

Interview with Dr. Ulrike Schaede, Professor at UC San Diego School of Global Policy and Strategy

# Could Japan's Management Reforms Lead to a New Model of Global Capitalism?

By *Japan SPOTLIGHT*

Dr. Ulrike Schaede, an expert on Japanese business and economy, has recently published a book titled *Shin Nihon no Keiei* ("New Japanese Business Management", Nikkei Premia, 2024). She highlighted Japanese management in the 21st century as being a rational and effective way to achieve growth and social stability simultaneously. *Japan SPOTLIGHT* held the following interview with her.

(Interviewed on July 10, 2024)

### Introduction

**JS:** The Japanese economy seems to be getting better these days, and there is a growing belief that Japan will return to a good economic performance soon. But pessimism about the economy is still strong. In your recently published book *Shin Nihon no Keiei*, you express greater optimism, so I would like to hear more about your views on Japanese business.

**Schaede:** I think that the pessimism was justified, if you only look at macroeconomic data. For many years since the bubble burst, the Japanese economy overall has not been very exciting. The adjustment has been slow. Then came the "Ice Age" for young people looking for jobs, when a generation of students graduating from university in the mid-1990s struggled to find good employment. But not all business has been bad, and if you look at the successful businesses, you end up with much more hope for the future of Japan. Even in those bad times, there were Japanese companies that managed to transform their business strategy and pivot the company for growth by doing the right things.

The decade after the burst of the bubble economy was truly bad, and it was not until roughly 2005, that is under Prime Minister Junichiro Koizumi, that things got better. But I don't think that businesses are really to be blamed for their slow response to the recession. They were incentivized to reorganize and restructure slowly, by policies and by society. Of course there were risk-averse or uninspired managers, but those exist in most countries.

In my research I would like to focus not on those bad managers, but on the good ones. We can learn from mistakes, of course, but rather than focusing on the negative aspects of Japanese business, I propose that we study Japan's successful companies and see what



Dr. Ulrike Schaede

we can learn. I also think that this year, 2024, is going to be a year of change.

But why Japanese business reforms and changes have been so slow is an interesting question. I think that initially Japanese business managers could not move much faster. Between 1998 and 2006, there were many revisions of corporate laws in Japan, and until those revisions were completed there was really not that much that Japanese companies, certainly large Japanese companies, could have done faster. This is because the government, including the Ministry of Economy, Trade and Industry, expected the large companies to uphold employment. The lifetime employment system was still dominant. So, even with hindsight, if we had been managers of a large

Japanese company in 1998, or even in 2001, there would not have been much we could have done differently. Some managers were certainly too conservative and too slow in their decision-making and reforms. But until 2005, I really don't think it's necessarily right to blame business leaders for their poor business performance. They didn't have a lot of wiggle room before the Corporate Law (*Kashia-hō*) of 2006.

### Japanese Business Success Even in the Lost Decades

**JS:** Japanese business performance depends upon sectors. In your view, Japanese material industries have been very successful in raising their competitiveness. Why do you think so?

**Schaede:** It's not only materials. Industrial machinery and factory automation and robots are also strong, as are now, once again, steel and chemicals. But advanced chemicals and materials are today

clearly a leading sector. Japan has a history in the chemical industry going back to the 19th century. Within Asia, it's only Japan that has that long history. Chemicals is a bit like cooking, and it is a high "tacit knowledge" industry. Even if you know the recipe, that doesn't mean you can cook the meal: you need practical knowledge on how to do it right. Likewise, you need to have gained knowledge of production processes and engineering. Chemistry is an important area of knowledge among many industries in this light. And right now, companies like LG Chemical in South Korea and some Chinese companies are trying to catch up with Japanese ones. They are trying to learn fast because this is key knowledge for many industries. But they haven't quite caught up yet with Japan.

In electronics a similar story of path dependency applies. You may recall NTT DoCoMo's iMODE, which was a big invention at the turn of the century. It was the best phone technology in the world at the time, and there were some that had a camera and could go online. It was just too soon for the global markets. In 2006, Apple developed the iPhone. Steve Jobs was very clear in saying that he would not manufacture it in the US and would have a global supply chain for manufacturing. He then looked around and asked himself where he could find companies that could make this new iPhone? And of course he found Japan, where the suppliers had an advantage because they had made the iMODE parts. More than half of the initial iPhone suppliers were Japanese companies. So in a way, leadership also goes back to the Japanese electronics industry in the 1980s and 1990s.

## The Mainoumi Strategy

**JS: Are these successful examples of Japanese companies in a niche market, just like chemicals?**

**Schaede:** We have to be careful when we say niche because when Japanese readers see "niche", they think about small companies. But that is not my story. Large companies can compete in smaller global markets, too, and their definition of small may be \$5 billion. In my book, I have labelled the newly emerging Japanese corporate business strategy the "Mainoumi strategy". Mainoumi was a sumo wrestler in the early 1990s at a time when the sumo champions were usually huge. Mainoumi was not, but he came to be known as the "Department Store of Superior Techniques". And that's really what I'm talking about with the aggregate niche strategy, which is a global strategy to be dominant in a series of upstream input parts and materials, each of which anchors an important step in the global supply chains. With some specific unique technologies or goods with a very competitive advantage, a Japanese company regardless of size can have an advantage in aggregate niche markets. For example, photoresist, a light-sensitive material important in the semiconductor market, would be a true strength for a company regardless of its size.

Each of these input markets might be \$5-10 billion globally. The

Mainoumi strategy is a strategy of large, listed companies that have moved upstream in the global value chains. They did this because they had to avoid head-on competition with South Korea, then Taiwan and then China. Their rise wiped out Japan's previous strategy of commoditization. So Mitsui Chemical, Mitsubishi Chemical, and so forth all have to find ways to add to their current businesses in commoditized products some new businesses that are location upstream in the value chain. They cannot compete powerfully in things like bulk chemicals anymore, because the profit margins are now too small in those sectors. And so the way forward is to say, we need to switch into something difficult to make and difficult to copy, so we can stay ahead of South Korea and China. And if those goods are really essential, they can set the price. Margins are much higher in these highly advanced goods. In this way, Japan can actually profit from the rise of China by leaving assembly to China and moving upstream. And the more the Northeast Asian competitors need Japan, the more powerful Japan will be. So in the aggregate, counting these upstream value chain markets, it all adds up very nicely.

## Strategically Indispensable Goods for National Security

**JS: I have a follow-up question. With geopolitical risks rising, economic security is becoming more important. So the goods you mentioned, in particular chemicals, must be very important in terms of national security for Japan. Are such goods strategically indispensable for Japan?**

**Schaede:** Japan still needs China for rare earths even in producing semiconductors, which could almost be produced by Japan on its own. But Japan is not 100% self-sufficient. Leaving aside the rare earth inputs, however, if you look at the value chain of a semiconductor, it can be rebuilt within Japan. Japanese companies dominate certain steps of the global value chain for semiconductors with an almost 100% market share. Without those materials from Japan, even the US cannot make semiconductors. So this puts Japan in a very powerful position. The threat of decoupling, in a way, is making Japan even more important. I'm hopeful that this will actually stabilize the region. China would not want to break those supply chains. We can hope that it makes no sense for China to invade Taiwan or Japan, because an old military insight is that you don't want to destroy a place that you need. I am hoping that this rationale can help maintain balance in the region.

## Merits of Japan's Slow & Incremental Reforms

**JS: Another thing in your book that impressed me is where you mention about fundamental reforms done**

## by many Japanese companies. What do you think are the important characteristics of Japanese business reforms? Do you think such slow reforms are unique to the Japanese economy?

**Schaede:** In English, resilience refers to the time it takes for recovery after a big external shock.

How long does it take for the market to recover from that shock? The shorter the time, the higher the resilience. Americans are often quite proud of how resilient they are.

I think the Japanese definition of resilience is very different. We can see this in the Toyota production system, which considers a steady flow of business activity the most important aspect, regardless of external shifts. So the understanding of a resilient system is one in which, even if there is a shock, the system still works and remains functioning within a certain band.

I don't think the US has overcome the global financial crisis. There are a lot of working poor, and a shrinking middle class. We could talk about the US for a long time. Japan decided that social stability was more important than GDP growth. And we do not know whether it was more costly or less costly. But there are many people now in the US who agree with me that the economic cost of the US system of slash and burn is one that has made the rich much richer more quickly and the poor much poorer more quickly. And the Japanese slow pace in addressing reform of its economic system is also clearly costly, given 30 years of stagnant GDP growth. But when looking at the sales of Japanese companies abroad or how many cars Toyota has sold in the US or how many chemicals JSR has sold outside of Japan, the story can be different. That means, the growth of Japanese industry has happened outside Japan. Some companies' profits overseas have returned to Japan but not completely.

Some Japanese companies are in great shape, but the Japanese economy overall is not. That is why we are seeing an excellent Japanese stock market performance right now. What we see are very strong Japanese corporate performances which may not have been necessarily reflected in GDP numbers.

### Shift from Social Stability in Japanese Business Management

**JS:** One question about social stability. Japanese companies consider stability as well as growth, and that does seem to make Japanese business unique. They try to achieve stability and growth simultaneously. Could this lead to a new form of capitalism in Japan?

**Schaede:** I believe there is a trade-off between economic growth and stability. To achieve higher growth sooner after the burst of the bubble, Japanese companies could have laid people off. It has always been actually possible to lay people off in Japan. But the

problem at around the turn of the century was the cost to reputation. So if a company had laid off a lot of people, it would have been criticized by the media and may have faced a consumer backlash. During the crisis at the turn of the century, it would have been considered socially intolerable for a company to engage in massive layoffs.

But today, I think the story is a little different. Two big changes are happening in 2024. One is that lifetime employment is ending. It's still there, of course, but because of labor shortages there is now excess demand for people. This has invited mid-career job-changing (*tenshoku*). For example, I read in the newspapers that more than 50% of new hires in 2024 by Mizuho Financial Group last year were mid-career hires. Happily, this is not a problem for university graduates because of the labor shortage. What that means is that large companies no longer have to worry about employing people for life. They can ask people to leave, because those people can find new jobs. The second thing that is happening now is the impending rise in interest rates, which will increase economic metabolism significantly.

You have a combination of economic situations – a labor shortage and the cost of money going up. Laggard companies that cannot adjust will pretty soon be wiped out, because they will not attract workers and will not be able to meet their interest payments on bank loans if they do not become much more profitable. The zero interest rate is over. Both the labor shortage and rise in interest rates happening at the same time may be one of those “lucky moments” for the Japanese economy because it will not impact society overall too much if these laggard companies are closed down.

### Japanese SME Policies

**JS:** On the question of metabolism, SME policies in Japan could work to discourage this because they help industries losing competitiveness to survive. So such policies are not so wise in some economists' view. But what do you think about SME policies?

**Schaede:** I don't know about the future. So let's talk about the past for a moment. I view Japanese SME policies, including subsidized loans for very small firms without a business model, as a kind of welfare policy. It's just a different way of doing welfare. In the US, if a small firm goes bankrupt, it goes to a government office and collects a welfare check which is paid for by taxpayers. In Europe as well, a similar process. The problem then is that the store owner or small firm manager is unemployed, which is not good for human dignity and morale, no matter what country we are in. Nobody in the world wants to go to a welfare office. In Japan, too, of course it is considered shameful and a failure. Japan's policy solution to this challenge is that rather than having store owners and so forth go on welfare by closing down their super-small businesses, they can receive a subsidized loan at very low interest. That loan can be

viewed as a welfare policy.

And Japan may have found a good alternative solution to welfare policy. We could actually do a really interesting study on how expensive this type of welfare system is, although the data collection might be difficult. In any event, Japan's SME policies are focused on preserving social stability. I think that is why studies on Japanese labor productivity are quite misleading. They should be done without very small firms to account for these SME policies as welfare policies.

But this all will soon end and correct itself. The average age of Japanese SME CEOs is about 75 years old, and many face succession issues. In the typical Japanese way of closing down a business, the past 20 years can be seen as "attrition", a waiting period for these very small business to gracefully exit the economy. The challenge is that the Japanese government is not good at phasing out policies, and the SME policies may be particularly difficult to end, especially as politicians are eager to hang on to their many voters among SME owners. But while there may be resistance against phasing out SME policies, again, luckily for Japan, I think because of the labor shortage there will be much less demand for these policies in the future. Under depopulation in an aging society, I think these policies will end because all labor will have to go to more productive use.

## **How to Activate Innovation in Japan, a Crucial Policy Goal for Japanese Economy?**

**JS:** Just one more question. Promoting innovation is very important for Japan because I think the Japanese economy is a little bit behind the digital economy. You may have heard about Panasonic's Game Changer Catapult initiative to encourage employees to solve societal issues through their own ideas. What do you think about this kind of entrepreneurship program inside a large company. Would it be a good idea to encourage innovation and catch up with other developed nations in terms of the digital economy?

**Schaede:** All of these measures are good attempts. I think Japanese innovation just functions a little differently. In Silicon Valley, we think of the image of very ambitious founders who work day and night, and they could be poor. They are said to be happy to take risks, and to be young. In reality, the average age of Silicon Valley business founders is 45 years old, and the challenge they face is that the failure rate is high. There is a high turnover, and people dare take these risks because they can get very rich this way. But in the US too, the social cost of failure is high and nobody wants to fail.

I don't think that's how things work in Japan. First of all, you can't get really that rich in Japan because the stock market just doesn't work in that way. And the risk-taking calculation is just different.

Therefore, the innovation sabbatical allowing employees to keep jobs in a large company while taking a sabbatical to work on innovative ideas, or having new patterns of innovation in large companies, is a great idea because it ensures job security. Because of the labor shortage, this unique innovation custom could show its full advantage. After starting your own company or working for a startup during sabbatical days, you can come back to your own company within a period of five years. You can come back to the same job category automatically. So there's actually job security behind that entrepreneurial spirit. Silicon Valley people would say that makes no sense to them, because if you're not hungry, how can you be so innovative?

But I think in Japan the story is the opposite. Knowing that there's a safety net, knowing that you can return to that status, would actually make people more willing to take those risks. It's a little bit of a different logic that I think comes out of social preferences for status. Therefore, anchoring new types of innovation in large Japanese companies is an excellent way to go, in my view. Startups are great because they can do all these things that large companies cannot do. But it is also true that large companies have everything that small companies need – except the willingness to do something fun and find new ideas. So if Japan can find a way to merge those two and have a breakthrough finding associated with large firms, that actually would be a much better solution than Silicon Valley.

## **Conclusion**

**JS:** So to sum up: Japanese business reinvention, with a care for stability, could lead to a new model of capitalism in the world. And that could be a good model for surviving the processes of aging and depopulation that face us.

**Schaede:** The US is the world's leading capitalist model, but its system is now sometimes called "late capitalism" and that no longer seems to work. We know that socialism does not work either, so we need something new. And Japan has always been an alternative. I really do think that more people need to look at the Japanese system, and wonder whether there's something that is working in Japan that they can adopt. Japan might actually be finding a new way of balancing technological progress with sustainability and ESG, and social stability with economic growth. And that would be very attractive to people elsewhere.

**JS**

Written with the cooperation of Rias Reed, a graduate student at Princeton University specializing in International Development.