THE STRATEGY AND PERFORMANCE OF FOREIGN COMPANIES IN JAPAN

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INTRODUCTION

I have two goals for this presentation. The first is to give you a clear picture of the actual operations of foreign firms in Japan based on investigations at my research institute at Kobe. Are these subsidiaries succeeding, or failing? What particular characteristics do they share?

The second goal is more forward-looking: to assess the future of foreign firm direct investment and entry into Japan. Will the number of firms entering Japan increase?

To answer these questions I will couple our research findings with changes in Japan's domestic situation and its place within the current international environment.

SUCCESSFUL FOREIGN COMPANIES

An important finding of our research is that most foreign firms in Japan are successful. This is clear from both subjective and objective evidence. In examining profitability, growth and other financial indicators, our survey of foreign firms in Japan found that 15% of the respondents consider their operations a "great success", and some 56% consider their operations as "successful". Thus, direct survey data finds that nearly three out of four firms consider their operations successful. Some 22% responded that their performance was neither successful nor a failure; 4% evaluated their performance as a "failure", and only 2% thought their activities a "great failure".

Because responses to a self-evaluation questionnaire may contain bias, our research also considered more objective evidence. Using profits as a measure, some 81% of the firms were profitable, and 48% of the firms remitted dividends. Finally, although 29% of the firms still have accumulated deficits, 71% now show accumulated profits. The average ratio of profits to sales for all firms was 5.6%.

In sum, the objective evidence corroborates the subjective managerial self-evaluations. Our overall conclusion is that the majority of foreign firms in Japan are successful.

COMPARISON WITH JAPANESE SUBSIDIARIES ABROAD

Our studies find that the most common reason for entering Japan is the attractiveness of the market. Some 87% of the companies gave this as at least one of their objectives. Next, identified by 77% of the firms, is the importance of Japan in their global business strategy. These two reasons are by far the most prominent, and we consider these as central reasons for foreign firms to enter Japan. The third most common response is Japan's role as the parent's base in Asia. Not only is the Japanese market itself important, but Japan is important as a base for entering the entire Asian market.

Despite the fact the Japan's closed market is the subject of much foreign criticism, overcoming these obstacles is given as a reason for entering Japan in only a very few
cases. "To overcome Japanese protectionism" was given by only 2% of the firms as a reason for entering Japan.

When firms consider entering Japan as part of a global strategy, they are not only considering markets. Their rationale is also based upon the technology and know-how available to them in Japan. Japanese companies are world leaders in electronics, automobiles, machine tools, and other important sectors. New products, technology and know-how are constantly being developed in Japan. In order to tap into these developments, foreign firms are entering Japan and establishing operations.

This means that financial objectives, while very important, are not the only reason for entering the Japanese market. Many firms enter with the intention of taking advantage of the information, technology, know-how, personnel, and other resources found in Japan. An increasing number of firms have recognized recently the importance of these non-financial objectives.

**WHAT ARE THE REASONS BEHIND THE FOREIGN FIRMS' SUCCESS IN JAPAN?**

Let me now turn to the reasons offered by foreign firms for their success in the Japanese market. The most frequent response points to superior products and services. The next most commonly cited factor is superior technology and know-how. "Capable Japanese personnel" was cited as a factor for success by 41% of the firms. In these foreign firms, localization of personnel has proceeded all the way to top management. In fact, two-thirds of the respondents stated that their firm president was Japanese. As a result, whether foreign firms succeed or fail depends in large measure on the quality of their Japanese personnel. Many companies also cited a famous corporate name or brand as a factor for success.

These reasons seem to be basic conditions for the success of foreign firms. Foreign companies may be handicapped by their international communication, limited knowledge of the Japanese market, inexperience in dealing with Japanese personnel, and so on. Superior technology and products help them overcome these disadvantages and successfully compete with domestic firms.

Our questionnaire survey also revealed that the following are important reasons for success:

- a good Japanese partner;
- parent company support;
- commitment to the Japanese market;
- timing of entry into Japan;
- superior marketing capability.

**WHAT ARE THE REASONS FOR FOREIGN FIRMS' FAILURE?**

The leading cause for failure cited by these firms is the large number of competitors. In Japan foreign firms have very many competitors.

Next in order of importance is a short-term ROI (Return on Investment) objective. Foreign firms are said to be focused on short-term profit objectives, and this is
borne out by the results of this survey. A number of other reasons for firm failure are simply the opposite of those underlying success, i.e. they are absent in the operation of factors given as reasons behind success.

For example, while a well-known company name and brand may be a reason for success, the lack of name recognition can be a cause of failure.

**MANAGEMENT IN FOREIGN FIRMS**

I will consider next a number of issues in the management of foreign firms in Japan arising from the surveys we have undertaken at Kobe. The topics discussed are marketing; production; research and development; personnel; the Japanese management style practiced by Japanese managers; and the relationships these firms have with their parent companies.

**Marketing**

The percentage of firms transplanting marketing practices of the parent company to Japan varies by the type of marketing activity. Slogans, product concepts and corporate images were the most common direct inputs from the parent and were cited by 38% of the firms. Next in importance are advertising and sales promotion campaigns, with 19% of the companies bringing these from the parent. Only 13% of the firms used the same price strategy as their parent companies.

Survey results indicate that, overall, Japanese subsidiaries do not borrow marketing strategies from their parent companies. In fact, 70% of respondents develop their own marketing strategies and programs for the Japanese market.

**Production**

Because of high wages, land prices, raw materials and other costs associated with doing business, Japan now has the world’s highest production costs. Despite this, the number of foreign firms establishing production operations in Japan is increasing. Why? One reason cited by foreign firms for producing in Japan was to demonstrate their customer orientation. Here, it is important to consider why production in Japan indicates an emphasis on the customer.

I will use the automobile industry as an example. Foreign automobile parts companies criticize Japanese automobile makers for not buying their parts, even though the foreign firms’ parts may be superior in quality and cost. Thus, as an explanation, they point to *keiretsu*, the system of vertically related companies that share resources and benefits. In this case, the Japanese automobile manufacturers give priority to Japanese parts makers in the same *keiretsu*.

Why is this so? Think about the factors considered when a Japanese automobile maker buys parts. Of course, price is one factor, as is quality. Parts that carry high prices and are of low quality are not acceptable. So, a low-price, quality product should be a popular choice, but this is not necessarily so.

The automobile makers also consider other factors. Can the supplier meet the desired delivery date? Is there concern about after-sales service should a problem arise? Next time an order is placed, will the supplier consider a price reduction? Will the supplier work to improve quality? Will the supplier cooperate in design-in activities for the next model change?

In other words, Japanese automobile manufacturers are not just buying a “product” from the component supplier;
they are also buying the “management” of the component supplier.

Therefore, it is not enough for the foreign parts manufacturers to simply try to sell a "product". They must also sell their "management". A key part of "management" is an attitude emphasizing the customer. And one very effective way of emphasizing the Japanese customer is to establish manufacturing operations in Japan. This is not just a characteristic of Japanese automobile manufacturers, but of Japanese customers in general.

Production Innovations from Japan

Our studies indicate that the performance of foreign firm manufacturing operations in Japan is often higher than other overseas operations of the parent company, even when compared with the parent company's home operations. Some three-fifths of the firms surveyed stated that their Japanese production operations performed at a higher level. In contrast, only 10% responded that performance was lower. We can attribute this to Japanese manufacturing technology which is often transferred back to the parent company and to other foreign operations. Over one-third of the survey respondents stated that there had been a “reverse transfer” of production technology from the Japanese subsidiary to the parent company and to other foreign operations. Thus, in many firms, global production innovations have originated in Japanese subsidiaries.

Research and Development

Nearly half of the foreign manufacturers are conducting some kind of R&D in Japan. A basic reason is the need to adapt products to the Japanese market. To meet Japanese customers’ needs, they must modify and improve the parent company’s products. Also, they may have to develop and introduce new products. The option of developing new products for the Japanese market at the parent company is unattractive. Locating this type of product development in Japan is faster.

Another reason that firms locate R&D in Japan is the excellent environment for R&D. Electronics, automobiles, machine tools, and office equipment are some of the fields in which Japan is an international leader in R&D.

The benefits from Japan’s R&D environment are not limited to operations in Japan. They can benefit the foreign firms’ parent and other subsidiary operations. Products developed in Japan are exported to the parent company. Technology developed in Japan is transferred back to the parent. Combined with the parent company’s own technology, this creates new products and processes benefitting both the parent company and other foreign subsidiaries throughout the world.

Consider the example of Fuji-Xerox, the Japanese subsidiary of America’s Xerox Corporation. In the seventies, Fuji-Xerox introduced a mid-size copier demanded in the Japanese market. They did this without any assistance from Xerox in the U.S. They developed and marketed the firm’s first such copier using their own technological capability. Compared to similar development projects at the parent, Fuji-Xerox accomplished this feat at nearly half the time and cost. The result: Xerox’s corporate development group studied Fuji-Xerox’s product development system and know-how to incorporate key elements into headquarter activities.

Within the R&D department at the Akashi Plant of Shill Caterpillar Mitsubishi, a group is working on the development of hydraulic excavators. Recently, as construction projects in crowded urban areas have increased, so has the demand for hydraulic excavators. A model of the hydraulic excavator originally developed at the R&D centre of the Akashi Plant is now produced in the US.

The usual pattern in multinational corporations is for products developed in the parent organization to be produced by
the overseas subsidiary. But these examples from Fuji-Xerox and Caterpillar-Mitsubishi show that the reverse process also occurs.

Applied Materials Japan and its American parent company are working hard to harmonize their R&D operations. Research is located in the US, while development is located in Japan. By ensuring an exchange of researchers and developers between the US and Japan, they hope to cover each side’s weaknesses while taking advantage of their strengths.

In our survey 64% of the respondents indicated that R&D results from the Japanese subsidiary— including patents, technology and products—had been transferred to the parent and other overseas subsidiaries. Thus, R&D in Japan is not used just for Japanese operations, but also benefits the parent and other overseas subsidiaries.

**Personnel**

Foreign subsidiaries in Japan have a difficult time obtaining Japanese personnel, particularly new male university graduates. Because of this, foreign firms put considerable effort into attracting new female graduates. In addition, they emphasize mid-career hires.

Why are foreign firms confronting such difficulty in obtaining personnel? The leading reason is that most foreign firms in Japan are relatively small in scale and their name recognition is low. Of the 436 firms responding to our survey, 43% have fewer than 50 employees, and 31% have between 50 and 200. Only 14% have more than 500 employees. In terms of the numbers of employees, most are small or medium scale enterprises.

The same situation exists for small and medium scale Japanese firms. They also have difficulty in attracting employees. Thus, it is to be expected that foreign firms encounter the same difficulty.

A second source of the difficulty in hiring employees is their negative image. The general perception is that when the business situation worsens and business results decline, they quickly lay-off and fire employees.

Actually, according to government statistics, there is no real difference in employment stability between Japanese and foreign firms in Japan. However, seeing the massive layoffs by the parent in the US, or seeing the "unfeeling" personnel adjustments in a very few of their Japanese subsidiaries, the foreign firms retain the image of unstable employers.

As the third reason, I would like to bring up the dilemma of localization, or "Japanization". Most of the foreign firms operating in Japan have Japanese managers and practice Japanese style management. The head of the personnel department is Japanese at 90% of the firms. As far as personnel matters go, the parent company has delegated essentially complete control to Japanese managers. In these firms, the localization of personnel management has proceeded quite far.

This localization of personnel management poses advantages and disadvantages for the firm in obtaining Japanese personnel. First, in order to hire and have Japanese employees do work, it is advantageous to have personnel management practices suited to local conditions. In this respect, localized personnel management is a plus. On the other hand, many of the Japanese people interested in working for a foreign firm in Japan are looking for something not found in the typical Japanese firm.

From our survey, we found Japanese employees have the following expectations of foreign firms. First, and most commonly, the expectation is for individual responsibility and a wide degree of freedom. Next, they expect the opportunity to develop and improve their own specialized know-how. Other common
responses were expectations of objective performance evaluations, short working hours, and male-female equality. Only 19% expected employment security.

While foreign firms must localize their personnel management, at the same time they also must maintain the attractive characteristics of a foreign firm. This is the dilemma of localization facing foreign firms.

**Japanese Style Management by Japanese Managers**

Of the 421 firms responding to our survey, 63% indicated that a Japanese serves as CEO.

Let me share a personal experience. About 10 years ago, at a meeting at the Kansai Economic Research Centre, the discussion turned to foreign firms in Japan, I had the following exchange with a number of managers attending this meeting. I had asked: 'For US and British companies setting up subsidiaries in Japan, should the CEO of their Japanese subsidiary be Japanese, or should the CEO be a foreigner? In unison, the managers there answered: "A Japanese is best, of course".

They gave the following reason for the answer: "To do business in Japan, you have to know the situation in Japan well. You have to be able to negotiate with bureaucrats. You have to be able to get along well with the people at the banks and industry. If you can't speak Japanese, you can't expect to be able to manage in Japan. Even though it's a foreign subsidiary, most of the employees are Japanese, and if you're going to manage employees it's best to have a Japanese doing it."

Then I asked, 'Tell me, all of you have foreign subsidiaries. Are the CEOs of these subsidiaries locals, or are they Japanese?' Everyone answered that the CEOs were Japanese, almost without exception. To this, I commented as follows. "For the CEO of a foreign firm's Japanese subsidiary, a Japanese is best. Also, for the foreign subsidiary of a Japanese firm, a Japanese CEO is best. In other words, a Japanese is the best choice for a CEO for a company anywhere in the world? Is that so?" 'That's right' the managers said, but even they recognized that something was strange. I also felt that something was strange.

If locals are the best choice for CEOs of foreign firms' subsidiaries in Japan, aren't locals the best choice for CEOs of Japanese firms' foreign subsidiaries? From that time on, with the hope of answering that question, I have been pursuing my research on foreign firms in Japan.

Localization of management is even more advanced at the functional top-manager level. The percentage of firms for which the top functional manager is Japanese are as follows, by function:

- Administration, 92%
- Personnel, 92%
- Finance, 84%
- Marketing, 83%
- Production, 87%
- R&D, 71%.

At the majority of foreign firms, Japanese management dominates, with 59% of the respondents indicating they are implementing Japanese style management. Only about 1% said that they were practicing American or European style management.

The style of management that dominates in the foreign firms is influenced by such factors as whether the CEO is Japanese or not, the ratio of foreign capital, industry, and the nationality of the parent company. Japanese style management is most common when the CEO is Japanese, the foreign company's share of a joint venture is low, the firm is in a manufacturing industry, and the foreign parent is an American firm. In contrast, we commonly find the parent company style management when the CEO is a foreigner, the foreign capital share is high, it operates in the finance or service industries, and the foreign parent is European.
Delegation of Authority from the Parent
Foreign firms in Japan are under the control of their parent companies. What is the nature of this parent control?

Control by the foreign parent centers on two points. The first is corporate policy and overall strategy. The other is finance. Besides these two areas, foreign firms in Japan are not under tight control from their parents.

FOREIGN SUBSIDIARIES IN JAPAN AS INNOVATION CENTRES

Now I want to return to a point which I made earlier. This concerns innovations that originate in Japanese subsidiaries.

One role of foreign firms in Japan as subsidiaries is to implement the parent firms' strategies for Japan. In this role, the subsidiary is in a basically passive position. However, among the subsidiaries in Japan, we find that they are pursuing innovations on their own, and some of those innovations are being transferred to the parent and other subsidiaries. Within the global management system, with the parent at the centre, the Japanese subsidiary is also acting to develop and spread innovations. These subsidiaries are what I would like to call "innovation centres."

Certain innovations are within the realm of management. This includes new marketing strategies and programs, or new distribution networks. Over 70% of the firms in our survey indicated that they had developed such marketing innovations.

Japanese style production methods are now well-known worldwide under such names as kanban system, "just in time system", or "lean production". Japanese style manufacturing operations are practiced by foreign companies in Japan. Further, they are being transferred back to the parent company, as well as to the firms other overseas subsidiaries. Thus, the Japanese subsidiaries are the source of innovations in production for the parent and other foreign subsidiaries.

Nearly half of the firms are undertaking R&D in Japan. These activities lead to new products and new technology. These also represent innovations born in Japanese subsidiaries.

Whether the innovations are in marketing, production or R&D, their main purpose is to adapt to the Japanese environment. However, some innovations can benefit the parent and other overseas subsidiaries. Such internationally applicable innovations are transferred. In our survey 30% responded that marketing innovations had been "reversely transferred" from the Japanese subsidiary to the parent and other subsidiaries. For production, 35% indicated that innovations had been transferred. For R&D innovations, the percentage leaps to 64%. In sum, our research reveals that successful subsidiaries in Japan are fulfilling a role as innovation centres.

The Japanese subsidiaries of American and European firms and the overseas subsidiaries of Japanese firms offer a study in contrasts. The majority of subsidiaries of Western firms in Japan are successful, showing strong business performance. In terms of progress in localization, these firms are also performing well. At 80-90% of these firms, the heads of production, sales, personnel, accounting and other departments are local (Japanese). In two-thirds of the firms, the CEO is also Japanese. Further, many of these subsidiaries are acting as what I have called "innovation centres". In other words, the subsidiary is developing new products,
technology and management systems on its own, and these are being transferred back to the parent company and subsequently to the firm’s other subsidiaries. They are the source of a "reverse transfer" of innovations, in spite of the usually passive role assigned to subsidiaries.

**PRACTICES IN JAPANESE SUBSIDIARIES ABROAD**

Let me now briefly draw some contrasts to the practices of Japanese subsidiaries abroad. They offer a stark contrast.

First, about half of the Japanese firms’ subsidiaries abroad have zero profits or post losses. The overall average profit-to-sales ratio is very low, about 1%. They are also, in comparison, slow to localize these operations. Although slightly more than half have local personnel as heads of some departments, only about 20% of them have locals as CEOs. They are dependent on the Japanese parent for nearly everything: technology, information, capital, personnel and other managerial resources. We do not find many examples of subsidiaries acting as the innovation centres I just described.

Looking at the characteristics of the subsidiaries of Western firms versus Japanese firms is like looking at the positive and negative images of a photograph. The positive is the foreign subsidiary in Japan, the negative is the Japanese firm’s subsidiary abroad.

The fact is that there are a number of problems in the foreign subsidiaries of Japanese firms. As part of solving these problems, Japanese firms can learn much from how foreign firms conduct their operations in Japan.

**FOREIGN FIRMS ARE WELCOME**

Now I would like to discuss a recent change in the historical trend of foreign investment in Japan.

In the 1950s and 60s, the Japanese government’s had very restrictive policies towards foreign investment. With Japan’s economic recovery and increasing internationalization, this restrictive environment gradually loosened, and liberalization proceeded. And in 1994, the stance of Japan’s foreign capital policy changed in a fundamental way. Attracting foreign investment in Japan became a basic policy goal. The Great Hanshin Earthquake of January 1995 had a devastating effect on Kobe city and surrounding areas and provides an example of the MITI-wide policy of promoting increased foreign firm entry into Japan. Since the earthquake, attracting direct foreign investment to the Kobe area has been one of the key elements of the local government’s recovery strategy. The regional office of MITI has also been making efforts to attract investment by foreign firms to energize industry in the Kansai area. Indeed, up to now, foreign firms have been concentrated around Tokyo’s metropolitan area. The MITI office is trying to lure foreign firms to the Kansai region.
WHY ARE FOREIGN FIRMS NOW BEING WELCOMED?

First, Japan must correct a huge investment imbalance. Foreign investment in Japan was a mere 6% of Japan's direct investment abroad, a ratio of 1-to-17. This is in marked contrast to other industrialized countries. For the USA, the same ratio (foreign investment to investment abroad) was almost unity. There is little need to mention Japan's trade surplus. It has given rise to a number of problems, commonly referred to as "trade friction." The investment imbalance can also give rise to "investment friction." Not only does Japan restrict products from entering Japan, it also seems that they restrict firms from entering. Such are the criticisms coming from foreign governments, industry associations, and firms.

The second reason foreign firms are now being welcomed to Japan is the expectation that they will contribute to a vitalization of the Japanese economy. They increase domestic investment; they increase employment; they bring in technology, know-how and other managerial resources; and they promote competition within Japan. These factors help energize economic activity.

FUTURE OF FOREIGN FIRM INVESTMENT IN JAPAN

I want to consider now some of the factors that will influence future foreign investment in Japan.

One of these factors is the size of the Japanese market, which is second only to the US. It is a market that is simply too large for foreign firms to ignore. Further, Japan's per capita GNP is near the top of all industrialized countries. This high per capita GNP is found in a population exceeding 100 million. Japan's market is perhaps the most important high class market in the world. Also, the Japanese market has largely been closed to foreign countries for a long time, and liberalization is still at an initial stage.

These three market characteristics-large scale, high-class and increasingly accessible-are probably the most important factors attracting foreign firms to Japan.

Foreign firms have two means of accessing the Japanese market-exports or local production. I believe exporting to be the main route. One reason for this is the high production costs in Japan mentioned above. Considering the high cost of production in Japan, we can hardly expect a future dramatic increase in the number of foreign firms manufacturing in Japan. As a matter of fact, we now see a steady trend by Japanese firms to move production overseas.

If Japan were to reverse the trend toward trade liberalization and become more protectionist and make it harder for foreign firms to access the Japanese market, then foreign firms might have to choose local production over exporting. However, everyone expects liberalization to continue. Foreign firms will then have an even greater chance to access the Japanese market through exports. Should exporting become the main way for foreign firms to enter Japan, we can also expect to see an increase in local manufacturing related to exports. Earlier I discussed reasons why foreign firms manufacture in Japan. Many indicated that local production in Japan is superior to exporting to the Japanese market. That advantage is not based on cost, but rather on non-cost factors. By manufacturing in Japan, the firm can provide adequate service to
consumers and customers. It serves as an assurance of future after-sales service and quality improvement. It helps gain the faith of suppliers and distributors. Additionally, the firm can better understand the needs of consumers and customers and produce products locally that meet these needs.

There is another reason why I think we will see an increase in local manufacturing linked to exports to Japan—the high performance level of Japanese manufacturing. Granted, from a cost basis, manufacturing in Japan is in many cases not a good idea. But when you consider quality, delivery time, service, and other non-cost factors, Japan just might be a good choice for manufacturing.

Further, in many industries, customer demands in the Japanese market lead or set the pace for markets all over the world. By developing and producing products for this challenging market, it becomes possible for the parent and other foreign subsidiaries to compete elsewhere.

Production in Japan also allows the firm to learn Japanese manufacturing and development methods. Earlier I discussed the role of some foreign firms as innovation centers. Many foreign firms would be wise to consider seriously the advantages of having an innovation center in one of the worlds largest, most advanced markets.