

Changing Japanese Corporate Structure

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February 11, 2000

It is a great pleasure for me to be here today and to be given an opportunity to address all of you at this conference. Given my title, "Changing Japanese Corporate Structure," I would like to first speak about the structural changes that corporate Japan is undergoing, then move on to the future direction that Japanese corporations should aim at.

Year 2000 should be a year in which the business sector takes the lead in uplifting the Japanese economy. Since Prime Minister Obuchi took office in 1998, the Japanese government, for its part, introduced stimulus packages on an unprecedented scale, accompanied by financial reform laws and low interest rates. With all these policies now in place, the year 2000 should be a year in which the business sector takes the lead in uplifting the Japanese economy.

During his visit to Tokyo in January, Mr. Lawrence Summers explained to me why he said the Japanese government's target for this year's economic growth (1%) was too modest. I inferred from what he said the importance of confidence, and I agree with that. From that perspective, it is encouraging to learn that business leaders are finally regaining confidence in bringing about a private-sector led economic recovery. According to the Nikkei survey published on January 20, 2000, 76.8% of corporate presidents said they expect to see a "private-sector led recovery within the year 2000."

Are Japanese Corporations Really Changing?

Many Japanese corporations are undergoing restructuring. Corporate executives must bring the ratio of good performing companies to the majority side. Having said that, I believe many of you here today are still wondering: Are Japanese corporations really ready to conduct vibrant and strong performances? Have they undergone enough restructuring?

My answer to the question is that many Japanese corporations are ready. It is true that bi-polarization of good and bad performing companies is still apparent. Therefore, it is up to corporate executives' to bring the ratio of good performing companies to the majority side.

IRREVERSIBLE SHIFT TO GLOBALLY ACCOUNTABLE CORPORATE SYSTEM

But how should we do this? I believe we can increase the majority side by accelerating the movement toward the Anglo-American management model. Many successful corporations are shifting to such a globally accountable corporate system. Let me introduce four signs illustrating Japanese corporations are transforming themselves into a more competitive corporate structure.

1) *Shift to Shareholder Value*

First of all, we can observe a shift in Japanese corporate management to value shareholders. The Nikkei newspaper on January 20, 2000 also reported that 35.5% of company presidents surveyed said they use "ROE" as their companies' performance index, second to "cash flow" which 50.4% said was important. Conversely, those who answered "sales revenue accounted for only 5.8%. This signifies a considerable shift

from the traditional focus on sales to pursuing shareholders value. As Japanese corporations come under close scrutiny by shareholders, we can expect higher performances.

2) *Introduction of Transparent Accounting Standards*

Second, transparent accounting standards are now taking hold. The key enabler is the introduction of the consolidated accounting system scheduled for April 2000, although the introduction of the consolidated taxation system was postponed until 2002 or later. By September 1999, 358 listed companies (equivalent to one sixth of the listed companies), double the number of 1998, have voluntarily disclosed their consolidated accounting. The shift to the consolidated accounting system will inevitably enhance transparency, as well as force corporations to focus on their core competency. In fact, corporations who have already undertaken the consolidated accounting are reorganizing their group companies. For example, Itochu decreased the number of companies subject to Itochu's consolidation from 1027 in March 1999 to 982 by September 1999, and Fujitsu decreased its group companies from 552 in March 1999 to 536 by September 1999.

3) *New Corporate Governance*

The third aspect is that corporations are establishing quality corporate governance by two means: introducing outside directors into the Board, and separating the Board members and corporate officers.

By inviting Board of directors from outside, management can hear impartial and varied opinions about their corporate strategies, allowing them to make revisions that are more competitive. In addition, inviting outside directors means revising management processes, which more often than not in the past have been secretive, so this will undoubtedly raise the degree of transparency of management.

Separating the Board members and corporate officers strengthens the role of the Board, since it separates the audit function from business operations. This was first introduced by Sony in June 1997, but within two years, approximately 10% of the listed companies (about 200 companies) have taken up the system. These movements have contributed to raising objectivity and transparency of corporate management.

4) *Changes in Human Resources Management*

Lastly, human resources management is changing. More corporations are now emphasizing employability over seniority and lifetime employment. According to a White Paper on National Life issued by the Economic Planning Agency, corporations who answered, “We will shift to employability based human resources management from lifetime employment,” increased to 49.5% in 1999 from that of 37.8% in 1993, while those who answered, “We will keep life-time employment,” dropped to 2.3% in 1999 from that of 11.0% in 1993.

The Nikkei survey also revealed corporations’ continuing engagement in employability rather than employment. Nearly two-thirds of all corporate presidents answered they will

continue to reduce the number of employees.

Lack of liquidity in the labor market has long been cited as the cause of slow change in the Japanese corporate structure. Emphasizing employability, coupled with the new pension system currently under discussion, would bring about higher labor liquidity and quicker change in corporate restructuring.

INCREASED INWARD FOREIGN DIRECT INVESTMENT IS ACCELERATING CHANGES

Foreign Direct Investment Creates New Value

Along with the introduction of a globally accountable corporate system, a rapid increase of inward foreign investment is functioning as another engine for corporations to change. The value of inward FDI in the first half of 1999 exceeded that of 1998, of which 34.1% was in the financial sector, and about 24% was in IT and retail industries. Japanese corporations, particularly in the 1980s, achieved high performance mainly through the pursuit of efficiency, such as quality management. I do not deny the importance of efficiency, but in today's global competition, we must also be effective, i.e., create new value. To do so, we need greater exposure to different values, which in many cases are brought about by inward FDI. FDI, in addition to the money, brings in investors' perspectives and corporate management styles that are not only new but also applicable to traditional Japanese enterprises. Consequently, FDI contributes in two ways: one is by strengthening competitiveness, and the other is by activating or creating new markets.

Strengthening Competitiveness

Japanese corporations are strengthening their competitiveness, particularly in the financial and auto industry, by means of foreign capital. For instance, many Japanese financial enterprises have accepted foreign capital² in the form of an M&A, and are re-establishing their competitiveness. In the auto industry, we have witnessed a successful M&A by Ford of Mazda, and hopefully Renault and Nissan will succeed also. By accepting foreign capital in the auto industry, there is a spill over effect on the vendors. In Ford and Mazda's case, the vendors were inevitably dragged into global competition. They are now required to meet not only Mazda's design but Ford, too. Furthermore, they have to compete with what used to be Ford's vendors in the U.S. Molten, a renowned manufacturer of athletic equipment (such as basketballs) and auto parts, interpreted the merger as an opportunity rather than a risk. By rapidly adapting to the global competition, Molten increased its revenue from Ford and Mazda compared to its revenue before the merger.

Creating New Markets

Inward FDI has activated and created a new market in Japan, particularly in the telecommunications sector. The price of telecommunications has dropped drastically (the price of an international call to the U.S. from Japan has dropped from about 450 yen for a three minute call in 1998 to the range of 100 to 200 yen in 1999) and new telecommunications services were created. Furthermore, we are witnessing the emergence of a new market such as Internet banking, by integrating the telecommunications and financial sector. The virtuous circle of

increasing inward FDI, which enhances competitiveness and creates new markets, will eventually contribute to private-sector-led economic growth.

CHANGES IN JAPANESE PEOPLE'S CONSCIOUSNESS

Another important factor that would encourage private-sector-led growth is the tendency of the national mentality to pursue competition and entrepreneurship, while there is less opposition to the infusion of foreign capital. For example, increasingly more Japanese people are welcoming the merger of Nissan and Renault, counting on Nissan's revival, while admitting the revival cannot be brought about without painful restructuring such as layoffs. Also, foreign investment banks are now attracting the attention of new graduates from universities.

1. Greater Focus on Employability is Encouraging People's Eagerness to Learn

With such a change in the national mentality, Japanese people are focusing more on employability over lifetime employment. According to Dentsu Institute for Human Studies' analysis in 1999, Japanese consciousness toward the Japanese employment system has changed. For instance, only 6.30% think that the seniority systems should be maintained, while 53.8% think that performance-based salaries should be introduced. In addition, more than half of the young men from their teens to their thirties were viewed as having entrepreneurial spirit.

The shift of people's preference to performance-based salaries is motivating them to learn specialized professional skills. According to a 1999 White Paper on National Life, more than 90% of the workers voiced the necessity of learning, and 50% of the workers are actually pursuing advanced skills. This movement will further strengthen Japan's competitive edge as a

source of rich human capital.

2. Check-list from “The Long Boom”

“Long Boom—A Vision for the Coming Age of Prosperity,” written by Peter Schwartz and Peter Leyden, presents “10 Guiding Principles” that are useful in checking whether the Japanese private-sector is ready to become the driving force to push the Japanese economy into a “long boom” age. The authors list “10 Guiding Principles” as enablers to maintain economic growth for decades to come. They are: 1) Go global; 2) Open up; 3) Let go; 4) Grow more; 5) Always adapt; 6) Keep learning; 7) Value innovation; 8) Get connected; 9) Be inclusive; and, 10) Stay confident.

From what I have presented so far, Japanese corporations are going global, opening up to foreign capital and letting go of the past management traditions to adapt to the new business environment. Japanese people want to keep learning. Japanese corporations are almost ready to take off. What we need to stress from now on is, as Mr. Summers has inferred, confidence.

FUTURE DIRECTION OF JAPANESE CORPORATIONS

Our ultimate goal lies beyond the market-oriented economy. Companies should continually create total societal value by paying attention to all stakeholders.

1. Continue Corporate Structural Reforms to an Autonomous Recovery

Let me move on to the future direction Japanese corporations should aim at. Needless to say,

Japanese private-sector's immediate task is to place the Japanese economic system in a position where it can meet the principles of a market-oriented economy. However, I don't think that the realization of a market-oriented economy is our ultimate goal. I believe that our ultimate goal lies beyond the market-oriented economy.

2. *Rethinking The Goal of Corporations — Corporate Social Responsibility*

While enforcing a dynamic shift to a market-oriented economy, Japanese private-sector leaders must think about the meaning of our company's existence in today's society. I think that companies should continually create total societal value by paying attention to all stakeholders. According to a survey conducted by J.P. Kotter and J.L. Heskett, both Harvard University professors, the performance of companies that balance the interest of all constituencies including customers, shareholders, and employees, as well as empathize with managers' leadership at all levels, is four times higher than those who do not.³

Conclusion

“Balancing market interest and public interest,” is ultimately impossible without individual governance. In aiming to balance the interest of all constituencies, I believe we must consider corporate management not just from a corporate perspective, but also from the perspective of a society as a whole. What should the vision of a good society be, and what kind of philosophy should function as the backbone of such a vision?

Since I was appointed Chairman of the Japan Association of Corporate Executives last April,

I have set my first assignment to “challenge to find the principles which will form the backbone of Japan in the next era.” To carry out this assignment, I have suggested that it is necessary to focus on four aspects of governance, namely; corporate governance, governance of society, global governance, and individual governance. This project has just taken off, and I plan to issue a project report by the end of this year. Whatever the conclusion of the report may be, I believe that realizing, “decent capitalism,” or, “balancing market interest and public interest,” is ultimately impossible without individual governance—conscience and sound judgement—of each of us individually.