

Part 2

Issues Japanese Enterprises Face When They Promote Globalization, Which is Indispensable for the Continued Prosperity of Japan - A Deductive Approach toward a New Style of Japanese Corporate Management -

In Part 2, based on the strength of Japanese enterprises we have looked at in Part 1 (what should not change), we will identify enhancement of the presence in growing markets (BRIICS and others) as an introduction, and then the development and use of human resources with a global perspective (fostering new leaders and diversity), growth strategy with M&A as leverage, and corporate governance/CSR as the issues we face when we expand the business globally (what should change) and try to make a proposal on how enterprises should tackle these issues in answer to the expansion of globalization. Furthermore, we will also offer suggestions about enhancing competitiveness of the service/finance industries, which is an area less globalized compared with the manufacturing industry, the symbol of the strength of Japan.

Part 2: Issues Japanese Enterprises Face When They Promote Globalization, Which is Indispensable for the Continued Prosperity of Japan

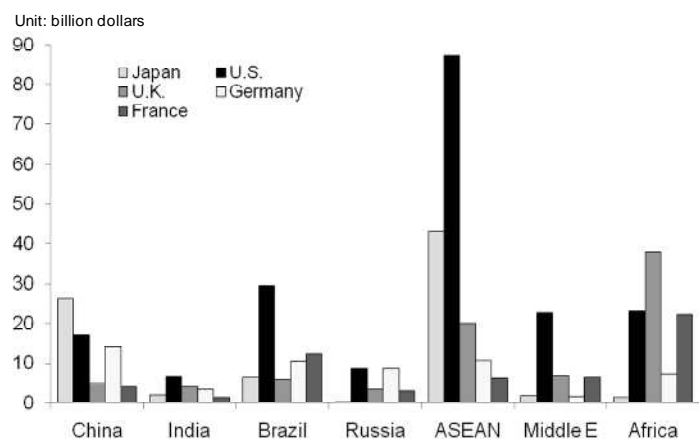
- A Deductive Approach toward a New Style of Japanese Corporate Management -

Introduction: Enhancing presence in growing market (BRIICS⁴ and others)

Generally speaking and with rare exceptions, Japanese enterprises, even some of the companies engaged in most globalized business, generate more sales and profit from the United States, Europe, and Southeast Asia than from other areas, when compared with other nations and regions in terms of market share in each area in the world (Diagram 2-1). This is due to the historical background and geographic conditions. This is the natural result of the strategy to target the nation (United States) or area (EU) with a large and well-developed market and neighbors (Asia) and is quite reasonable.

When the world economy was developing comparatively smoothly, this approach was not controversial at all. Facing an unprecedented global recession, giant markets of developed nations, such as the United States, Europe, and Japan, are more remarkably damaged. On the other hand, China and India still sustain high rates of growth, although they slowed down compared with the best days. When they see that the proportion of these nations and areas in their business is severely reflected in each company's performance, many such companies recognize the necessity for balanced globalization.

Diagram 2-1: Balance of direct investment from five developed nations to the developing nations



Source: Trade White Paper 2008

However, if we want to fully enter these newly emerging markets, we need to develop new business models and marketing strategies different from the ones we have for developed nations. No one would disagree with the examples of low-price cars in the automobile industry and generic drugs in the pharmaceutical industry. In Part 2, we will discuss the base of globalization, including this kind of approach, namely fostering global leaders, approach to diversity and M&A and will touch upon corporate governance and CSR.

⁴ Six nations consisting of BRICs (Brazil, Russia, India and China) plus Indonesia and South Africa

I. Development and use of human resources with a global perspective

In Part I, we pointed out that human resource development was a characteristic and a strength of Japanese enterprises that should be maintained and enhanced. Successful Japanese enterprises have implemented human resource development from a long-term perspective, nurturing employee loyalty to their company and a sense of ownership. They put the focus on general employee education rather than training leaders, aiming at the enhancement of overall ability. This is also the point that should be maintained and strengthened, and it is the fact that one of the characteristics of successful companies is its overwhelming teamwork. Yorihiro Kojima of Mitsubishi says, “At a general trading company, even if an individual employee finds a business opportunity, that person does not take personal credit but rather discusses it with colleagues to create a business model for the company. Adding value to oneself is important, but the business should attach market value to the company. Japanese people are accustomed to this way of thinking, which is very important.” The high level of awareness of employees is the outcome of employee education.

Education provided by the company is not the only thing that matters. The ability to think and judge must be cultivated long before joining a company, and the fact is that elementary and secondary education is very important. We would like to avoid talking about the essence of education here, as long as it is not the objective of this report. However, we just want to point out that school education, which is most important, is often ignored when employee education and the fostering of new leaders are discussed and that leader education in a true sense is difficult unless elementary and secondary education in Japan does not improve.

In Part II, we would like to focus on two of the challenges faced by Japanese enterprises when promoting globalization, which is essential to maintaining the prosperity of Japan in a more globalizing world society: “being global” and “leader.” And, we will consider the fostering of new leaders from the viewpoint of a deductive approach toward the New Style of Japanese Corporate Management.

1. Fostering new leaders

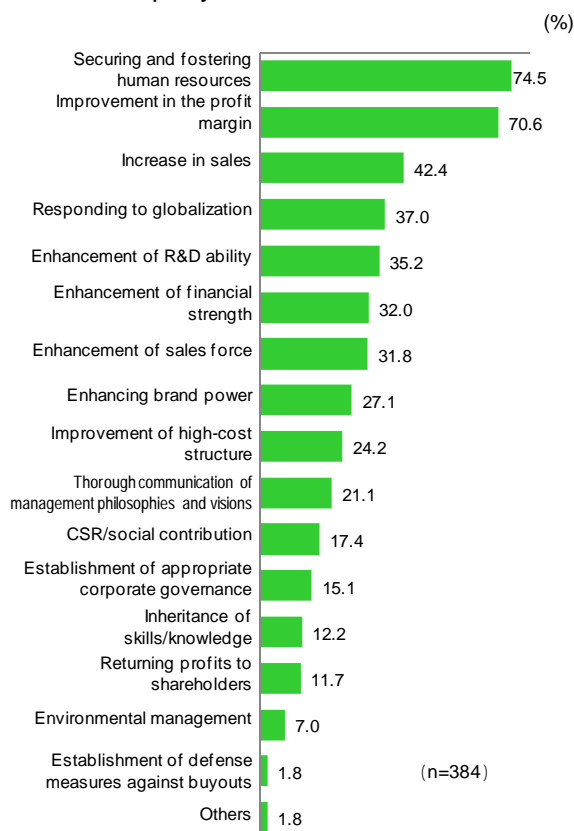
1) Necessity of fostering new leaders

If we ask a corporate leader about the most important job is as a leader, the answer will be “fostering leaders of the next generation.” GE has a 130-year history and is known for its excellence in human resource development. The first CEO, Charles Coffin, noticed that GE’s most important product was not an incandescent bulb or a power generating system but a “system” that enabled sustainable growth. He thought hiring the most excellent human resources and fostering them within the company was necessary, and so he built the foundation for the human resource development system, which has worked until today. He pioneered the

implementation of diversity by recruiting excellent human resources regardless of race, religion, and political conviction.

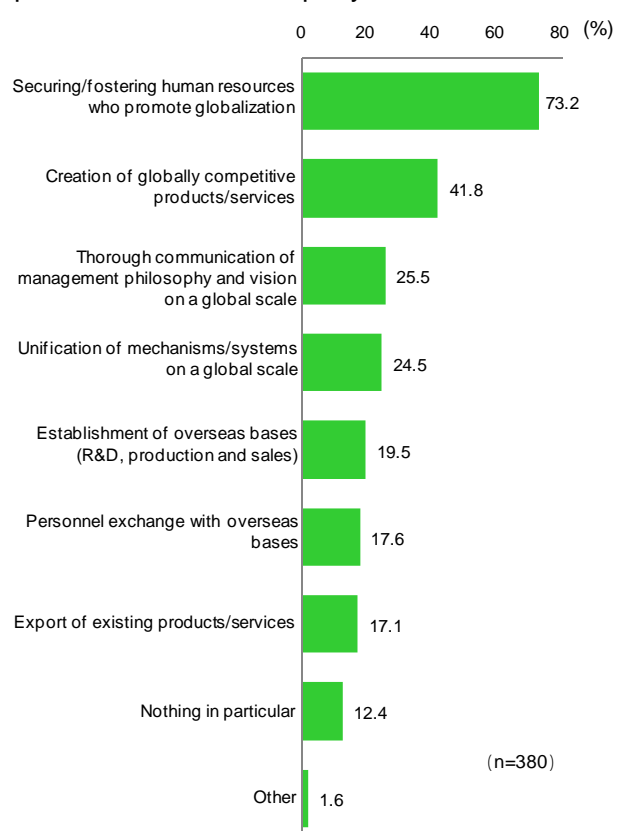
Japanese enterprises have a strong need for human resource development. The questionnaire results show that the first priority is on “securing and fostering human resources” among all important managerial issues of Japanese enterprises (Diagram 2-2). “Securing and fostering human resources who can promote globalization” is outstanding in the answers to the question asking to identify the important issues for each company concerning promotion of globalization (Diagram 2-3). Many companies conduct human resource development programs, but there is a question as to whether they are really producing global leaders who are competitive in this rapidly globalizing world.

Diagram 2-2: Important managerial issues of each company



Source: Questionnaire about Corporate Management by Keizai Doyukai

Diagram 2-3: Important issues in globalization promotion of each company



Source: Questionnaire about Corporate Management by Keizai Doyukai

2) Process of fostering new leaders

Generally, a leader is a corporate leader as well as a practitioner of the corporate philosophy at the same time. Based on this perception, we would like to focus on how such human resources can be fostered, and then we will focus on globalization.

Leaders cannot be fostered simply by developing educational programs or by leaving everything to the personnel department. Corporate leaders must take responsibility for fostering practitioners of the corporate philosophy and developing an integrated process,

including on-the-job training. This is the foundation of human resource development.

New leader development of the ten excellent companies representing Japan, as you see in Part 1, include not only mere training programs but also the passion of corporate leaders, consistency with the corporate philosophy, and practice and experience as factors. If we consider and add employee performance appraisals, corporate strategy, and personal career path to these factors, it will be true leader development. The factors are as listed below. They do not produce a sufficient effect if used individually, but achieve a significant effect if operated as a process where all are associated with each other.

- a) Commitment of the corporate leader and distribution of resources
- b) Clarification and documentation of the corporate philosophy
- c) Leadership training (in the company)
- d) Leadership training (outside the company: MBA, domestic educational institute, etc.)
- e) On-the-job training (overseas assignment, exceptional promotion, etc.)

a) Commitment of the corporate leader and distribution of resources

GE invests 100 billion yen in human resource development every year, and the leaders spend one-third of their time on it, which means an extraordinary commitment. Takeshi Niinami of Lawson always spends about half a day with participants for discussions with them on the last day of the company training session. He uses one-third of his time for human resource development, including communication of the corporate philosophy. Almost all excellent companies in Japan and overseas, including Toyota, Mitsubishi, Panasonic, Sony, and Caterpillar, invest in corporate educational programs. In many cases, the leaders take time to directly listen to the presentation at the leadership training courses. Without the commitment of the top leaders, no leader can be fostered.

b) Clarification and documentation of the corporate philosophy

Kunio Nakamura of Panasonic says, “Companies remaining successful have key briefs and a philosophy, which compare to the backbone of the human body as values shared by all employees worldwide. Otherwise, long-lasting success is hard to achieve.” The importance is represented by his words. Jack Welch of GE also indicates that “having 300,000 employees share the common GE value irrespective of language and culture across the world” composes the base of fostering new leaders. There is no doubt that practitioners of the corporate philosophy, represented by the Toyota Way and Komatsu Way, have become leaders. Fostering new leaders means to clarify the corporate philosophy and to produce practitioners. We interviewed or listened to lectures from 10 companies, and their corporate philosophies are listed on pages 30 to 32 of Part 1. Human resource education of successful companies is based

on a clarified and documented corporate philosophy.

c) Leadership training (in the company)

There are some best practices for leadership training within the company. Listed below is a summary:

- Focus of cultivation is on candidates for management and middle-level managers.
- Structured programs are prepared since different education is required for a different level.
- In most cases, participants are selected. In many cases, selection is based on the employee appraisal to guarantee fairness.
- The corporate philosophy is thoroughly communicated. Leaders are the practitioners of the corporate philosophy.
- An opportunity to exchange opinions with top management including the president is always provided.

d) Leadership training (outside the company)

Leadership training outside the company includes sending employees to business schools at home and abroad (MBA), short-term business schools (often applicable to managers), ISL,⁵ Aspen Institute Japan,⁶ and domestic leadership education institutions operated by university leadership courses. These programs, however, have some restrictions, such as high cost, long terms, and limited numbers of students, and thus they cannot respond to the demands of the majority of companies.

e) On-the-job training (overseas assignment, exceptional promotion, etc.)

In addition to educational programs, workplaces provide very valuable opportunities for training. Seven & i and Honda attach importance to experience in the actual workplace. Toshifumi Suzuki has a policy on this point: “You cannot make leaders; people grow to become leaders themselves.” Details of fostering new leaders based on this idea were explained in Part 1, but the importance of giving opportunities is also found in the example of Honda. When fostering globally competitive Japanese leaders, the company gives weight to the experience of working abroad with local people in their younger days. To further enhance each individual’s leadership, it is extremely valuable to have experience in the workplace, such as responsible duties abroad, a leadership role at an investment destination, stretch assignments, and tough assignments.

What is important here is whether giving an opportunity for experience in the workplace is

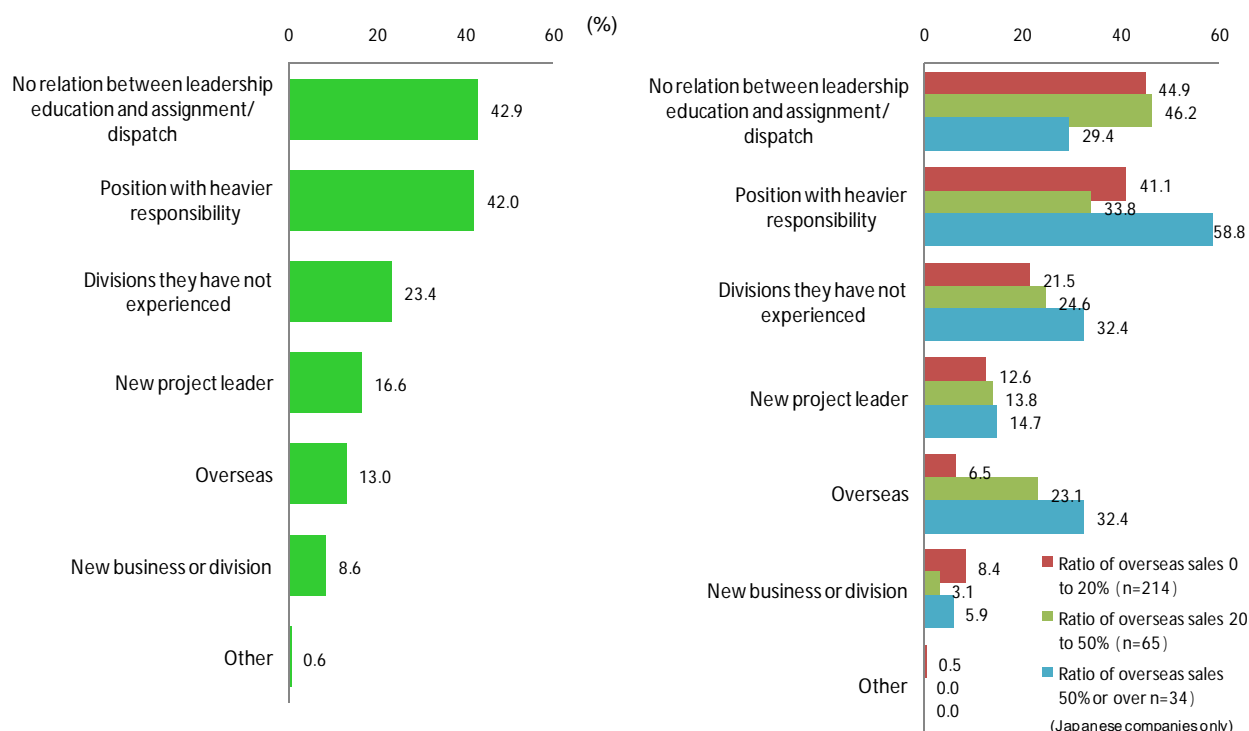
⁵ ISL (Institute for Strategic Leadership) is a non-profit organization (NPO) for leadership development and enlightenment of society.

⁶ An institute established to sophisticate the natures essential for leaders, such as insight into humanity, perspective, intelligence exceeding expertise, ability to judge, and decisiveness, based on the classic texts for leaders and future leaders in every sector of society.

really regarded as one of the processes of leadership education or not. Human resources should be systematically assigned or dispatched to other divisions or overseas in the process of fostering new leaders, not for the mere purpose of gaining experience. This can only add value to the experience.

To the question “Where are the leadership trainees intentionally assigned or dispatched?” in the questionnaire, many answered “position with heavier responsibility,” “overseas,” and “divisions they have not experienced.” On the other hand, approximately 40 percent answered “No relation between leadership education and assignment/dispatch” (Diagram 2-4).

Diagram 2-4: Where are the leadership trainees intentionally assigned or dispatched?



If a leader is a practitioner of the corporate philosophy, the best place for education must be the workplace. As Panasonic’s basic idea is “the subject of human resource development is the workplace itself,” educational processes need to be related to the practice in order to make leadership education investment more effective.

3) Globally competitive leaders

To be a globally competitive leader, you need to obtain “global” factors in addition to the basic nature as a practitioner of the corporate philosophy. What is global competitiveness? It must be the leadership capability that prefers and can lead a diverse team beyond the differences in culture and language. It is not questionable that language ability, namely English, is required to some extent. However, English cannot be everything. You need to learn through education and training to have a fearless attitude in front of foreign people, the ability to get to the point straightforwardly, and communication capabilities for presentations and

debates. What is more important is, however, leadership ability with which you can recognize each other's cultural differences, respect other cultures, share values and principles among people from different cultures and languages, and determine the direction of people's behavior based on common values. Panasonic provides training for employees assigned to other countries. In the intercultural communication session, they recognize that Japanese common sense is sometimes local and not accepted in other parts of the world, and the course helps to deepen the understanding of ways of thinking that differ from Japan, differences in culture and values, and diversity for a trouble-free work life in foreign countries. These are the basics of leadership on a team consisting of diverse members.

To foster globally competitive leaders, the following criteria are required:

- Fostering future leaders is a process where the company's strategy, philosophy, leadership education programs, and on-the-job training are associated with each other. To produce global human resources, on-the-job training with a special focus on experience outside Japan needs to be provided so that trainees experience other countries in addition to implementation of the process of fostering new leaders. Commitment of corporate leaders and the time when they participate in the education is also necessary.
- Leaders are practitioners of the corporate philosophy. It is important to establish a corporate philosophy that is understandable in any part of the world and to build a system that helps employees worldwide understand it. The corporate philosophy must surpass differences of culture, language, and religion, and unite all employees in the world. A genuine global leader can convey it globally, obtain understanding of it, and practice it.
- A personnel system and culture based on equal opportunity, where the same opportunities are provided for all employees all over the world, must be built. A mechanism, where the same opportunities are available to employees throughout the world beyond the barriers of culture, religion, language, and nation, must be made. Global Japanese enterprises work to exchange management-level staff globally by appointing a local employee as the head of the local company or appointing an employee with foreign nationality to an executive position. Still, further globalization of the personnel system is required.
- Globalization of the headquarters in Japan is necessary. GE's objective is to have the same component ratio in the nationalities of management-level employees as the ratio of sales by region. The company started building a system for its realization. This is an example of globalization of headquarters. Kunio Nakamura of Panasonic says, "If all employees shared the briefs and philosophy as common values, anyone could manage a company. So, it would be better if local people were involved in management of the company in each region." In this globalizing world, the number of companies with this kind of culture will surely increase. In fact, the best means of fostering global human resources is the environment, where the culture and the system of the whole company have undergone a shift, and employees

compete with each other irrespective of national borders, in other words Japanese employees do not compete with other Japanese but with people all over the world. This will be an engine to accelerate the competitiveness of Japanese enterprises in the end.

2. Diversity

1) Why diversity is required now

“The world is flat.” As Thomas Friedman mentioned in his book,⁷ the world has become flat when we consider the economy and culture. An incident that took place on the other side of the world affects the exchange market in Japan on the following day, and movements in the finance industry have an influence on the manufacturing industry immediately. What was thought to be barriers in terms of communication and business expansion, such as time, distance, national borders, and personal relationships, has been broken down. As a result, every change on the earth is intricately entangled and has an impact on an unexpected place at terrific speed (Diagram 2-5).

In this way, now is the time when it is difficult to predict the future, and everything changes fast. What is most important for an enterprise to survive in this period is the ability to respond to changes instantly.

How quickly and dynamically a company can shift the businesses keeping

pace with the change in an environment is challenged. Charles Darwin said, “It is not the strongest of the species that survive nor the most intelligent, but the one most responsive to change.” The exactly same thing is happening in the current business world.

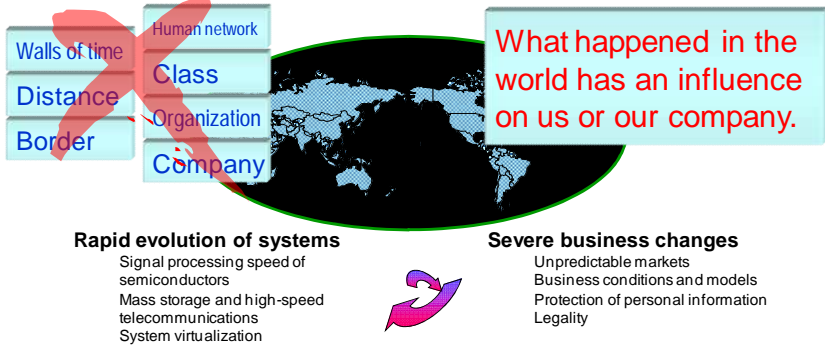
By being united based on “monoculture,” where the same experience, values, and successful experiences are shared, Japanese enterprises have been brilliantly successful. During the time when business changed very slowly, it was the strength of Japan and contributed to the growth of Japanese enterprises.

During that period, the number of vertically integrated companies operating all related sectors by themselves also increased. Neither “monoculture” nor “vertical integration” helps companies survive the rapidly changing time of globalism.

In the rapidly changing globalized business environment, a company needs to abandon the

Diagram 2-5: Rapidly flattening world

- Geographical location of a provider of product/service/information has no meaning.
- Markets, competitors, and rules are changing.



Source: Berlitz International, Inc.

⁷ *The World Is Flat*, Thomas L. Friedman

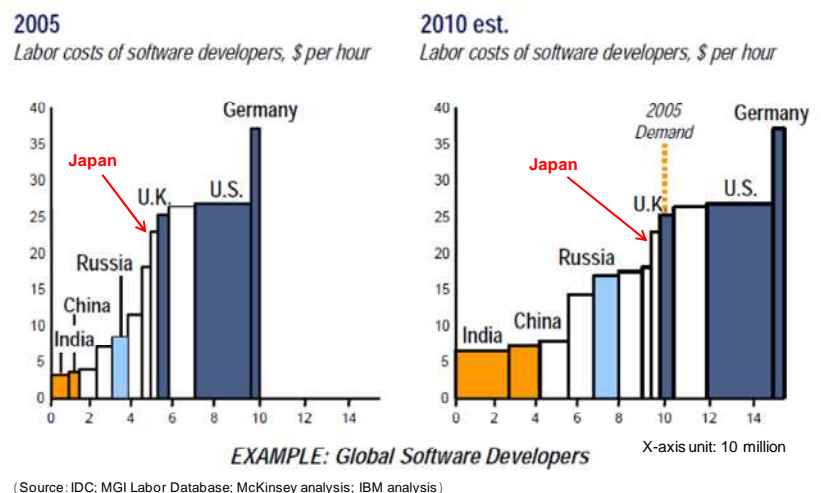
idea of vertical integration. It must be flexible enough to introduce excellent products, services, or functions and adopt an attitude of competitors based on open innovation. A company can flexibly respond to a change that even exceeds expectations simply by changing the combination of companies, depending on the circumstances. Diversity in a corporation means to know its own strengths and weaknesses and utilize the strength of other companies. As a means to enable it, M&A is one of the important options.

2) Effects and method of promoting diversity among employees

a) Securing excellent human resources from around the world

Under the circumstances where the constitution of a company and business models are required to change quickly, the biggest issue for a company is securing and fostering human resources (Diagram 2-3). Global enterprises abroad, including in newly emerging countries, promote the recruitment of excellent human resources from all countries worldwide. On the other hand, in Japanese companies, most managers are Japanese males. However, Japan's population accounts for only above 1% of the total world population. It is obvious that the number of excellent human resources would be significantly different between two cases: seeking resources mostly from males in Japan only or from all over the world. If we take human resources in the IT sector for example, the number of human resources is increasing in emerging nations such as India,

Diagram 2-6: Importance of recruiting human resources from across the world including emerging nations (examples of human resources in IT field)



China, and Russia (Diagram 2-6). If you want to acquire human resources who are prepared for the future, you need to find them not only in Japan but also from every part of the world.

b) Innovative idea from diverse values

b) Innovative idea from diverse values

Recruiting human resources from across the world means that people with diverse senses of value get together. Lifestyle habits are different. Religions are different. Common sense and sensitivity may be different. In the age of rapid change, corporate innovation, such as new business models and new systems, is required. However, people with a similar sense of values and background can produce similar ideas only. If diversity has been promoted, people with a different sense of values will discuss and trade opposing viewpoints. It is not easy to define one direction in this situation, but a novel and innovative idea is likely to come from such

discussions. It can be expected that a unique idea one would not have thought of may change the company.

c) Efficiency by visualization of business operation

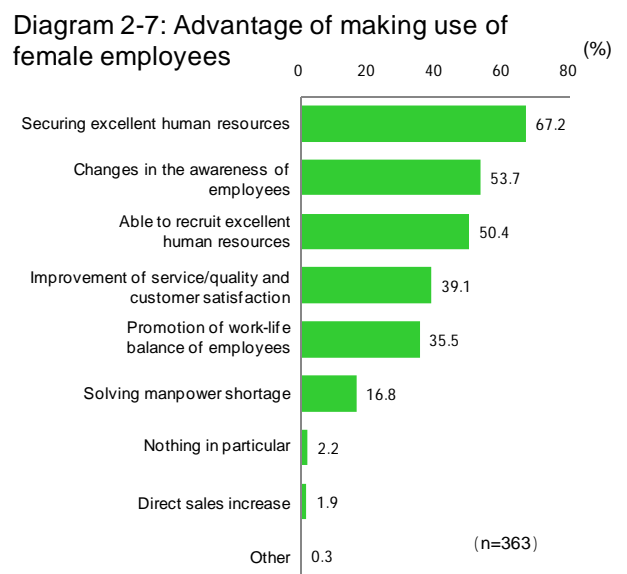
In a Japanese-style monocultural workplace, the process of business tends to be rigid, precedents are followed without any doubt, and such a procedure becomes almost routine in many cases. Where responsibility resides is not clarified, and importance is often attached to forming a consensus of all participants rather than listening to an individual’s idea. It will be difficult to catch up with changes and speed in the future.

If foreign employees with a different culture join a company, first of all, they will ask about the details or roles of the operations or working processes they do not understand. Then, people in the workplace are forced to review the operation or work that has been a routine. As a result, details of the operation, performance goals, and progress become clear. Unnecessary work may be omitted, and the processes may be streamlined. In addition, to have people with different backgrounds understand the work, where responsibility resides, and how to evaluate each process must be presented in an easily understood manner. In other words, promotion of diversity requires visualization of all targets, business processes, systems, and evaluation methods. By facilitating visualization, acceleration and high efficiency in the operation can be expected. Furthermore, even when the business environment is undergoing significant change, you will see what should be changed.

d) Promotion of the use of women’s ability as the first step to diversity

Realistically, it is very hard for a corporation constituting of mostly Japanese males to recruit foreign staff, and it is not easy to make preparations for welcoming them. Then, it is a good idea to make the best use of female employees working in the company as the first step. Actually, many companies identified “securing excellent human resources” as the advantage of using female staff (Diagram 2-7).

There is only a small cultural gap between males and females. Because the two speak the same language, it is easy to communicate with each other. However, female employees are thought to have a different background from males, and non-verbal communication cannot be established between the two. So, the details of the business operation and its locus of responsibility and evaluation methods must be



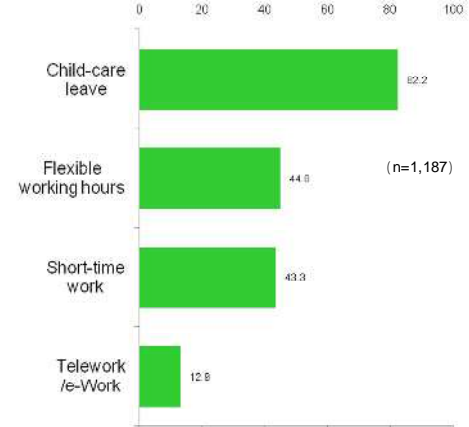
Source: Questionnaire about Corporate Management by Keizai Doyukai

explained in an easily understood manner. Again, visualization of operations, which is essential for diversity, is naturally promoted.

Some female employees may have career intervals due to marriage or pregnancy. Some may experience a time when working full time is difficult. This does not mean that their motivation or ability is inferior. To make the fullest possible use of the abilities of such female employees, it is necessary to provide an environment where they can control time and place freely, through a flexible work style such as teleworking (Diagram 2-8).

What matters in these cases is appraisal. Under conventional Japanese-style corporate management, spending an extended period of time and working hard in front of the boss was regarded as good, and such subordinates tend to be highly evaluated. If a company uses teleworking, this appraisal system needs to be changed as well. That is to say, it is necessary to set clear criteria with which people producing the same results must be equally evaluated regardless of the time they spend and their location. As a result, visualization is further promoted and a variety of people, including foreign, elderly, or handicapped people, are welcomed. Thus, the company can step into the substantial phase of diversity.

Diagram 2-8: Ratio of utilization of the company's support systems (for working mothers) (%)



Source : Working Women's Work & Life Survey 2009, J-Win

3) Necessity for and conditions of global leaders

a) Global leaders promoting diversity

When diversity has been instilled in the company, Japanese-style leaders cultivated in a conventional monoculture will find that it is difficult to lead the team. People are needed who can put together the thoughts and values of diverse and excellent people and lead the team aggressively. This is type of global leader we want in this rapidly changing society.

b) Conditions for global leaders

The elements required to be a global leader are diversity and inclusiveness. A variety of human resources with different values is attracted to a company that has achieved diversity. It is important to value each individual, fully utilize their strengths, avoid equalization and unification, captain the team in a comprehensive way while accepting the differences, and make them strive to achieve company goals. Global leaders must have these two abilities. Specifically, the following two endowments are the conditions of the leader of a global team:

- Able to understand different cultures

In a company where people from different nations work together, values, cultural

backgrounds, historical perspective, and the religion of each nation must be accepted and respected.

- Able to analyze precisely and think logically

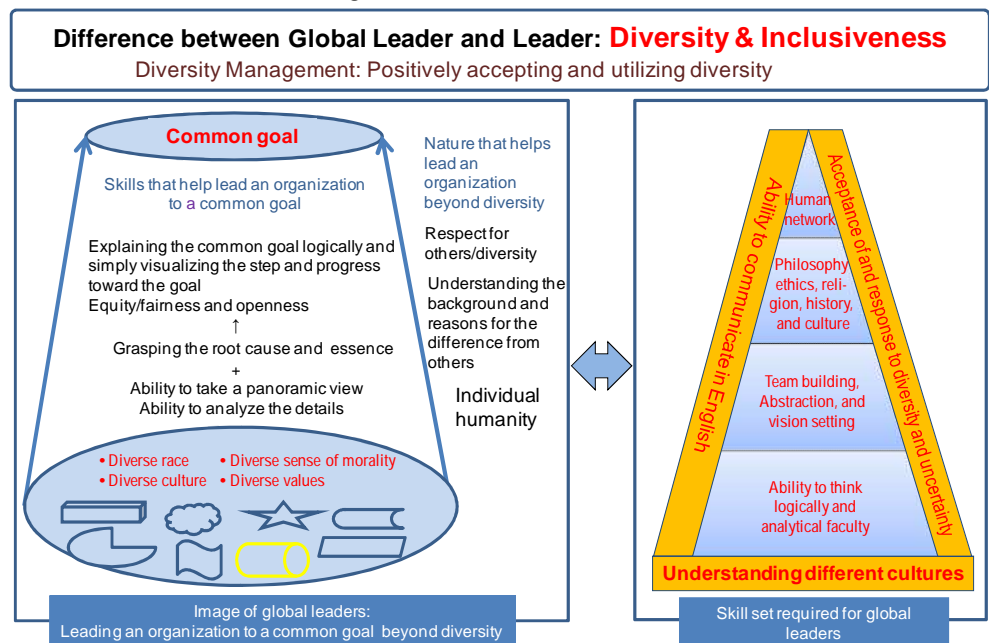
To lead a group of people with different backgrounds and opinions, what is most important is to be logical. Unless you explain analytically, logically, and cogently, no one can accurately understand what you say. The leader must have the ability to convince others irrespective of any difference in opinions, instead of relying on nonverbal communication.

To improve as a global leader, knowledge of philosophy, ethics, religion, history, and culture will be necessary in addition to the two endowments above. In fact, when we see corporate leaders who demonstrate global leadership, we notice that many of them are very attractive as a person. Of course, they have excellent managerial abilities but their capacity is not limited to occupational skills. They have their own philosophy and ethics as well as a profound knowledge of art and literature. These kinds of abilities must be acquired to become world-class global leaders in the truest sense (Diagram 2-9). These people have their own personal global human network in addition to one based on their social position and are very active on the international stage.

Going along with the crowd has long been a virtue in Japanese society, so that there are many who do not demonstrate their own sense of values. Unless you have established yourself,

you cannot accept others. It is required of future leaders to mature as a person with a robust sense of values. To foster new leaders who can be successful in global circumstances, each individual's *raison d'être* is most important, in fact.

Diagram 2-9: Conditions of global leaders



(Source: Berlitz International, Inc.)

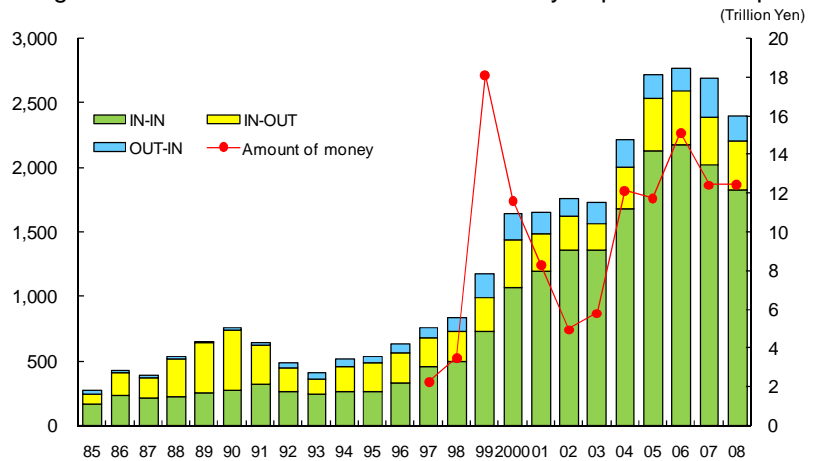
II. Growth strategy with M&A⁸ as leverage

1. Background and awareness of discussing M&A in this report

1) M&A of Japanese enterprises

The number of M&As, mostly the acquisition of foreign companies (in-out M&A⁹), where Japanese enterprises, were involved increased in the late 1980s. This was the result of Japanese companies acquiring more foreign companies (especially in Europe and the United States) to promote diversification to supplement the slowed growth as their regular

Diagram 2-10: Number and amount of M&A by Japanese enterprises



(Source: Recof)

business matured. In those days, some Japanese companies could not evaluate corporate value so that they paid a ridiculous amount of money. Some excessively imposed Japanese-style business or terms of employment on the acquired companies, ignoring the difference in corporate cultures and the characteristics of nations. On the other hand, some excessively adored Western-style managerial approaches. In this way, only a few M&As contributed to the growth of the company compared with the huge investment. They were criticized from abroad that they were shopping for foreign companies and assets. Many Japanese companies could neither deny it nor create new value, resulting in failure. After the collapse of the economic bubble in 1991, in-out M&A by Japanese enterprises became sluggish.

Later, some laws were executed to promote M&A, including removal of the ban on holding companies and forward triangular mergers as well as introduction of stock swap M&As and current value accounting. In 1999, the number of M&As started to increase again, keeping pace with the increase in mergers between domestic companies (in-in M&A). In 2004, the total number exceeded 2,000. The low profit-earning rate of so-called non-core businesses of conglomerates became apparent after the burst of the bubble, and M&As intended to dispose of underperforming businesses in the process of selection and to focus on over-performing businesses became active. In the process of nonperforming loan disposal by Japanese financial institutions, many companies merged and were acquired by corporate reconstruction funds. These are the factors for the dramatic increase in M&As. During the depression after the collapse of the economic bubble, called the lost decade, some Japanese companies recovered

⁸ Mergers and Acquisitions

⁹ M&A between Japanese enterprises is called “in-in,” acquisition of a foreign company by a Japanese company “in-out,” and acquisition of a Japanese company by a foreign company “out-in.”

their power and energy through the selection and focus on managerial resources. They conducted in-out M&As for the purpose of enhancing their presence in the global market and of strengthening and supplementing their core business (Diagram 2-10).

2) Avoiding excessive competition in the domestic market

Japanese enterprises must realistically consider how they should respond to the shrinkage of the domestic market caused by the substantially declining birthrate, a growing proportion of elderly people, and the decrease in population as a result. Corporate leaders are expected to tackle this problem. However, many companies cannot abandon the strategies they had during the high economic growth era. They are reluctantly involved in a war of attrition, or price competition, for the purpose of more sales or a greater share in the industry's excessively competitive market. Many suffer from low profit margins and low ROE. The major premise of Japanese enterprise's global expansion is to improve efficiency in business through administrative mergers and to recover management vitality instead of trying to get in the way of too many competitors. As long as globalization is expanding in Japan, more foreign enterprises will enter the Japanese market. Consequently, it is important to have a viewpoint on how they can escape cutthroat competition. It is the time when we should consider M&As as one of the effective measures to solve this problem, if it is cleverly used.

3) Globalization of business aiming at growth

The next step for the company that has achieved a critical mass in Japan is to draw up a growth strategy targeting overseas markets. As globalization of the world economy develops, not only European and American enterprises, but also ones in Asia and other newly emerging countries are becoming powerful competitors of Japanese companies. Dependence on the company's organic growth has its limits, so that M&A is becoming essential to survive in the global market. In this case, accepting a buyout offer from overseas enterprises would be one of the options in addition to the acquisition of other companies.

4) Necessity to respond to globalization in the domestic capital market

Because the ban on forward triangular mergers was removed, there is a risk of hostile acquisition by overseas companies. Recently, a growing number of companies are introducing measures to prevent such acquisitions. When there is an attempt at a hostile acquisition, management becomes emotional and fights, and the stockholders agree with their attitude as seen from past deals, although it may increase stockholder value in the future. The Japanese capital market should attract more investment from overseas. Only some companies have this kind of opaque tendency but it may worsen the image of the Japanese capital market by foreign companies and investors and may result in restraining investment. Sound M&As may lead to the vitalization of the capital market or improvement in industry efficiency. The current

investment environment, where such M&As are eliminated without an excusable reason, must be changed.

5) Eliminating legal impediments to M&A

In the past, there was a case where the Antimonopoly Act and other laws inhibited M&As that had been originally designed to increase international competitiveness. The Fair Trade Commission should not be a barrier to the improvement of international competitiveness of Japanese enterprises, though there is still a need to monitor more closely the risk of a monopoly of resources through a global-scale M&A. It is undesirable that M&A brings about an extreme monopoly or oligopoly situation by some enterprises where consumers may suffer disadvantages. However, a legal system or a policy that promotes global strategies of Japanese enterprises or does not inhibit M&A for the enhancement of international competitiveness should be promoted.

2. Keys to success found in the cases of successful M&A

Only 26% of all Japanese enterprises that experienced M&A during and after 2000 can be regarded as successful.¹⁰ It clearly indicates the difficulty of management integration. Although it is difficult to accurately identify the reason for the success or failure of the M&As, the survey reports that many of the failed companies aimed at entering into different industries or utilizing external human or other resources. This gives evidence of the fact that acquisition of new businesses or technologies is far more difficult than expected by the company. Many successful companies had quantitative criteria and conducted the M&A based on a management strategy to achieve a clear objective. On the other hand, if a company pays a higher-than-necessary premium with an excessive commitment to consistency with its business strategy, it will be difficult to secure interest on invested capital, and it will exert a negative influence on the financial status of headquarters. The company also has a responsibility to explain the validity of the grounds to shareholders. When the existing business of the company is in a downturn trend, some may want to enter into new business areas for the purpose of diversification of the business structure to maintain growth. However, in many cases, a company had not examined the strategy and determined acquisition only because they needed to diversify the business or because the purchase price was low. They could not create business synergy effects or internal harmony and could not achieve the effect of purchasing, resulting in failure. Even after learning these, to compete in a global environment, in addition to the enhancement of core businesses, M&A should be examined and should lead to success, if the aim is new business fields, sales channels, and technologies based on a management strategy or aimed at “purchasing time” by merger and acquisition instead of

¹⁰ A survey of 2,079 Japanese enterprises that experienced M&A during and after 2000, conducted by Deloitte Tohmatsu Consulting from September to October 2008.

starting new capital investment or R&D from scratch for the necessity of shifting business categories.

An example of a successful M&A, we would like to identify the cases of four companies and identify the essence of success; JFE Holdings and KDDI are successful examples of the in-in M&A, and Daikin Industries and Ricoh are successful in the in-out M&A.

1) Issues they face and purposes of M&A

a) M&A of domestic companies (in-in M&A)

JFE Holdings, Inc., and KDDI Corporation are the examples of successful companies in the M&A between Japanese companies. Their common background for management integration is the “sense of crisis.”

JFE Holdings was born from the merger between Kawasaki Steel Corporation and NKK Corporation. The two companies were losing power in price negotiations in the midst of excessive competition in the industry triggered by a decline in demand after the collapse of the economic bubble and by global reorganization of mining companies, which were the suppliers, as well as automobile and other industries, which were the clients. The efforts of cost reductions within the companies in response to environmental changes were reaching the limit. Finally, they decided to pursue the advantage of scale to secure the ability to negotiate by reducing the number of players in the industry. They also targeted new technological innovations by integrating technologies, reducing costs, and inventing new products, which became the starting point for the M&A.

KDDI was born as a result of the merger of KDD (Kokusai Denshin Denwa), DDI (Daini Denden), and IDO (Nippon Ido Tsushin). Competitors in the mobile communication industry, NTT Docomo and J-Phone, respectively, composed one group, while the three companies had headquarters in each region. The question to this point was the factor of management integration.

b) M&A of foreign companies (in-out M&A)

Daikin Industries, Ltd., and Ricoh Company, Ltd., succeeded in an M&A with foreign companies. Many of the companies successful in the in-out M&A, including the two, aimed at enhancing or complementing the core business to improve their presence in the global market, regardless of the nationality of the target: European, American, or Asian and other emerging nations. Thus, the M&A was conducted from the viewpoint of compensating for their own weaknesses. They did not simply intend to take in sales and profit or obtain new business from the acquired companies. They always kept in mind the creation of new value by mutual complementation or the combination of existing and acquired managerial resources, which is an obvious characteristic. It is largely different from the large-scale M&As by European and

American giants, aiming at cost synergy effects and resulting in restructuring.

Before the acquisition of OYL (Malaysia) in 2007, Daikin Industries had produced no particular results in North America, although the company was achieving good results in Europe and Asia. It had tried entry to the market twice by itself, both resulting in failure. The acquired OYL had a balanced sales structure in North America, Europe, and Asia. It can compensate the weakness of Daikin, in such fields as know-how of low-cost production and operating bases in North America.

Ricoh regards M&A as one of the measures to achieve growth of the existing business and obtain what is insufficient for the expansion into new business fields in a short period of time. The targets of M&A conducted by now were leading sales agencies in Europe and America because they aimed at improving and strengthening the direct sales systems overseas. Under the circumstances where the value offered to the clients was shifting from hardware to solutions and services, a shift from agency sales and OEM (original equipment manufacturer) to direct sales was urgently required, because they needed to provide appropriate products (solutions and services) and therefore they need to meet the customer directly.

2) Factors and approaches that lead M&A to success

a) M&A of domestic companies (in-in M&A)

Three years were required for the integration process of JFE Holdings from the alliance agreement among participating steelworks to the completion of reorganization of the subsidiary businesses in April 2003. The reason for the success was that they put the decision into practice very quickly, while making steady preparation based on the integration plan or middle-term management plan. Other important factors in the success include establishment of fundamental principles and the relationship of mutual trust and strong beliefs of the presidents. They put the principles on the wall of the meeting room saying, "Cast off the interest of each individual company you belong to, put first priority on the benefit and development of the new company, and judge and behave rationally and fairly." It was a constitution of management integration. At the same time, these companies actively exchanged personnel, resulting in improved production efficiency in the manufacturing sites and producing more profit than expected.

In the case of KDDI, the keys to success were that the two biggest shareholders showed understanding and that the presidents of the three companies, DDI, KDD, and IDO, agreed to DDI's initiative in the new company. The merger preparation committee was established in December 1999, when the merger was announced. It consisted of the presidents' meeting and the subcommittees of three companies. Its characteristic was the clarification of the decision maker. They agreed that the three companies would have thorough discussions but the final decision would be made by the then-president of DDI. Dissemination of the new basic principles of KDDI was also important. It was documented as the KDDI Philosophy in 2000

when the new company was established. All group companies agreed that they would act based on this philosophy.

b) M&A of foreign companies (in-out M&A)

Many companies that succeeded in M&A with foreign companies have one common element. They did not replace management of the acquired company with management of the parent company but they built a good relationship of trust with management of the acquired company and left management in the original position. They tried to retain key human resources to build a win-win relationship.

Daikin Industries made it a policy that the two companies would accept the difference of cultures and complement the weaknesses with each other to realize growth that had never been realized by one company. For two to three years after the merger, it respected the independence of OYL. Before entering the integration process, they determined the policy that management of OYL would continuously run the business and that the two companies would pursue the synergy effect cooperating with each other. When three months had passed after the merger, the executives of the two companies got together in Hawaii, which was not the base of both companies, and had an opportunity for mutual communication for the purpose of sharing visions and pursuing the synergy effect. Both companies established a committee to ensure and follow up the synergy effect of the merger and thus accelerated the implementation.

Ricoh had a policy to most utilize the assets of the acquired company including its brand. As for the company management and mechanism, they shared the strengths of the acquired company within the group and used it to strengthen the ability of the whole group. In this context, they improved the efficiency of the group, including integration of product distribution and order placement/receiving systems, and promoted the mixture of corporate cultures by exchanging executives.

3) Key to the success of M&A

a) Leadership of top management and merger of corporate cultures

What is common to the four successful cases is that they selected a target suitable for the issues and purpose they have, completed the M&A with the strong leadership of top management, and mixed the corporate cultures.

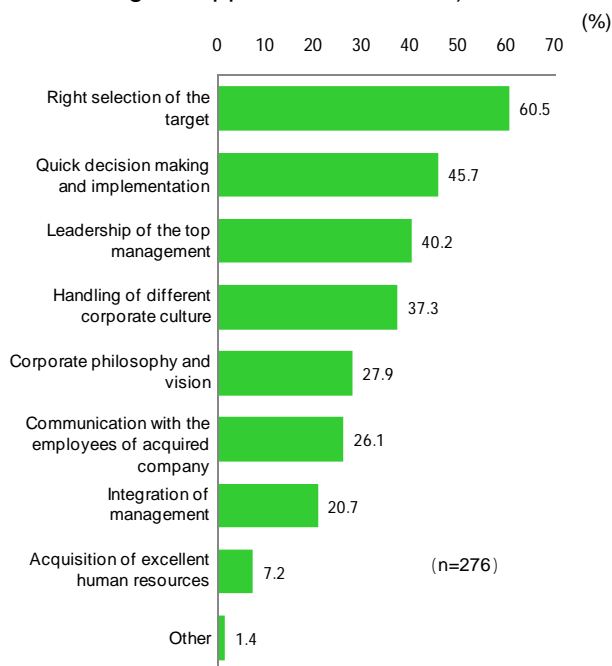
Responding to the questionnaire, as the keys to the success of M&A, “right selection of the target,” “quick decision making and its implementation,” “leadership of top management,” “handling of different corporate culture,” and “management philosophy and vision” are identified (Diagram 2-11). To achieve these key points, sufficient preparation and speedy implementation are required. Therefore, it is essential that the corporate leader exerts strong leadership and a corporate system to support it is established. Among all, the gap in corporate climates/cultures and personnel systems must be filled at an early stage. Otherwise, it is likely

to lead to the moral degeneration of employees (Diagram 2-12). It is important to identify the issues precisely and show the attitude toward taking measures for resolution at an early stage.

Especially when purchasing foreign companies, it is important to build and enhance a good relationship of trust with local management and employees, which requires greater efforts than the acquisition of domestic companies. For this purpose, it is essential to foster global leaders who can understand different cultures and make the diverse staff look in the same direction.

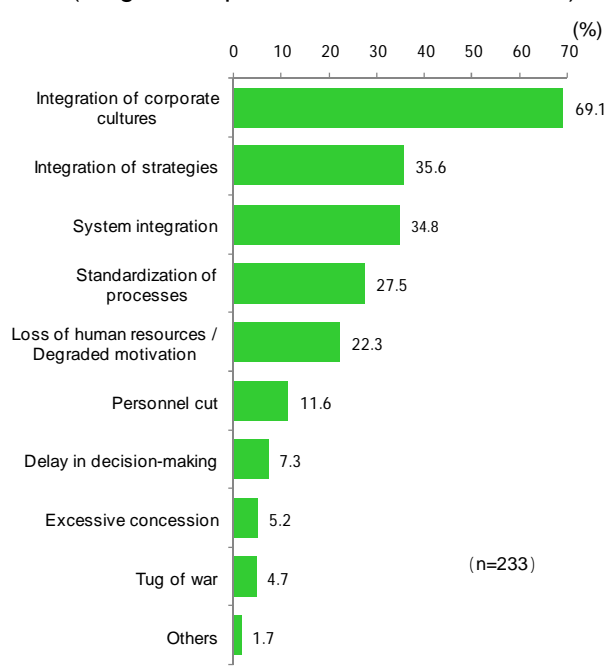
When Daikin Industries acquired OYL, they provided opportunities for human exchanges, such as Vocational Olympics and Bon-odori dance festivals, to overcome the barrier of languages and cultures and to enhance the good relationship with local management and employees, in addition to the above-mentioned executive meeting in Hawaii, and such events are continuously held even now. The corporate leader of Daikin immediately visited the major factories of the acquired company all over the world to explain the policy after the M&A and convey their expectations for further growth by mutually complementing each other's strengths and weaknesses. This deepened the understanding and sense of trust.

Diagram 2-11: What is required for successful M&A? (Companies that conducted M&A and are examining the opportunities of M&A)



Source: Questionnaire about Corporate Management by Keizai Doyukai

Diagram 2-12: What troubled you in the process of M&A? (Target: companies that conducted M&A)



Source: Questionnaire about Corporate Management by Keizai Doyukai

b) Selection and focus based on the core competence

M&A is often discussed together with a company's "selection and focus." This is because "M&A" as a capital policy instrument, and "selection and focus" as a corporate strategy are two sides of the same coin. Corporate strategy concerning "selection and focus" generally means withdrawal from the underperforming operation and return to the core business. It is a

promotion of the corporate behavior with streamlining of business in mind.

Core competence (core technologies and capabilities that can help differentiate from competitors, and for which the company has earned an excellent reputation in the true sense) for which the company believes it is good may be two different things. “Selection and focus” exerts its effect only by focusing managerial resources on the business where core competence has been established. It is necessary to correctly identify the company’s core competence, regardless of whether it is the current core business or not.

3. Attitude of corporate leaders toward M&A

To implement a new style of Japanese corporate management and to achieve sustainable growth and prosperity of Japanese enterprises, there is little doubt but that it is important to take M&A as a management strategy and utilize it effectively. Under the circumstances where the speed of technological innovation is accelerated and the requirements of final consumers change so frequently, it is becoming more and more important to introduce M&A as one of the options of a growth strategy from the viewpoint of “purchasing time” to respond to changes.

Corporate leaders need to consider aggressive M&A as a part of its growth strategy and be ready for the possibility of buyout offers from a global enterprise overseas in a worldwide industry restructuring. They should always think about the measures against buyouts and maintain the mindset as leaders that prevent them from becoming upset.

Considering the influence of the financial crisis, if a listed company’s aggregate market value of listed stock is constantly smaller than its net assets (ignore it if it is a temporary phenomenon), corporate leaders would better think over the meaning of being listed on stock markets. It is not enough to rely on institutional defense measures against buyouts, but implementing the best corporate management after considering the meaning of listed stocks is the best measure to implement. It is important to be strongly aware of it.

M&A is not something that only leaders of large-scale enterprises should be aware of. For corporate leaders of middle and small-sized companies, it is also an extremely effective measure to secure a successor and human resources, as well as to avoid excessive competition, and it should be utilized more positively.

It is essential to enhance the vitality of local areas for the vigorous development of the whole economic society. Each region should not rely on the national government but try to enhance its own appeal. It is necessary to make and continue efforts to improve value and profitability together with other enterprises in the same region. As a part of the local revitalization strategy, the importance of management integration and strategic alliance to move into the next phase of growth is increasing, helping companies from the situation of excessive competition and price competition caused by an excessive number of companies in the same industry and sector.

III. Corporate governance/CSR

1. Corporate governance

The purpose of corporate governance is to establish and faithfully operate a system where transparency, objectivity, appropriateness, promptness, and disclosure are fully secured from the viewpoint of stakeholders, including shareholders in terms of how a company's business status and management decision-making should be. Major constituents of the organization or system to fully secure transparency, objectivity, appropriateness, promptness and their disclosure are thought to be the "roles and constituents of the board of directors," "remuneration and privileges of directors," "internal control system, and appropriate disclosure." In this section, we would like to discuss them in comparison with examples from the United States.

1) Roles and constituents of the board of directors

The primary role of the board of directors is monitoring corporate management in place of shareholders, which is common in Japan and the United States. However, there is a significant gap between Japan and the United States regarding in the operation of the board of directors.

a) Independent outside director¹¹

Originally, it was a system introduced in the United States to secure transparency, objectivity, appropriateness, and promptness. The majority of board members comprise independent outside directors in the United States.

As it becomes clear in the process of the recent collapse of financial markets in the United States, this system does not necessarily ensure the realization of observation and checking in place of stockholders, even though independent outside directors are the majority of the board with a committee system where outside directors take the initiative. This lesson should not be forgotten. In other words, there are many cases where the CEO and friends, respectively, play the roles of independent outside directors of each other's companies. Under the circumstances, it is true that observation of corporate management in place of shareholders in the truest sense cannot be realized. Whether a system works effectively is largely dependent on the sense of ethics and values and the commitment of the person who operates it. Therefore, a person in power should remember it at all times.

On the other hand, it is left to the judgment of each company in Japan whether it would appoint independent outside directors. Although the number of companies that introduce the

¹¹ Generally speaking, "independent" means being independent from business transactions with a parent company, affiliate companies, important business partners, companies with cross-shareholding relationships, main banks, and major shareholders as well as human relationships including blood relationships with corporate managers.

system is increasing year by year, it is less than half even now.¹² Furthermore, many of the companies that have introduced it have only one such director (Diagram 2-13).

Diagram 2-13: Appointment of Outside Directors Meeting Certain Independence Criteria*

* In this case, "outside directors meeting certain independence criteria" (or "independent outside directors" in short) means outside directors who do not fall into any of the following categories: "parent company," "affiliated company," "major shareholder," "relative," or "compensation relationship."

(n=2,378)	Average number of outside directors, per company		Average number of independent outside directors, per company		Ratio of independent outside directors out of all outside directors		Ratio of companies with outside directors		Ratio of companies all of whose outside directors are independent	
		Change from 2006		Change from 2006		Change from 2006		Change from 2006		Change from 2006
Companies with Statutory Auditors	0.78	0.06	0.55	0.09	70.6%	6.3%	44.1%	3.3%	28.2%	4.6%
Companies with Committees	4.47	0.10	3.24	0.15	72.4%	1.8%	100%	0%	50.9%	6.8%
Companies with outside directors	1.90	-0.01	1.35	0.10	70.8%	5.7%	100%	0%	63.4%	6.3%
Companies with parent companies	1.05	-0.17	0.26	-0.02	24.5%	2.1%	56.5%	-3.9%	7.4%	1.7%
Companies with takeover defense measures	1.00	-0.03	0.88	-0.06	88.6%	-3.9%	52.6%	4.5%	44.8%	4.3%

Using data in the reports of companies listed on the Tokyo Stock Exchange, previous data (as of end of October 2006) and newest data (as of August 21, 2008) are compared.

Source: TSE-Listed Companies White Paper on Corporate Governance 2009, Tokyo Stock Exchange, Inc.

Keizai Doyukai (Japan Association of Corporate Executives) has long recommended the introduction of independent outside directors. In fact, however, the system is becoming popular only little by little. We have identified the following impediments. Logically, if the system functions properly, it is possible to prevent abuses by the chairperson or president, even if the worst happens. When the company is making a difficult business decision, they would be able to give valuable advice based on their own experience. This provides a perspective different from the people inside the company, and the advantage of it is thought to be significant.

Possible impediments to the introduction of independent outside directors

- Not enforceable
- There are few successful corporate leaders who have experienced several companies as a professional corporate leader in Japan. It is difficult for Japanese leaders to find human resources suitable for independent outside directors.
- This may be contradictory to the above, but many Japanese corporate leaders have worked for one single company. They know everything about its business operation and, at the same time, attach importance to the sense of being in the workplace. For that reason, independent outside directors without this knowledge and sense are thought not to be able to function effectively, when they joined.

¹² Among all companies listed on the Tokyo Stock Exchange, the ratio of the companies that appoint outside directors including independent outside directors accounts for 45.4% (according to *TSE-Listed Companies White Paper on Corporate Governance 2009*, edited by Tokyo Stock Exchange).

- The chairperson and president are afraid of the possibility of their opinion being rejected, when independent outside directors are a majority of the board.
- They seldom have a chance to hear the case of a company that has introduced the system and enjoyed a concrete advantage.

There are some impediments as above. Logically, however, if the system functions properly, it is possible to prevent abuses by the chairperson or president, even if the worst happens. When the company is making a difficult business decision, they would be able to give valuable advice based on their own experience. This provides a perspective different from the people inside the company, and the advantage of it is thought to be significant.

To further disseminate the independent outside director system, implementation of the following measures is necessary:

- Legal obligation on the appointment of independent outside directors
If the law is enforced in a short period of time, it is likely that many companies will make a system for form's sake but it will not work. Sufficient lead-time for approximately five years will be required.
- Building a pool of human resources suitable for independent outside directors
It may be effective that not only such private organizations as the Japan Association of Corporate Directors but also Nippon Keidanren (Japan Business Federation), Keizai Doyukai (Japan Association of Corporate Executives) and others will independently or jointly establish a system where member companies recommend one or more pooled candidates, regardless of whether the person is active or retired, and information is given to the companies who want to introduce independent outside directors, provided that confidentiality is guaranteed.
- Policy on remuneration from outside the company
If an active leader is appointed an outside director of another company, it is desirable to offset the remuneration by compensation from the company to which the outside director belongs. However, it is totally left to the discretion of the company. In the end, each company will make a policy from the viewpoint of whether it can achieve accountability to the shareholders and other stakeholders.

Although it cannot substitute for the independent outside director system, an advisory board can be an effective means of supporting governance. Especially, for many of the rapidly globalizing Japanese enterprises, it is effective to appoint corporate executives who have experience in exercising control over a nation or region, executives from a think tank, or ex-administration officials as advisors and use them as a sounding board (a person who assumes the role of verifying an idea) from time to time, which will be helpful when the

company faces a variety of problems in an unfamiliar nation or region.

b) Introduction of a committee system¹³

The Companies Act provides that a company that has adopted the committee system shall establish three committees: Nomination Committee, Compensation Committee, and Audit Committee. Whether a company selects to have the committee system is left to the discretion of each company. Once it has decided to introduce it, the majority of each committee must consist of outside directors, which is designated by the Act.

By the way, Institutional Shareholder Services (ISS) expresses an opinion as a representative of foreign institutional investors at each individual general stockholders meeting. Such organizations often judge the transparency of the governance of Japanese enterprises by whether they have an independent outside director system, such directors occupy the majority of the board, or they have introduced a committee system, and request improvement to the companies that do not meet the criteria. We cannot deny it is generally desirable if a company satisfies the formal requirements. As in the example of the United States, it is a fact that many companies meet the requirements for form's sake but the system will sometimes not work. Therefore, ultimately, the corporate leader should decide which system of governance is appropriate, observing the current state of each company.

2) Remuneration and privileges of active and retired directors

In a traditional governance model of Japanese enterprises, even after retiring from the position of director (including chairperson and president), an employment relationship is retained with a variety of titles, such as honorary chairperson, advisor, special consultant, consultant or "company friend." In this case, it is typical that they receive a substantial amount of remuneration and a variety of privileges, including a dedicated company car and secretaries.

Recently, an increasing number of companies abolished the allowance system for the retirement of a director and the advisor/consultant system, and shortened the term of service of directors to one year. That is to say, it is desirable to pay appropriate remuneration to active directors. Once they resign the post, they retire from the service completely to avoid a dual power structure. On the other hand, however, if they assume the role of director or independent outside director of outside organizations, it would be desirable for them to have an appropriate title within the company they belong to (honorary chairperson, chairperson, advisor, special consultant, consultant, or "company friend") in many cases. Considering such cases, titles may be given as necessary, only nominal compensation should be paid, and no dedicated secretary or

¹³ Among all companies listed on the Tokyo Stock Exchange, the ratio of the companies which selected to be a company which has adopted the committee system accounts for 2.3% only (according to *TSE-Listed Companies White Paper on Corporate Governance 2009*, edited by Tokyo Stock Exchange).

car should be provided. Furthermore, age limits should be established on the titles given to persons with outside roles. Thus, a system to eliminate a dual power structure or prolonged employment relationship to the greatest extent possible is desired.

3) Internal control system

Other than the board of directors, each company has its own governance control system. What would be common are consultation/decision-making facilities, including Management Council, Compliance Committee and CSR Committee, and systems like Control Self Assessment (CSA) and an in-house reporting system. These facilities and systems may not be legally obligatory, as conditions vary from country to country. Thus, establishment and operation of these are basically left to the discretion of each company. For example, if you want to have the Compliance Committee function effectively, it is desirable to appoint dedicated compliance officers, leave the operation to them, and top management (chairperson or president) shall not be directly involved. It is also effective to establish a window to accept reports by an outside legal office in order to grasp internal information quickly and appropriately. In any way, corporate governance and an internal control system are “two wheels of one cart” to secure transparency, objectivity, appropriateness, promptness, and disclosure. In fact, higher priority is placed on their promotion and appropriate operation in today’s business environment where globalization advances every day.

4) Appropriate disclosure

It is essential for maintaining good governance, as well as indispensable for securing transparency for stakeholders, to disclose in a timely and appropriate manner, as required, the details of governance control enhanced by the establishment and strict operation of rigid schemes. Regarding disclosure in a timely and appropriate manner, some are stipulated by law and others are determined by each company. Compliance is a minimum requirement, of course. Beyond it, companies are required to disclose information with high transparency in a timely manner today. How the latter should be will change in keeping with the times. You have to always keep it updated and ensure that you have achieved consensus and updated the system in order for anyone to transmit the same message for the same issue.

2. The Role of Japanese Enterprises as a Global Corporate Citizen (CSR¹⁴)

1) Concept of CSR by Japanese enterprises and Keizai Doyukai

Some Japanese enterprises have their beginnings in the Edo period (1603 to 1867) as merchants. Their philosophy of business, typically family precepts, includes some idea of today's CSR. Typical examples include "Intoku Yoho"¹⁵ and "Sanpo Yoshi."¹⁶ This tradition is often passed on to companies founded after World War II. A representative example is "A company is a public entity of society" (Panasonic).

In 1973, Keizai Doyukai (Japan Association of Corporate Executives) proposed that "making a complete about-face from the attitude of seeing society from the viewpoint of a company to viewing a company from the perspective of society" is necessary. In December 2000, it set out the 21st Century Declaration¹⁷, saying companies need to endeavor to change the market that would be evaluated from its social and human nature in addition to the economic nature. It also produced the 15th Corporate White Paper¹⁸ as a culmination of management based on social responsibility, and it was fully utilized in the activities later. In April 2009, it advocated the concept of "triple-mirror management," as the vision of ideal corporate management, which placed importance on capital markets (shareholders), employees (employment), and society. It positioned CSR as the basis of the all business activities related to corporate management and proposed "CSR that creates future value," where corporate managers fulfilled social responsibility with their entrepreneur spirit.

2) CSR of Japanese enterprises needing globalization

Keeping pace with the global expansion of Japanese enterprises, their stakeholders, consisting of each surface of "triple mirrors," are also being multi-nationalized and diversified. CSR has a different concept in each nation or region. Globally developing companies need to have CSR activities based on each nation's culture and history. The ratio of overseas sales and employees is increasing in global enterprises, but the field of CSR activities is often limited within Japan. Globalization of CSR activities in step with the globalization of business needs to be realized.

Creation and maintenance of employment, payment of taxes, and corporate philanthropy are thought to be the core of CSR activities by Japanese enterprises. This is based on the idea that CSR meets the requirements of society or shares profits within the confines of the core business performance. Companies in Europe and the United States do not generally have the

¹⁴ Corporate Social Responsibility

¹⁵ Doing good secretly gives him/her obvious benefits.

¹⁶ Business should satisfy society in general and give happiness to the seller and the buyer. It is a philosophy of merchants in the Omi district, literally meaning good for seller, buyer, and society.

¹⁷ See <http://www.doyukai.or.jp/en/policyproposals/articles/001225.html>

¹⁸ See http://www.doyukai.or.jp/en/policyproposals/articles/pdf/030326_1.pdf

idea of relating CSR to the creation and maintenance of employment or the payment of taxes, but they conduct wide-ranging activities. Included are many activities related to business activities and events where employees and local residents are involved. To globalize CSR activities, it is necessary for each company to take the characteristics of each nation and region and develop original programs.

GE has the concept of “Corporate Citizenship.” Every year, they set, tackle, and follow up themes for each of six business portfolios, based on a matrix that measures importance for business and society. Characteristically, they introduced an approach most appropriate to the region where they operate (“company to country”). Some Japanese enterprises like Toyota and Panasonic adopted “corporate citizenship” as their slogan and started CSR activities targeting global fields. Multi-nationalized companies must face a number of social issues they have not experienced, including human rights issues, poverty, or food problems in developing country as well as diverse employees. Therefore, globalization of CSR activities in step with the globalization of business is necessary.

IV. Enhancing competitiveness of the service/finance industries

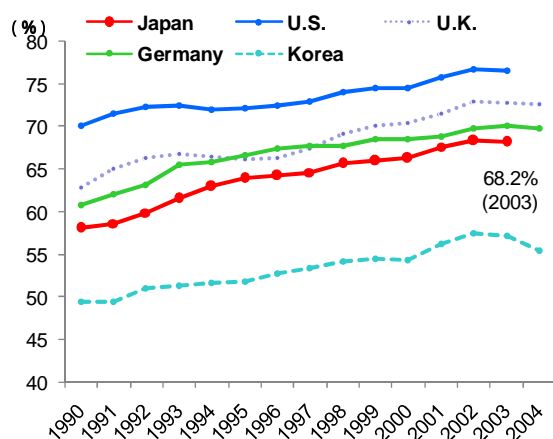
1. Enhancing competitiveness of the service industry

1) Current situation of the service industry in Japan

a) Expanding industry

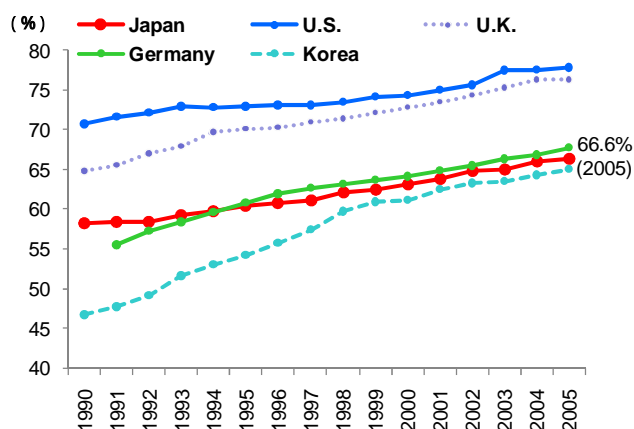
Japan's service industry in the broad sense of the term is defined as a "tertiary industry." It accounts for approximately 70% of all businesses in terms of both nominal GDP and the number of employees. The ratio of the service industry is high at the moment, and it is still increasing year by year. The ratio is also increasing from a global perspective and it exceeds 70% in the United States (Diagram 2-14 and 2-15).

Diagram 2-14: Ratio of added value of the service industry against the nominal GDP of each nation



Source: Trade White Paper 2007 by Ministry of Economy, Trade and Industry

Diagram 2-15: Ratio of service industry in the number of employees of each nation



Source: Trade White Paper 2007 by Ministry of Economy, Trade and Industry

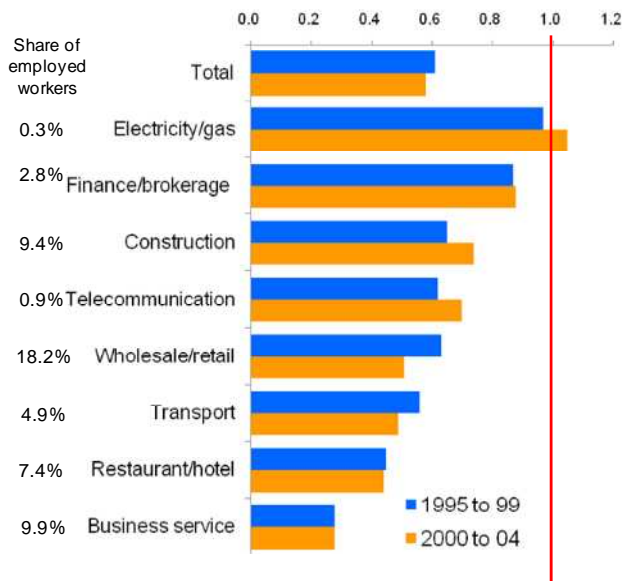
b) Low productivity

When we compare the labor productivity of Japan and the United States, it is comparatively high in electricity, gas, and financial intermediation services in Japan, where foreign companies have entered to some extent, but very low in the service industry in the narrow sense of wholesale/retail, transportation, restaurant/hotel, and business services (Diagram 2-16).

Productivity in the service industry in Japan is low and, what is worse, it is not improving (very slow). The annual pace of the increase in labor productivity was less than 1% from 1995 to 2005. It is lower than the United States and the United Kingdom (Diagram 2-17).

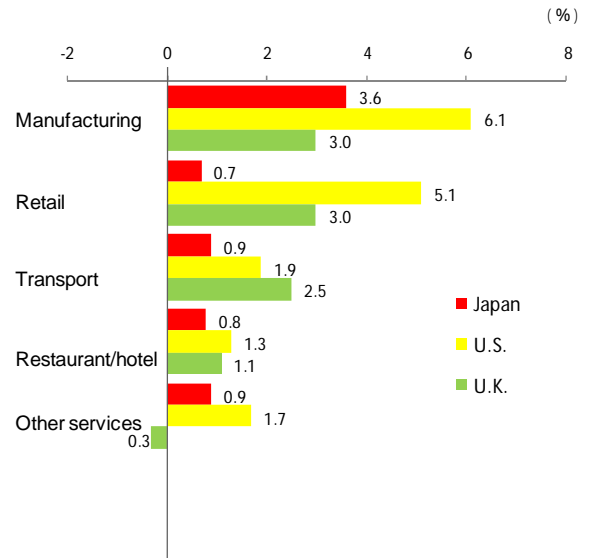
Diagram 2-16: Difference in labor productivity in the service industry between Japan and the U.S.

(Productivity in U.S. is counted "1.0")



Source: *Current Productivity of Japan*, the Cabinet Office April 2007

Diagram 2-17: Percentage of rise in labor productivity by industry in Japan, U.S., and U.K. (yearly average from 1995 to 2005)



Source: *Trade White Paper 2008*, Ministry of Economy, Trade and Industry

c) Factors that keep productivity low

We can find many reasons for low and not-improving productivity in the service industry in Japan, especially in the industry in a narrow sense, such as wholesale and retail. Listed below are the major ones:

- **Small scale of operation**

The scale of operation of service businesses is generally small in Japan. This inhibits investment into service process improvements and human resource development. Therefore, it is difficult to share know-how or make it explicit knowledge and to develop chain-style businesses.

- **Lack of information**

The characteristics of the service industry are that it has no shape (intangible product) and is simultaneous (the product disappears at the moment of service provision). This makes evaluation of service details difficult. For this reason, enough information about the service details cannot be communicated to consumers, and this makes competition difficult. Recently, the prices of the product you want to purchase and where it is sold can be easily obtained and compared on the Internet. There are price comparison sites for restaurants and other service businesses. However, comparison of practical information, such as service details, is still difficult.

- Customized (not standardized) service

Generally, the IT-related industry offers service that satisfies the needs of each individual customer. This prevents the industry from pursuing efficiency by standardizing the service. In the United States, the software suite is the mainstream, but a product customized to meet individual needs is the mainstream in Japan.

Service businesses in Japan generally tend to invent services from scratch for an individual customer, which is symbolized by the words “hospitality” and “Treasure every encounter, for it will never recur.” This is a factor in diminishing profits. Providing a customized service fixes the relationship between the user and vendor. It is pointed out that promotion of competition is difficult.

- Delay in globalization

Even in the service industry, penetration of the Internet enabled overseas production (service provision). For example, companies in the United States and Europe have established call centers and IT services (system operation and application development) in India and other English-speaking nations to great success. As language is a barrier for Japanese, it has started only in some parts of Asia.

2) Characteristics of successful service business

The Committee on Corporate Management interviewed four excellent companies (Seven & i Holdings, Lawson, Namco Bandai Holdings Inc., and Kumon Institute of Education Co., Ltd.), and we would like to compare the above-mentioned characteristics of the low-productivity service industry with the corporate management of the four companies to find the way for Japan’s service industry to proceed.

a) Nationwide business network based on its own policy including M&A

Seven & i (Seven Eleven, here) is improving management efficiency by focusing store distribution on a specific area, based on its dominant strategy (high-density store distribution). Lawson opens stores throughout Japan but sticks to quality, using investment efficiency as its criterion. Kumon pursues the strong ideal of the founder, Toru Kumon; “providing our learning method for as many children as possible” with operations in 46 countries and regions worldwide (as of March 2009).

b) Development and provision of services that satisfy customers

Successful service businesses segment customers according to the specific characteristics of each region and promote store/product development to obtain as many target customers as possible, which enables standardization and modularization of the product.

Seven & i adopts “responding to change” as their universal slogan. In the past, it provided

one kind of *sobatsuyu* (seasoning soy sauce for *Soba* noodles) only but, as the economy matures and the characteristics of local areas become distinguished, it now provides six kinds of *sobatsuyu* to satisfy the taste of each region. This is an implementation of a community-based approach.

Lawson focuses on homemakers and elderly people, who had not been the target customers of convenience stores and improved infrastructure to realize the small-portion packaging of food products. These were the preparation for opening new-type stores named Lawson Store 100.

Namco Bandai enhanced the development and sales function in the United States, in addition to the system for development in Japan and other regions, to satisfy a variety of customer needs based on the differences in culture worldwide. It also expends efforts to enhance the distribution of content produced abroad in addition to the export of Japanese content. As the desired price range is different between Japan and overseas, the company localizes products by omitting many functions from the toys sold in Japan, and products with only core functions are sold at low cost.

Kumon teaches only reading, writing, and calculating; that is, arithmetic (mathematics), language (native language), and a foreign language. Their texts are not compliant with the Education Ministry guidelines of each nation but they invented their original multilevel learning materials consisting of focused subjects only, which may be taught from children to high school students. Thus, it supports teaching even at the high school level. The learning materials for arithmetic (mathematics) are universal and controlled by common material numbers. As for other subjects, the basic philosophy is shared globally and then local staff and experienced Japanese staff work together to research and develop the learning materials.

c) Global expansion of business aiming at growth

Seven & i made Seven Eleven Inc. (United States) its subsidiary, and it owns approximately 7,000 stores in North America at the moment. It has already entered the Chinese market. Lawson also accelerates overseas operations mostly in Asia, where market growth is expected. Namco Bandai set the goal of increasing the ratio of overseas sales to more than 50% and endeavors to expand in the United States, Europe, and other regions. This is triggered by the heightened sense of crisis over the shrinking Japanese market due to the falling birthrate. Kumon has six regional headquarters,¹⁹ including Japan, under a holding company, and the number of overseas students is larger than that of Japan,²⁰ increasing profits overseas.

¹⁹ Six regional headquarters; Europe & Africa, China, Asia & Oceania, Japan, South America, and North America

²⁰ The number of classrooms (Japan: 17,100 vs. overseas: 7,800) and the number of students (Japan: 1.47 million vs. overseas: 2.75 million) as of the end of March 2009

d) Promotion of standardization utilizing engineered approach and IT environment

Seven & i has a hypothesis verification cycle utilizing POS data and has employees at stores thoroughly understand it, helping accurate selection of goods and space management at stores. Lawson has enhanced IT support tools to improve the accuracy of order placement and store productivity. Kumon supports instructors all over the world by standardizing the diagnostic tests used to judge the academic ability of each student and the criteria used to judge the level of progress.

e) Unique human resource development at each company

Seven & i provides human resource development attaching importance to direct communication that conveys the management philosophy and policies directly from the corporate executives, using such opportunities as *Gyokaku* and field counselor meetings.

At Lawson, the corporate leader takes the initiative to communicate its corporate philosophy to employees to share the sense of values. Lawson University, which is a corporate educational institute, provides leader education programs and educational/instruction courses designed for owners and part-time workers who support store management.

Namco Bandai locally recruits university graduates with foreign nationality who understand Japanese and provide education in Japan for a few years to teach them Japanese-style business and the way to produce gaming software. Then, it sends them back to their home countries and they disseminate the philosophies in the local language. Thus, it promotes a mixture of culture and the exchange of knowledge and technologies.

Kumon thoroughly shares its principles among not only employees but also instructors who operate the school locally. Instructors are essential factors for Kumon to localize education. It constantly promotes information sharing and organizational culture where they learn with each other. This is for the purpose of improving teaching techniques in each nation or region. In addition, it provides opportunities where they learn across the border of nation and region, including instructor research conferences held at each regional headquarters and nation, as well as world instructor research conferences held in Japan where instructors and employees get together from every corner of the world. A quarterly president's meeting is an opportunity for the heads of all group companies worldwide to gather for discussions. At this opportunity, they share human resource information for the purpose of fostering local employees. At the Yearly World Brand Task Force, core human resources assemble and discuss the education of leaders who play an important role in communicating the corporate philosophy, the Kumon Way, in each region.

3) Measures should be implemented to enhance competitiveness

a) Realizing systematic support that helps the market mechanism work

A system that hinders withdrawal by entry regulation or protective policies should be

immediately abolished. If a new company enters a market and expands the business with new ideas and advanced operational processes, then inefficient companies withdraw. Replacing the old with the new is a way to improve the productivity of the industry. Introduction of support that helps companies focus on highly value-added business and outsource other operations in an easy way needs to be discussed, as it continuously accelerates a dynamic and thorough review of business operations.

b) Promotion of standardization utilizing engineered approach and IT environment

As the company size is small in the service industry, dependence on experience and intuition has been the mainstream of the industry. There are many management techniques that have shown significantly successful results in the manufacturing industry and can be used in the service business. For example, know-how of product management, utilization of information technology, and innovation of operational process achieved important results. These two industries share some operations, and good results are expected.

c) Investment focused on quality and human resource development

Quality of interface with customers (contact with customers) determines the quality of the service business. The interface consists of the quality and development of human resources at the “output” channel (service delivery) as shown in the case of Seven & i, Lawson, and Kumon and the ones at the “input” channel (identifying needs) as in the case of Namco Bandai. Which is relatively important is dependent on the type of business, but investment should be focused on the improvement of these interfaces, if the company regards differentiation by quality as its strategy.

If the company intends to provide high-quality service globally, the key to both interfaces is human resource development, while it means the promotion of diversity abroad. However, as the industry mostly consists of small-scale companies, human resource development within the company naturally has limits. Therefore, it is necessary to define the ability commonly required by the industry and establish and operate an ability evaluation system through industry groups. If we can identify the elemental technologies of service businesses, we will be able to help higher education facilities work as a source of technologies, like universities supplying competitive engineers and developers to the manufacturing industry. Such efforts would be required.

d) Promotion of business consolidation and M&A

To further enhance competitiveness, the service industry in Japan must avoid excess competition, or price competition, which hinders securing appropriate profit, and continue investing in future innovation. According to the analysis and test calculation by the Ministry of Economy, Trade and Industry, withdrawal of inefficient companies from the market will

improve Total Factor Productivity (TFP) by almost 30% in the retail business and approximately 30% in the service industry in a narrow sense. The major premise of global expansion by Japanese enterprises, which is the next step, is to expand the scale of business and achieve critical mass. For this purpose, business consolidation and M&A should be promoted to create an environment where efficient management, human resource development, and global business expansion can be easily sought.

e) Cultivation of cutting-edge service business

To enhance competitiveness, it is important to create high technology and advanced businesses in the service industry as in the manufacturing industry with high-tech business. By sharing the best practices of the service businesses that have entered these fields or by utilizing administrative measures, it is necessary to positively nourish the cutting-edge service business in Japan.

f) Globalization of service (incoming and outgoing globalization)

The appropriate market scale of Japan with a population over 100 million is pointed out as one of the factors hindering globalization of Japan's service industry. Now, Japan suffers from a declining birthrate and a growing proportion of the elderly. Although there are some exceptions, such as the medical and nursing business where demand is expected to grow, entering growing overseas markets is essential in order to enhance competitiveness in the future. At the same time, globalization that invites demand from abroad into Japan is also important.

It should be remembered that you have already been caught in the competition with foreign competitors, even if you are operating only in the domestic market. One example is the luxury hotel industry in Tokyo. Foreign capitalized companies are conquering the market. For companies doing business only in Japan, it is essential to be ready for globalization.

As for "outgoing" globalization, the fact is that many service businesses lack the knowledge, information, and know-how required to advance into foreign markets, but the examples of overseas operations by the above-mentioned four companies will be helpful. All four companies promote localization of company management and devote energy to fostering local employees who understand the corporate philosophies, which are clear characteristics.

Globalization will be successful only after the processes of having a clear corporate philosophy, helping local employees understand it, and having business based on it. We must accumulate useful know-how for success and promote globalization of the service industry with all the might of the national government and the industry.

Intellectual property rights, including business models, trademarks, logos, and characters must be protected in the service industry. Otherwise, they will be easily copied outside Japan. It is important for each company to control the rights and be ready to implement appropriate

measures in case such rights are infringed.

2. Enhancing competitiveness of the finance industry

1) Characteristics of the finance industry of Japan

The finance industry in Japan has the strengths typical of Japanese enterprises as explained in Part 1 (e.g., corporate management from a long-term perspective, accuracy of the business implementation based on consensus-oriented management, strong sense of ownership, etc.). On the contrary, they also have weaknesses, which seem to be the opposite of the strengths. Therefore, its global position is not necessarily high. For example, according to a survey by Brand Finance, which compares corporate brand values, it makes a good showing in the commercial bank category but no Japanese bank appears in the top 10 of the investment bank category (Diagram 2-18). If we compare aggregate market value, only one Japanese bank is included in the top 20 (Diagram 2-19).

The details will be discussed in (a) and (b) but the Japanese financial industry has attributes that relatively fit the commercial banking operation. Some investment banking operations do not fit. Generally speaking, operations toward the market have heavier weight in investment banking, including development of new financial products and powerful leverage. They are positive about risk taking, and these are the areas where financial institutions in Europe and the United States have been good. After experiencing the global financial crisis, however, investment banks reflect on the business model of producing profit from their own accounts, utilizing securitized paper and excessive leverage, and return to operations that do not use their own assets, i.e. original financing and mediator of asset management. For these reasons, it may become an area where the strength of Japanese enterprises, which attach importance to the process and do careful business with customers, can be exerted.

Diagram 2-18: Top Banking Brands (By Sector, 2009)

Top10 Commercial Banking Brands			Top10 Wholesale Banking Brands		
Rank	Brand	Brand Value (US\$M)	Rank	Brand	Brand Value (US\$M)
1	ICBC	4,372	1	JPMorgan	8,079
2	China Construction Bank	4,257	2	Goldman Sachs	5,754
3	MUFG	3,384	3	BNP Paribas	4,860
4	HSBC	3,291	4	Deutsche Bank	4,494
5	Bank of America	3,286	5	Credit Suisse	3,840
6	Bank of China	3,017	6	HSBC	3,507
7	Banco do Brasil	2,864	7	Morgan Stanley	3,104
8	Rabobank	2,624	8	Wells Fargo	2,378
9	Mizuho	2,547	9	Prudential	2,347
10	Sberbank	1,729	10	Societe Generale	2,215

Source: Brand Finance

Diagram 2-19: Banks with Top 20 Aggregate Market Value (2009)

Rank	Company	Market Cap (\$Bn)
1	Industrial & Commercial Bank of China	175.3
2	China Construction Bank	128.7
3	Bank Of China	112.8
4	JPMorgan Chase	94.5
5	HSBC	78.3
6	Wells Fargo	62.1
7	Mitsubishi UFJ Financial	56.2
8	Banco Santander	54.1
9	Goldman Sachs	45.7
10	Royal Bank of Canada	40.3
11	Bank of America	40.1
12	Bank of Communications	38.0
13	BNP Paribas	37.5
14	Westpac Banking	34.0
15	Commonwealth Bank of Australia	31.5
16	Credit Suisse	31.2
17	China Merchants bank	31.0
18	Banco Itau	30.3
19	Toronto-Dominion Bank	29.1
20	UBS	29.0

Source: Financial Times, March 23, 2009

a) Strength of the finance industry of Japan

The greatest strength of the finance industry of Japan is that they have Japan's economy, which is currently in second place in the world in terms of scale, as their mother market and do business with Japanese enterprises, who are global competitive, and a retail market with financial assets of approximately 1,500 trillion yen. Compared with financial institutions overseas, it boasts rich liquidity, sound assets, efficiency, and accurate business operations. With these as a backdrop, it is highly trusted by customers.

From the viewpoint of risk management, Japanese banks have established a risk management system. Japan is one of the nations whose banks are most compatible with Basel II.²¹ People tend to avoid risks thanks to its corporate culture.

When we talk about human resources, it must be pointed out that financial institutions achieve high popularity every year, which is obvious if you look at the university student's company popularity rankings. It means they are in an environment where they have access to excellent human resources (Diagram 2-20). As the

Diagram 2-20: Ranking of the companies university students want to join

R	2009	2008
1	Tokio Marine & Nichido Fire Insurance	All Nippon Airways
2	The Bank of Tokyo-Mitsubishi UFJ	The Bank of Tokyo-Mitsubishi UFJ
3	All Nippon Airways	Toyota Motor
4	Panasonic	Panasonic
5	JTB Group	Sony
6	Mizuho Financial Group	Sharp
7	Sumitomo Mitsui Banking	Tokio Marine & Nichido Fire Insurance
8	Mitsubishi UFJ Trust and Banking	Mizuho Financial Group
9	Central Japan Railway	Suntory
10	East Japan Railway	Mitsubishi Corporation

Source: Nikkei Employment Guide

evaluation and remuneration structure is not excessively achievement-oriented, it can provide customers with services based on a long-term perspective after sharing information with all relevant divisions, which is a strength. In other words, Japan's financial industry can control risks from the viewpoint of customers and realize business operations of high value for customers with a superior customer interface. Here is an opportunity where they can demonstrate strength.

About the business fields, the profits of commercial banks in Europe and the United States are largely dependent on trading, while Japan's commercial banks have a profit structure that focuses on banking. Japan's investment banks demonstrate strength in the field where they fulfill their roles as a mediator of the flow of funds, such as asset management, funding, corporate revival, and advice on M&As.

b) Weakness of the finance industry of Japan

As the opposite of strength, the following have been identified. First of all, it has a

²¹ Basel II is a new capital adequacy framework for financial institutes. The final version was published by the Basel Committee on Banking Supervision in June 2004. Based on the recent advances in risk management operations by banks and sophistication of financial technologies, it aims to facilitate the improvement of risk management by banks, while more precisely evaluating the risks that banks face. It consists of three pillars: 1) minimum capital requirements, 2) self-management of banks and the supervisory review process, and 3) market discipline. (Source: Website of the Financial Service Agency).

corporate climate that is conservative and avoids risks. It has been pointed out that it leads to the lack of innovation. It has been the rule of right that a bank ensures safety to customers, so that it lacks the ability to take risks and construct a financial product.

As for human resources, Japan's financial institutions have a strong orientation for generalists; therefore, they fall far behind other countries in fostering specialists. What remains to be seen is specialist education for excellent human resources fresh from university. Japan has rigid and horizontally egalitarian evaluation and remuneration systems, which is led by a feeling of repulsion of Western cash incentives and short-term orientation.

As for the business fields, it is weak in M&A and the investment business. It falls far behind the financial institutions in Europe and the United States in terms of the amount of transactions in investment banking, as well as the amount of investments in venture capital and buyouts. When we compare the ratio of the amount of investment by venture capital firms vs. GDP in major countries, we find a large gap between Japan and the United States or Korea (Diagram 2-21).

As long as the original strength is sensitivity to risks and high quality for customers supported by the quality of human resources, the business fields where financial institutions of Japan can demonstrate its strengths should be much broader. Japan's financial institutions operate most of its business only in Japan. Delay in globalization is a serious issue.

2) What it should aim at for improvement of competitiveness and challenges

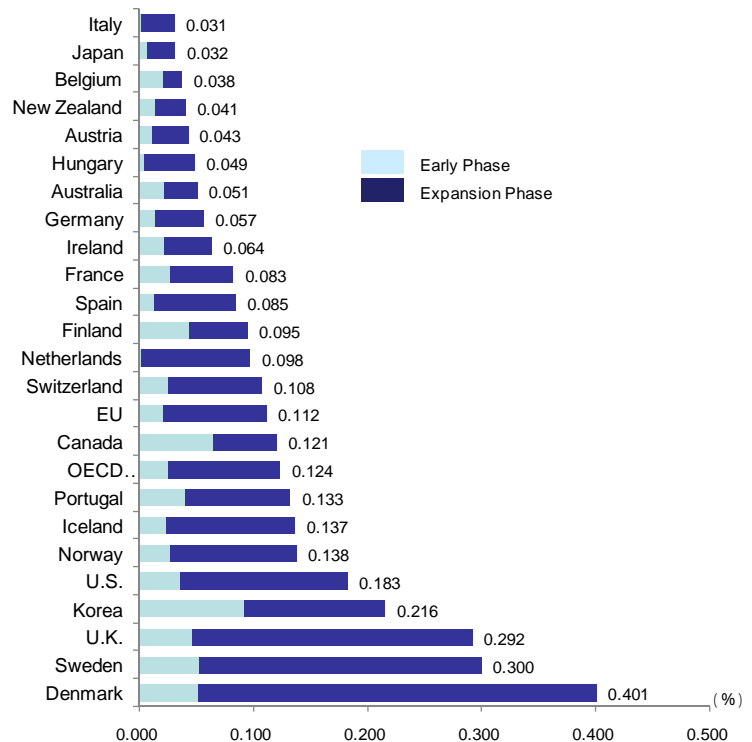
The financial institutions of Japan should aim at globalization of business and then, enhancement of financial solution functions based on the risk management capability, which we'd like to discuss here.

a) Globalization of business

- Direction of globalization

The following are the possible directions of globalization by Japan's financial industry:

Diagram 2-21: Ratio of investment of venture capitals in major nations vs. GDP (2005)



Source: OECD Science, Technology and Industry: Scoreboard 2007 OECD

- Using foreign resources (foreign financial institutions and products) in Japan
It plays the role of mediator between Japanese customers and foreign investors and between customers.
- Global expansion focusing on transactions with globally expanding Japanese enterprises
If Japanese enterprises promote the globalization of business as a part of its growth strategy, transactions by Japanese enterprises outside Japan are expected to increase in number.
- Business expansion targeted to the overseas market
It is expected that promising markets for Japanese financial institutions are expanding in Asia, especially in East Asia. Asia needs financing for its future growth, but the capital markets of Asia are not well developed, and the current situation is that companies procure capital mostly from indirect financing. There is a possibility to further expand business in Asia, with a focus on financing, which is the strength of Japan, and cooperation with local banks, which has already started. HSBC and other banks have already enhanced the foundation by means of the strategy targeting retail business (personal customer), aiming at being a Global Local Bank and increasing profit in newly emerging nations. If Japan adopts a strategy based on a long-term perspective, which is the strength of Japanese enterprises, and establishes a bridgehead in the areas where financial and capital markets will expand in the future, then it would be helpful for future growth.

- Issues to be solved for the promotion of globalization

To expand business in a foreign country that has regulations, capital markets, and customer segments totally different from Japan, it is necessary to have the ability to raise capital, the ability to develop products satisfying the conditions of each country, and the human resources with diverse values to enable them. Although the financial industry of Japan has secured excellent human resources, their homogeneity destroys innovation. A system is needed where excellent human resources can be fostered, including the recruitment of people of foreign nationality.

As these are problems that one company cannot solve instantly, an alliance or M&A (purchasing or purchased) with a leading foreign company to compliment weaknesses would be one of the options to consider. In this case, as there is a big gap between the culture of the Japanese financial industry and foreign ones, careful attention must be paid to management after any merger.

b) Enhancing the financial solution functions based on the risk management ability

For individual customers, the need for the functions of traditional investment banks,

including personal asset management and security services, is increasing, in addition to the functions as a commercial bank for savings, exchange, and settlement. For corporations, it is expected that the need for advice on M&A and the revival of business will increase. The key to these businesses (from the customer's point of view), in addition to the financing for corporations and project finance, would lie in risk management.

In a world where simultaneity is extremely likely as it is today, risk management is also significantly affected by the ability to expand business globally, including into newly emerging countries. It is one direction that Japan's leading financial institutions with the world's most excellent risk management ability, which exceeds the excellent manufacturing businesses or general trading companies, aim at providing good financial solutions for customers worldwide. With the ability to collect information, it is essential to enhance the financial solution functions that can provide added value to individual customers and corporate customers, regardless of globalization.