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Corporate Self-Transformation as an Engine for Growth

Chairman's Message at the Fiscal 2014 Annual Meeting

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Introduction

Abenomics with its aim to end deflation and revive the Japanese economy has arrived at a watershed point where success and failure hang in the balance. Success hinges on the third arrow of growth strategy and whether sufficiently bold steps can be taken to reform the systems that obstruct growth. Sustained growth cannot be realized without determined reform. Compared to other countries, Japan is saddled with numerous constraints that cannot be easily or quickly resolved, among which are the declining birthrate, the aging society and the resulting shrinkage of the population. In light of these constraints, Japan has no choice but to implement fundamental and bold reforms without delay.

The most important key to ensuring that the fruits of reform are translated into economic growth rests in the hands of businesses and their ability to contribute to the increase of national wealth through their own growth. For this reason, companies must have a keen awareness of their role as locomotives of growth, and as corporate executives we must remind ourselves that ceaseless pursuit of self-transformation will provide the engine for growth that the Japanese economy needs.

In the pursuit of growth strategies, there are two broadly defined challenges that deserve the special attention of both the nation and Japanese companies. The first challenge is “being the world’s most advanced” in an environment of global competition. The true competition for many Japanese companies comes from global companies. We must stare this reality in the face. To survive the pressures of intense competition, Japanese companies must enter global markets armed with the most advanced high value-added products and services, where they must absorb the vitality and energy of the world. And finally, our nation and our companies must transform themselves to create the world’s most advanced environment that will attract the world’s best companies and human resources to our shores.

The second challenge is to improve productivity by “accelerating the regenerative process of replacing the old with the new.” This applies to both our industries and businesses. The achievement of economic growth against a backdrop of a declining birthrate, an aging society, and a shrinking population will require far-reaching improvements in capital efficiency and labor productivity. Promoting the reorganization, consolidation, and exit of businesses, and improving productivity in service industries will be of particular importance. To accomplish these objectives, corporate executives

must stand at the forefront of implementing reforms in areas where the resolution of problems has been long postponed.

As we stand at the start of a new fiscal year, I would like to share some of my thoughts with you keeping this framework in mind.

1. Pursuing Corporate-Led Growth with Firm Resolution

During fiscal 2013, Keizai Doyukai established the National Reform Platform and the Center for Policy Study and Analysis. Our goal was to enhance our capacity for presenting timely and dynamic opinions and recommendations to the government. However, economic growth cannot be realized by merely requesting the government to take action. It is vitally important for us to take the initiative in overcoming difficult challenges and to transform ourselves into highly competitive and profitable companies. It is through these accomplishments that we will be able to take a leadership role in achieving robust economic growth.

I have mentioned the two basic challenges that must be met in realizing growth: “being the world’s most advanced” and “accelerating the regenerative process of replacing the old with the new.” To overcome these challenges, companies must bolster and redouble their commitment to taking innovative action.

The first such action is the practice of global management that takes the offensive to achieve victory against global competition. In particular, Japanese companies that are competing in global markets must actively increase investments and exports of products, infrastructure, and services to emerging economies. By doing this, they will contribute to economic growth and improvement in the standard of living in those countries, while also acting as a locomotive force for Japan’s growth by contributing to trade and income account surpluses.

However, this will require Japanese companies to achieve levels of competitiveness and profitability comparable to that of European and American global corporations (not only major corporations, but also second-tier companies and SMEs that hold top shares in niche markets). Specific requirements include the following: active pursuit of M&A strategies, including the acquisition of overseas companies; bolstering R&D capabilities through open innovation approaches, including the participation of overseas universities, researchers, and start-up companies; promoting diversity, including the appointment of women and foreign nationals to decision-making boards; and strengthening corporate governance to ensure good management.

Second, Japanese companies must orient their management toward high capital and labor productivity. In Japan, management resources, such as human resources, capital, and business seeds (technology and ideas), do not flow smoothly from mature industries to growth industries, and instead remain trapped in businesses and industries that have already lost their competitiveness. This represents a serious structural problem for Japan, and Japanese companies must face this challenge squarely. Instead of avoiding reorganization, consolidation, and exit, companies must adopt a positive attitude toward

reorganizing their businesses, consolidating their facilities, and accelerating the process of regeneration through spin-offs and spin-outs.

Special efforts must be made in Japan's service industries where productivity is markedly lower than in Europe and the United States. Information technologies must be more extensively deployed, and optimal scales of operation must be achieved by restructuring and consolidating businesses and companies under executives and corporate entities that are in possession of sophisticated management know-how.

Efforts must also be made to smooth the movement of human resources to growth sectors. In the past, Japanese companies developed various systems and arrangements predicated on lifetime employment. These systems (for example, retirement allowances based on final salary) should now be thoroughly reviewed. It is absolutely essential to adopt new systems and arrangements that do not work to the disadvantage of people who choose to take on new challenges.

2. Calling on the Government to Implement Thoroughgoing Institutional Reform for Strengthening the Foundations of Growth

We are calling on the government to pursue two courses of action: to take concrete steps toward transforming Japan into the easiest country in the world for conducting business, and to implement fundamental reforms that will enhance productivity and accelerate the regenerative process of replacing the old with the new in industry.

Regarding the former, the first step should be to speed the development of innovative initiatives in National Strategic Special Zones. In March 2014, Tokyo and certain other areas were designated National Strategic Special Zones. It is important for the designated areas to thoroughly exploit all the possibilities for regulatory reform provided under the Act on National Strategic Special Zones and to continuously suggest additional regulatory reforms. For example, using Singapore as a benchmark, implementation of the world's most advanced initiatives should be permitted in the Special Zones in order to transform them into the easiest regions in the world for starting new businesses. By accomplishing this, Japan should strive to transform itself into a country that attracts businesses, human resources, and funds from all parts of the world.

As the second step, the government should pursue economic partnership agreements. As a country rich in human resources but poor in most others, Japan achieved its prosperity by making maximum use of the benefits of free trade. This fundamental position will remain unchanged in the future. Japan must realize a high level of liberalization in trade and investment. It must strive toward standardization of international rules and regulations and harmonization of certification processes. The Trans-Pacific Partnership Agreement (TPP) is particularly important, as it represents a breakthrough to economic growth and will accelerate the process of Japan's globalization. Therefore, we fully support the TPP negotiations and strongly urge the government to overcome all obstacles so that Japan can join this framework.

With regard to accelerating the regenerative process and improving productivity, the first step should be to halt the overprotection of companies and businesses that are no longer competitive. This means curtailing and abolishing subsidies and preferential tax measures. The financial resources that are freed as a result of this policy should be used to reinforce safety nets and to smooth the movement of human resources to growth industries in order to ameliorate the pain that accompanies the closure of businesses.

The government's second step should involve the elimination of vested interests and the promotion of regulatory reform aimed at facilitating new entries. Industries protected by regulation, particularly service industries providing services of a public nature, are shielded from competition and have little incentive to improve their productivity or quality. As a result, they do not engage in the regenerative process. Smart regulations should be applied to these industries to increase new entries and to encourage productivity and quality improvement. The outcome of such policies would be to promote growth and expand employment in such fields.

The third step should be aimed at reforming work styles to facilitate greater creativity in the workplace and to enable the wide range of human resources, including women, older persons, and foreign nationals, to demonstrate their full talents. Measures must be taken to provide women with more opportunities in the workplace. In addition to current measures, tax and social security systems that discourage women from working must be reviewed. These systems should be redesigned to be neutral with regard to how women choose to work.

We should create a society where older persons are able to work and remain active. This is a common challenge for the entire world, but particularly for the advanced nations. In Japan, we already have the know-how and experience to make this happen. And most importantly, we have a population of older persons who are highly motivated to work. Japan should act on these advantages to create a model of an ageing society and share this model with the entire world.

Creative work that generates high added-value will become increasingly important in the future. With this in mind, the fundamental principles of the employment system must be drastically reformed to shift to a style of work that encourages the expression of individual creativity. Japan must adopt the position that the development of the individual's capacities and the individual's growth raises the competitiveness of not only the company or organization to which the individual belongs but also the competitiveness of the entire nation. Acting from this perspective, Japan must establish systems that allow highly diverse human resources to work flexibly without being tied down by time and space constraints.

3. Revitalizing Japan by Restoring Fiscal Soundness through Sustained Economic Growth and Revenue and Spending Reform

The revitalization of Japan requires the realization of fiscal soundness through simultaneous progress on two fronts: achieving sustained economic growth and

reforming the structure of government revenue and spending. As difficult as this may be, it is the only option available.

However, the government's Mid-Term Fiscal Plan announced last year lacks clear and concrete prescriptions for achieving a primary balance surplus by 2020, as Japan has pledged to the international community. Therefore, the government must ensure the confidence of the international community by showing its unshakable commitment both domestically and internationally through the incorporation in the Basic Plan for the Economic and Fiscal Management for fiscal 2014 of specific measures and schedules for promoting growth strategies and restoring fiscal soundness. Also, playing an active role in global economic recovery should enable Japan to make a "proactive contribution to peace" that contributes to both world peace and international stability.

To show its determination, Japan must act on government revenue reform. A two-stage consumption tax hike has already been legislated, and the initial stage has been implemented. Therefore, the government should first move forward to stage two of the consumption tax increase. At the same time, the effective corporate tax rate should be reduced to ensure equal footing with other countries and to strengthen Japan's locational competitiveness. Special taxation measures and various other preferential corporate tax measures should not be continued after their policy objectives have been achieved. To prevent this situation, such measures should be rigorously examined from the perspective of their purpose and impact, and should be scaled back or abolished as needed.

Second, in the area of government spending, fundamental reforms for achieving a sustainable social security system must be debated and concrete measures devised to keep social security expenditures down. In particular, effective measures must be taken to slow the increase in health and nursing care spending. In this context, it is absolutely essential to strengthen the linkages between health and nursing care services, to achieve greater efficiency in health and nursing care service delivery systems, and to bolster the productivity of operators. Institutional and structural reforms are unavoidable if these objectives are to be accomplished.

Third, intra- and inter-generational disparities in bearing the cost of social security must be reduced. This will require a thorough review of the distribution of the burden of social security. Placing an excessive burden on working generations and applying systems and policies that impede the fair distribution of the burdens of social security can drain the economy and society of its vitality and become an obstruction to economic growth. To achieve economic growth and sustainable social security systems against a backdrop of a declining birthrate and an aging society, the cost of social security will have to be broadly and fairly borne by the whole of society.

The fourth pertains to political and administrative decentralization. Although this is not currently included among the government's priority policies, decentralization should not be forgotten. Japan is a major country with a mature society, and the needs of its people are becoming increasingly diverse. As such, Japan is already very close to the limits of centralized governance. It should be noted that among the mature major countries of the world, those that are doing relatively well are countries functioning

under a federal system. It is time for Japan to earnestly pursue the early adoption of a *doshu* system of regional autonomy.

Conclusion: Vision for the Future of Keizai Doyukai

As we have seen, there are many problems that Japanese companies and the government must overcome. It would not be an exaggeration to say that the difficulty of resolving these problems is on par with the difficulties that were surmounted in reconstructing the nation from the utter devastation of World War II. Two years from now, Keizai Doyukai will be feting the 70th year of its founding. Looking back to this history, we must call to mind that our organization was born of the enthusiasm and commitment of our founders who pledged themselves to rebuilding the Japanese economy from the ashes of the war.

The role and significance of Keizai Doyukai has gradually evolved with the changing times. Today, Japan finds itself standing at a critical watershed. Will Japan regain its luster and presence, or will it miss the opportunity for revival and slip toward decline? Keizai Doyukai should take this opportunity to return to its origins to reevaluate its *raison d'être* and to reexamine its future course. It is with this awareness that a Project Team for a Future Vision of Keizai Doyukai is being formed in fiscal 2014 with a mandate to engage in thorough discussion during the coming year.

Keizai Doyukai is an action-oriented policy group that is itself willing to change, and I call upon all members to actively participate in our activities and to contribute to resolving problems by bringing to the table their experience, knowledge, and dynamism as corporate executives. On my part, encouraged by the support of our members, I am committed to doing everything possible during the remaining year of my term to achieve the goal of returning the Japanese economy to a path of growth and revitalization to which I pledged myself when taking this office.

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