOs, board members, managers, young employees, entrepreneurs, small shop owners, mothers and fathers, students, government officials, consultants, bankers, IT hackers, language teachers, steelworkers, private equity investors, and hedge fund managers. This experience is the primary source of information on which this book is built.

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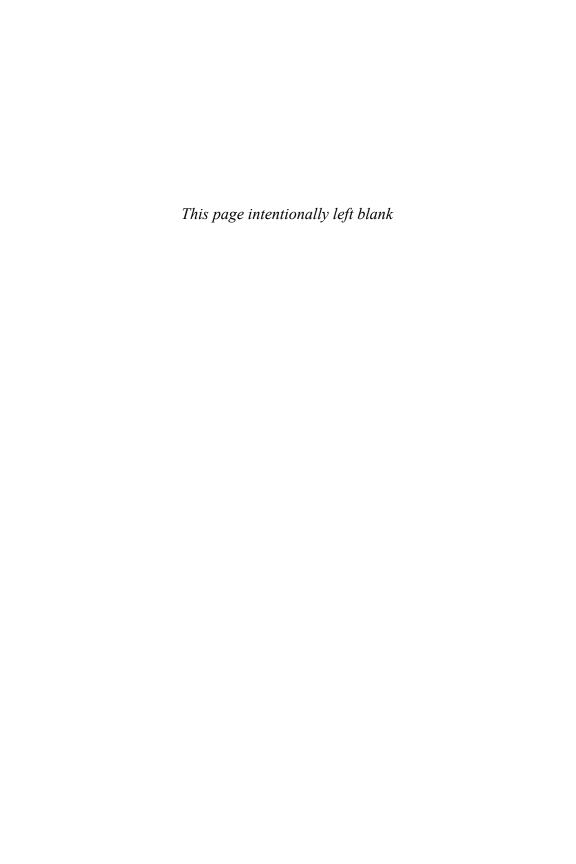
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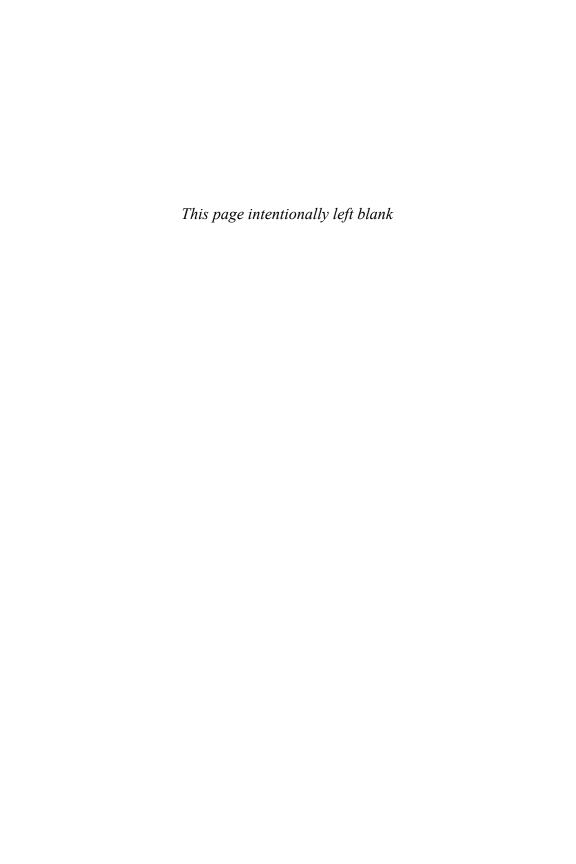
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THE BUSINESS REINVENTION OF JAPAN



Advance Praise for 'The Business Reinvention of Japan'

"Ulrike Schaede's new book combines an invaluable primer on Japanese business culture with a striking analysis of Japan's little-understood strategy for producing enduring economic strength based on manufacturing excellence and constant, managed change. I came away with renewed admiration for the country's political and corporate leadership, and Japan's ability to forge a successful economic future despite the many daunting challenges one often hears about."

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"For more than a generation, the outside world has been ready to write off Japan's economy as yesterday's story, in contrast to the tomorrows being created elsewhere, especially in China. Ulrike Schaede clearly and convincingly lays out how out-of-touch that judgment is—and how much more impressive the creativity, flexibility, and reinvention of the Japanese business system look when examined up close. The crispness and concision of the book make it a pleasure to read, and its originality will make it useful for anyone who wants to understand the next stage in global business."

—James Fallows, The Atlantic

"Schaede truly understands Japanese business strategy and culture. With deep insights and keen analysis, she offers an update on how Japanese companies are evolving to compete in the new global economy, and she shows how they carefully harmonize social stability with economic success."

—Kyota Omori, Chairman, Mitsubishi Research Institute

"A gem! Schaede links corporate culture to incentives and outcomes, and shows how Japanese firms have kept the tight corporate culture that makes things right, but add elements of the loose culture that makes the right things. She gives concrete examples of Japanese firms that got it right and how they did it."

—Robert Alan Feldman, Professor, Tokyo University of Science

"Japan's economy and its evolving business systems matter, and this insightful evaluation explains how and why. A definite read."

—Hugh T. Patrick, Chairman, Center on Japanese Economy and Business, Columbia Business School