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ORGANIZATION PRACTICE

## Japan's globalization imperative

**Why are General Motors and Volkswagen more successful in China than Honda and Toyota?**

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**For all the international success** of Japan's big, well-known companies, many still lag behind their global rivals in the most important markets. Why are General Motors and Volkswagen more successful in China than Honda and Toyota? Why are LG and Samsung bigger in India than Panasonic and Sony? Why is IBM larger in Japan than Fujitsu is in the United States?

These questions are more than academic. Survival for many Japanese companies may depend on their ability to greatly increase overseas revenues and profits, given demographic and economic trends that suggest slower or stagnant growth in the home market. Even Japanese companies with established global businesses face stronger competition and must rejuvenate their overseas business models.

Building a globalized company will require many Japanese executives to think in new and unfamiliar ways about organization, marketing, and strategy. The approaches that proved successful in the past—for example, replicating practices from the Japanese market in foreign operations—have outlived their usefulness.

The good news is that the sleeping giant that is Japan Inc. has begun to awaken. There's an uptick in international mergers and acquisitions, a new sense of urgency in boardroom discussions, and a few bold moves by Japan's more progressive companies to use English as a global corporate language and to recruit talented non-Japanese executives. Still, as with most such awakenings, the pace is slow and the approach often opportunistic and confused rather than strategic.

### **A matter of survival**

Japan's biggest companies have been losing relative market share over the past ten years: their proportion of the Fortune Global 500's total revenues decreased to 13 percent, from 35 percent, between 1995 and 2009. One of Japan's longtime strengths is electronics, for example, but its share of the world's export value of electronic goods has fallen from 30 percent in 1990 to less than 15 percent today, according to the Japanese Ministry of Economy, Trade, and Industry. Many Japanese companies have no alternative to globalization if they hope to continue growing.

### **A shrinking consumer base and lagging productivity**

For the past 40 years, Japanese companies achieved global leadership by dominating their home market, but no longer. Japan's population is expected to fall from 127 million today to less than 100 million between 2040 and 2050. A declining population will almost certainly reduce the absolute level of private consumption, along with tax revenues and, potentially, overall GDP. Private consumption in Japan, at the end of 2008, stood at 220 trillion yen (\$2.7 trillion), 59 percent of GDP. It is (optimistically) forecast to reach 293 trillion yen in 2040, with an underlying assumption of an absolute increase in GDP per capita of more than 50 percent—something that is difficult to fathom in the current deflationary environment.

Another economic issue is lagging productivity at home. Despite a handful of world-leading industries and companies, Japan has among the lowest labor productivity rates of any major developed country. Japanese companies are therefore generally less competitive and more vulnerable to foreign attackers at home. Japanese workers tend to be among the world's most diligent, but they are both collectively and individually inefficient—particularly those who do not toil in factories. Our conversations with senior executives suggest that Japanese managers are acutely aware that their headquarters are overstaffed, that employees focus more on work effort than on impact or outcomes, and that Japanese companies have hobbled efficiency by limiting outsourcing and offshoring to a handful of IT-related functions.

#### Foreign inroads

Meanwhile, foreign competitors have penetrated Japan's once-insular market, taking advantage of the Japanese consumer's enthusiasm for digital commerce and new openness to foreign products. In many ways, these consumers, long touted as unique, behave increasingly like their counterparts in Europe and the United States: what they want is value. In a Japanese context, value means products that look attractive or stylish but are nonetheless significantly less expensive than traditional offerings.

With a few exceptions, Japanese companies have been slow to offer such value, giving foreign competitors a chance to muscle in, especially those that have significant control of product distribution. Businesses have attracted consumers around the world by offering some combination of value and an exciting shopping experience (Costco, H&M, IKEA, Zara) or a simple, intuitive user experience (Amazon, Apple). Other companies, such as Wal-Mart, use their global footprint to bypass Japan's multilayered distribution system and thus to introduce products at prices significantly lower than the Japanese competition's. While the overall share of foreign competitors remains small, their growth rates often far exceed those of most larger Japanese rivals.

#### A tired innovation model

Japanese companies once were leaders in providing innovative products appealing to consumers in developed markets. But consumers in fast-growing emerging markets have different needs. Japan has found that trying to identify them in R&D labs at home—the typical approach—is a challenge. That issue is not relevant only to emerging markets; Japanese companies must get closer to their customers everywhere. The current, made-in-Japan model is insufficient.

In fact, the emerging corporate-innovation model is globally collaborative, with product ideas, customer insights, money, and talent coming from all over. Procter & Gamble, for instance, reports that more than 50 percent of its innovation initiatives involve collaboration with outsiders. Shiseido executives say they can't assume that all of the company's innovations, both in beauty care products and in channels, will come from Japan; hence the 2010 acquisition of US-based Bare Escentuals, for \$1.7 billion. What

makes traditional Japanese lab-based R&D less effective today? In short, increased competition from China, South Korea, and Taiwan; the wide availability of component parts; and an increasingly fast speed to market.

Investment in research and development is often seen as a proxy for innovation, and it is true that Japan is a leader in R&D, spending 3.8 percent of GDP on it. But this view misses a crucial point: innovation across many categories once dominated by Japan now comes from outside the country. A 2010 report by the US-based National Association of Manufacturers listed Singapore and South Korea as the world's top two countries for innovation—far ahead of Japan and even ahead of the eighth-ranked United States.

### Getting to global

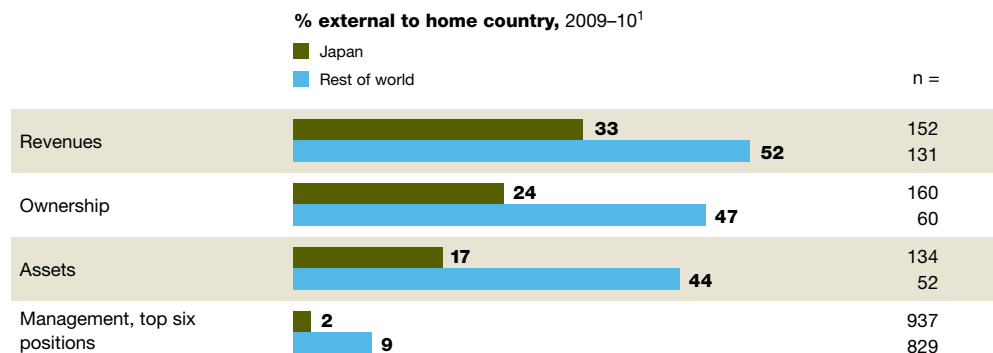
Many Japanese companies should be global leaders, given their manufacturing and technological prowess and overall size and scale. But they are not. We analyzed the ten largest Japanese companies in each of 16 industries to better understand their global profiles. On average, Japan's ten largest companies in 15 of these industries—automotive is a notable exception—are less global than their overseas peers, as measured by the percentage of revenues, assets, and stock ownership outside Japan. By those measures, Japanese companies made no progress toward globalization from 2006 to 2009 (exhibit).

Averages don't tell the whole story, and some Japanese companies are quite global even by these standards. For most, however, globalization is a work in progress. McKinsey's

#### Exhibit

### Japanese companies are less global than peers from other countries.

For the top 10 public companies by revenues across 16 selected industries,<sup>1</sup> n=160



<sup>1</sup> Specifically, for Japan, the top 10 Japanese companies in each industry; for all others, the 10 largest non-Japanese companies by revenues. To ensure a representative analysis, we categorized Japan's public companies into the following 16 industries; automobiles and parts, basic materials, construction and materials, consumer electronics and leisure goods, durable house products, financial services, food and beverages, health care, industrial goods and services, media and telecommunications, oil and gas, personal goods, retail, technology, travel and leisure, utilities.

experience in Japan suggests five steps—across organization, marketing, and strategy—that its companies should take to globalize successfully.

#### Making the case for globalization

Many Japanese companies understand the benefits of globalization. But their executives may lack a compelling “globalization story” for employees—global goals, aspirations, and value propositions. Are these widely understood and properly communicated in a way that excites and energizes the organization while addressing the anxiety that comes with big changes in direction? Spending time and effort developing such messages may seem trivial, but a globalization effort won’t get far unless employees are on board.

Shiseido illustrates some attributes of a successful case. The company’s senior executives must, for example, explain the globalization story in a way that makes it meaningful to other employees. When Shiseido’s Shinzo Maeda (now the company’s chairman) became chief executive officer, in 2005, he made globalization a top priority. Maeda constantly reminds employees of the company’s vision: to “become a global player representing Asia with its origins in Japan.” This positioning clarifies the company’s overall strategy—reinforced by a major acquisition and the establishment of a global rotation program—without diminishing the home market’s importance.

Senior executives should understand a company’s distinctive strengths and capabilities clearly and ensure that they form part of its global strategy. For Shiseido, this means training and technology. The company extensively trains thousands of beauty consultants each year and has implemented the same approach in China, Russia, and the United States. While many Shiseido products don’t bear the corporate brand name abroad, most are sold as the fruits of Japanese research and technology.

Strong—and sometimes not so popular—acts by senior executives can back up the talk. Upon assuming the top job, Maeda jettisoned some smaller, long-established brands, while doubling down on global megabrands better positioned to become category leaders at home and abroad, though he left room for local brands. He also hired an experienced foreigner, Carsten Fischer, to run Shiseido’s international business, which currently accounts for more than 40 percent of the company’s revenues. Fischer demonstrated his desire to be part of the Japanese team by shunning a corporate office, opting for an open cubicle among the rest of the staff.

#### Adopting English as the company language

Making English the main company language may be controversial and difficult to execute. But its importance in a globalization effort cannot be overstated, especially for monocultural Japanese companies. Our experience suggests that the decision to conduct most of the company’s business and internal interactions in English was an important

success factor for the globalization efforts of multinational companies such as France's Danone and Israel's Teva Pharmaceutical Industries.

The move to English is critical because it opens up a world of talent. Everything else in the globalization journey follows from gaining access to a higher-quality employee pool. It's hard to get a rich exchange of talented people across units and geographies without a *lingua franca*. As irritating as it may be to cultures that speak other languages, the trend toward English is unstoppable—nearly one billion people use it as their first or second language. Talented Asians with global aspirations tend to learn English, not Japanese or Russian.

How will Japanese companies adopt English? That's a big question. In 2009 Japan had the lowest score of any of the International Monetary Fund's advanced economies on the Test of English as a Foreign Language, administered to foreign students who want to study in the United States. It had the second-lowest score among Asian nations, outperforming only Laos.<sup>1</sup> Still, companies like Rakuten and Uniqlo have announced that they will make English their corporate language by 2012, and Nissan and Takeda conduct many meetings in English. Should prestigious schools such as Tokyo University or a few of the leading Japanese companies make high English scores a prerequisite for acceptance, we would imagine a rapid increase in overall English ability.

#### Designing an aggressive talent-management strategy

Typical Japanese executives have never held an international assignment or worked outside their companies or business units. Nearly all senior executives are Japanese. Such professionals may be quite capable of managing domestic businesses but are increasingly ill-prepared to run global enterprises in fast-changing, competitive markets. Japanese companies are painfully aware of this handicap. A 2010 government survey of 263 senior executives found that the single biggest hurdle for globalization was the "securing and training of human resources in Japan."

In general, the Japanese corporate human-resources model lends itself well to domestic business but not to international. The defining characteristics of Japanese talent management are well known: tenure-based advancement, egalitarian compensation, and lifetime employment. The HR function focuses almost entirely on recruiting at the university level and on greasing the wheels of the lockstep, tenure-based promotion system.

International experience not only isn't essential to advancement but also is often seen as a negative. Japanese organizations tend to be monocultural and monolingual, making it difficult for foreigners to succeed. Also, women have trouble advancing: Japan placed 94th of 134 countries in the World Economic Forum's Gender Gap Index 2010. Among high-income countries, only South Korea had a lower score.

<sup>1</sup>Daisuke Wakabayashi, "English gets the last word in Japan," *wsj.com*, August 4, 2010.

Most Japanese companies need to rethink HR's role and to adopt an employment strategy incorporating new approaches to career paths, compensation, and performance evaluation. Some, like Komatsu and Shiseido, are moving ahead, but elsewhere progress is slow. Best-practice talent-management programs apply meritocracy at all levels and emphasize diversity. They manage talent strategically to attract the best people and find places for them, not just to fill open positions. These are the basic steps Japanese companies can take to upgrade their talent management:

- Embrace diversity and set aspirational targets for women, foreigners, and Japanese managers from other companies and industries. We are not recommending a quota system, but without targets there is no way to guide the HR organization or track progress.
- Create a global rotation program open to the top 100 to 200 executives, enabling them to work abroad in other parts of the company. The program should guarantee their original positions and tie promotions to participation. Globalization and similar strategic projects can help improve this group's capabilities and experience.
- Hold HR more accountable for talent strategy and development rather than just internal placement and recruiting. This responsibility includes establishing a broad leadership-development program and giving support to coaching for managers.

Komatsu, for example, has its own in-house management-training program. Local executives manage most of the company's major country operations, and employees know that overseas experience offers a path to rapid advancement. In fact, more than two-thirds of Komatsu's executives in Japan have had meaningful work stints abroad. Shiseido, joining the ranks of Nissan and Sony, hired a foreigner as its top executive managing the international business and installed one of Japan's first up-or-out employment policies: if managers fail to be promoted within a certain time, they will be asked to leave.

#### Building a global marketing function

In recent years, Japanese consumer product companies have had trouble turning their technical and manufacturing prowess into brand equity and products tailored for foreign consumers. Indeed, they have spent too little time trying to understand consumers and are often disconnected from the markets where they want to build share. Many executives of Japan's largest consumer companies privately acknowledge that they have fallen behind the likes of Apple, P&G, Samsung, and Unilever in their efforts to ensure shopper-focused rather than R&D lab-centric product development.

Some of the best-known Japanese companies lack proper marketing functions, believing that a product-development group, a sales team, and a contract with a leading Japanese advertising firm will suffice. But this approach has had its day. The ever-faster pace of



product development—homogenizing products, prices, and channels—makes marketing and branding more important than ever. Samsung, for example, introduced the Galaxy Tab in November 2010, just six months after Apple launched its iPad.

World-class marketing organizations have several points in common: a meaningful role for global marketing in the innovation and product-development process, the presentation of a consistent customer experience, the ability to absorb insights from other industries or markets, and the use of cutting-edge techniques to better understand consumer needs. A few Japanese companies, such as Nintendo and Toyota, have both strong global brands and well-developed marketing capabilities, but these are exceptions.

Brands are immensely beneficial to their owners when they have unique value propositions effectively communicated to strategically selected customer segments. But the concept of brand management is alien to most Japanese consumer companies. Each business unit and geography tends to control the brand on its own turf, and that sometimes leads to an inconsistent brand identity or experience. In 2010, only five Japanese companies made the WPP BrandZ Top 100, an annual ranking of brands based on inputs from over one million consumers globally. They accounted for less than 5 percent of the total brand equity created by enterprises on the list.

In the majority of global companies that have built substantial brand equity, the most important marketing decisions are made by the chief executive officer, the equivalent head of an autonomous business unit, or someone, such as the chief marketing officer (CMO), who reports directly to the organization's most senior decision-making position. In these companies, it's the CMO who makes the final call on the balance between global and local marketing, on trade-offs among go-to-market channels, and on how much to invest in new advertising media. However, fewer than 1 percent of Japanese companies with revenue above \$1 billion have a CMO, compared with more than 10 percent in US companies of equivalent size. Of the top 12 Japanese beverage manufacturers, for example, we could find only one with a separate marketing organization reporting to the CEO.

How can a Japanese company with global aspirations become truly brand-oriented?

- Decide which powers accrue to the CMO position and where it should be in the organizational structure. At least until global brand-equity thinking becomes second nature in a company, the CMO must have disproportionate air time at all key decision-making forums.
- Recruit marketing talent worthy of the brand-value goals. The key positions must be filled with people who are as fluent in global marketing insights as they are in Japanese culture. To bring in alternative ways of thinking, it will be necessary to recruit marketing talent from other industries or geographies.



- Reallocate power to global business units and brand “owners.” Matrix structures—characteristic of organizations in which both country managers and global brand and business unit owners share power—do have their challenges. Yet delegating all decision making to a specific geography is unlikely to create successful global businesses. Marketers increasingly tend to identify “tribes” of consumer archetypes that cross borders. Each archetype involves similar products and brands. Meanwhile, the Internet’s increasing power has forced companies to coordinate marketing messages globally. For Japanese companies, shifting to a model that looks more like the approach of the world’s leading global consumer companies is worth the short-term pain that adopting it would entail, and will probably raise their global brand equity.

#### Getting more from strategic corporate development

Any serious globalization attempt will inevitably lead to more M&A, joint ventures, and alliances, as well as greater use of other expansion models. It’s clear that Japanese companies will have to move aggressively in this arena, since in many markets organic growth—important as it is—will not provide the scale needed for competitiveness.

Japanese companies are not shy about doing overseas deals. In fact, M&A has increased recently, in part because of a stronger yen and the increasing recognition that the domestic market is shrinking. Over the years, some individual deals have proved successful. But only a few Japanese companies have tried and perfected a serial-acquisition strategy, such as those of Cisco Systems and P&G, considered models in this area. One company that’s trying is Rakuten, Japan’s leading online shopping site, which completed deals in China, France, Indonesia, and the United States, all within a 12-month period.

Besides M&A, many companies have tried partnerships with trading concerns, minority joint ventures, and alliances. Generally speaking, these approaches have disappointed, in part because they neither build capabilities nor help companies share best practices; at best, they provide an international revenue stream or rudimentary access to new markets. Indeed, many Japanese multinationals act more as holding companies for international subsidiaries than as truly global organizations. When they buy companies, they do minimal integration, except to consolidate revenue—ignoring opportunities for cost-cutting, engaging talented employees of the acquired enterprise, and identifying its best products and taking them global. In some cases, Japanese acquirers have even found themselves acquiring minority interests in companies that have competing interests, leaving the target companies paralyzed on how to grow.

Senior Japanese executives express frustration to us about this kind of ineffective postmerger management, which often stems from language and other cultural barriers. More than one Japanese company we know of has made an overseas purchase and then sent a team to the acquired company’s headquarters, only to return with little to show for

the effort because of communication challenges and a lack of clarity about how to share best practices.

We have observed some companies trying to globalize by experimenting with business models that are pointedly unlike those at their core. In one approach, the Japanese company creates a “second home,” which offers freedom from the constraints of headquarters—meaning more room for across-the-board experimentation and for decision making free of home market bias. Existing businesses run from the Japanese headquarters remain undisturbed, while managers can share with headquarters the lessons learned in the second home. Executives can create one by reorganizing the company to eliminate the distinction between domestic and foreign markets, acquiring a foreign business and using it for pilots and experimentation, and moving a business unit to a foreign country.

Panasonic is moving in this direction. In late 2010, its president, Fumio Ohtsubo, announced that the company would eliminate the distinction between domestic and global markets in its consumer products marketing operations. This decision comes two years after the company retired the Japan-only National brand and refocused its efforts on developing affordable products for emerging markets. Komatsu, the world’s second-largest maker of construction equipment (after Caterpillar), conducts annual reviews of its business units’ operating plans not at the Tokyo headquarters but in each of the company’s eight major markets, to signal their importance.

Another way for Japanese companies to grow internationally involves joint ventures with domestic competitors. In many cases, these companies can’t compete for overseas projects, because of high costs, a lack of scale, or inexperience navigating in foreign markets, so they could consider collaborating. We find more and more examples of this approach, including an agreement between Hitachi and Mitsubishi Heavy Industries to cooperate on railway systems in overseas markets.



Globalization is a means to an end. The end is to create and sustain a self-reinforcing cycle of profit growth and value creation, access to a richer asset and talent pool, and a more compelling value proposition for employees and investors. Getting there will be difficult. Many Japanese companies must make big changes, but most will start the journey with considerable advantages: scale, relative strength in the home market, formidable quality standards and service, and experience working with an aging and digitally sophisticated population. At the time of this writing, Japanese companies also have a strong currency for doing international deals.

Nevertheless, the path forward will seem difficult for most senior Japanese executives, figuratively standing on the shore and looking across the ocean to a world whose language

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many of them don’t speak and whose habits and successful behavior seem radically different from their own. Even if they have concluded that some things in their companies must change, it may be difficult to imagine how to move the organization in a new direction. The most expedient path, we would argue, is “getting the boat pushed out into the current” by ensuring that faster globalization becomes a leading priority over the next few years. 

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