

# ***Japan's global champions*** Reinvigorating the nation

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## **At a glance**

The challenges facing Japan threaten its economic strength and the might of its largest and most dynamic companies.

During this time of change, these companies—Japan's global champions—must confront issues such as globalization, innovation and talent while harnessing traditional strengths to reinvigorate the nation's economy.



*The multiple disasters of March 2011 brought Japan's long-term challenges into sharp relief. After two decades of drift, the tragedy has left people nationwide determined to rebuild much more than just the shattered Tohoku region. That shared sense of purpose now drives the discussion on a wide range of issues—from energy and education to debt and demographics—all critical to one key imperative: recharging the engine of national prosperity. The challenges may be complex. But once the Japanese people share a clear vision of the path ahead, history shows they are capable of miracles. Starting with next to nothing in 1945, in a single generation Japan built remarkable enterprises that deserve recognition as “Japan’s global champions.”*

*Although Japan’s global enterprises retain immense strength, there is a sense that their competitive edge is in decline. Thus, the key question: **What will it take to reinvigorate Japan’s global champions?***

**A legacy of economic achievement**

Japan’s global champions, the country’s largest and most dynamic companies, represent a remarkable explosion of human productive effort; an economic achievement without precedent or parallel. During the postwar period, Japan laid the foundation for economic strength,

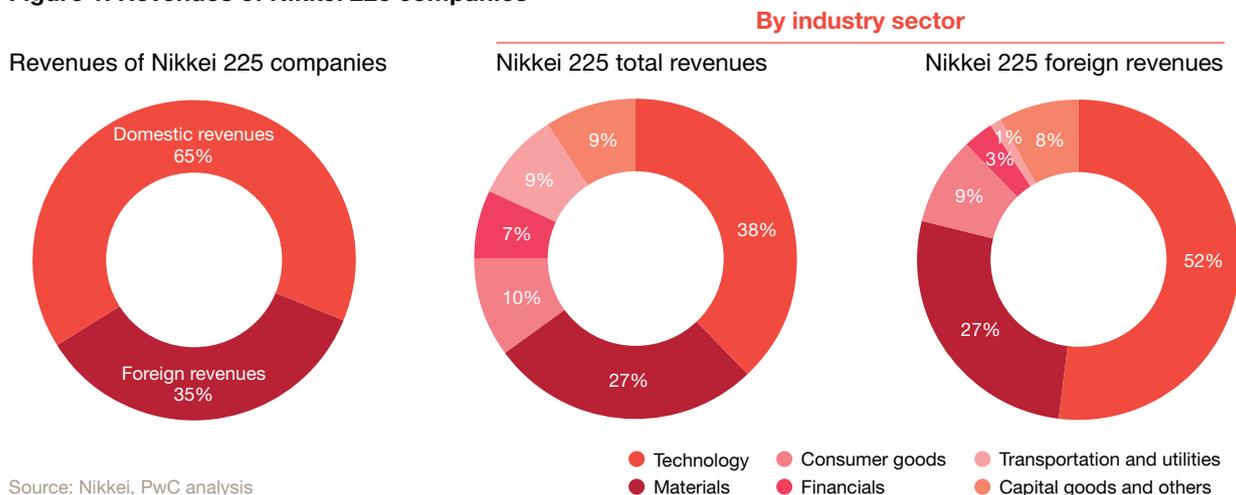
becoming the world’s second-largest economy in 1968 and experiencing explosive growth in the subsequent two decades. The reconstruction was backed by an almost unchallenged mastery of the manufacturing process; “Made in Japan” was firmly established as the global benchmark for product quality. Japan’s global reputation for quality stands as the collective achievement of

hundreds of enterprises and millions of workers. The strength of Japan Inc. is a testament to the exceptional characteristics of the Japanese people: personal diligence, respect for education, teamwork, loyalty, craftsmanship and a tireless work ethic.

Japan has a legacy of being insular and culturally unique—the legacy of more than two centuries of isolation under the Tokugawa shogunate before the eventual awakening of the Meiji Restoration. However, the strength of the postwar Japanese export machine exceeded any foreign expectations. Unmatched product quality allowed Japanese firms to enter new markets and gain market share at the expense of local competitors.

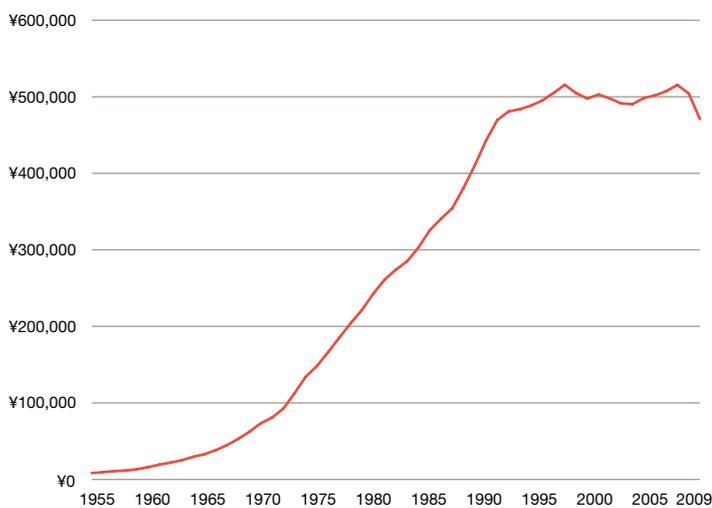
The global enterprises that dominate Japan’s Nikkei 225 index now extend far beyond the nation’s shores (see Figure 1). These enterprises are the proprietors of global brands and the stewards of capital provided by citizens and international investors alike. Today, multinational companies need global operations and an international workforce. This is the heart of the challenge facing Japan’s global champions. How can they retain the historic strengths and characteristics of Japanese enterprises as they adapt to meet aggressive foreign competitors,

**Figure 1: Revenues of Nikkei 225 companies**



**Figure 2: Gross GDP growth from 1955 to 2009**

GDP nominal,\* in billions JPY

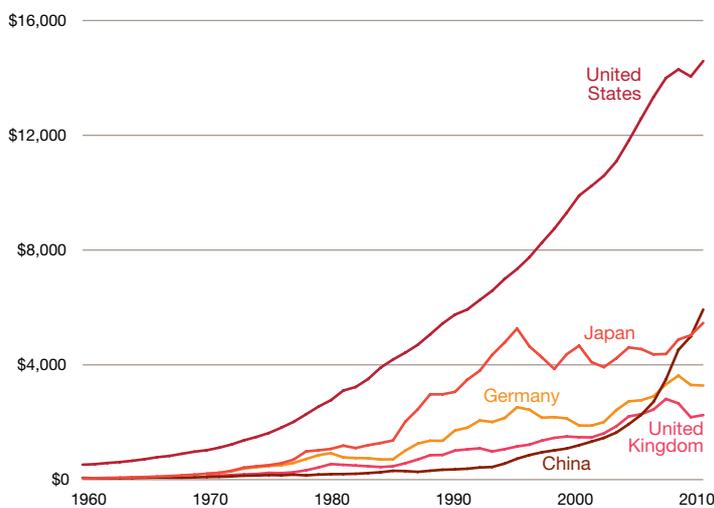


\* 1980 to 2010 data are based on 1980–current series; 1955 to 1979 data are estimates based on 1955–1998 series

Source: Cabinet Office, Government of Japan

**Figure 3: Japan vs. US, Germany, UK and China**

GDP, in billions current USD



Source: World Bank

as well as the imperatives of globalization, innovation and harnessing of human talent? What must endure? What must evolve?

### **After 40 meteoric years, “yaku-doshi”—a reversal of fortune**

Starting in 1985, Japan’s exporters faced a fundamental change in their competitive landscape. The Plaza Accord of 1985 resulted in coordinated intervention in the global foreign exchange market by the largest economies in the world. Consequently, in January 1989, the month Japan’s Showa Era ended, the yen skyrocketed from 237 to 127 to the US dollar.

“Endaka,” the yen’s steep rise, was only the first of many challenges in the early years of the Heisei Era. Although a stronger currency and sharply higher market capitalization gave many companies the financial might to shift from an export focus

to global production, the bubble economy spawned moral hazards that distorted corporate priorities.

The bubble economy inevitably collapsed and, amid the economic turmoil, growth was hard to achieve. Japanese GDP grew only 3.7% in real terms from 1999–2009, actually contracting in nominal terms. This is a sharp contrast to the period from 1980–1990 when Japan experienced real GDP growth of more than 45%. Amid the broad acknowledgement that reinvigoration is necessary, Japan’s global champions must develop new strategies to maintain the nation’s global economic position (see Figures 2 and 3).

### **Defining the journey to come**

In recent years, challenges have emerged to compound slow growth at home. Rivals old and new have narrowed Japan’s historic lead in quality, process efficiency and innovation. A historically high yen has bled

margins. Increased company size has burdened some with excessive bureaucracy. And Japan’s hierarchical corporate system is increasingly at odds with global norms.

Many of the challenges now facing Japan’s global champions are common to companies around the world. Disruptive technologies, upstart competitors, demand shifting to emerging markets and talent gaps are issues all multinationals must contend with. What may be unique to Japan is the degree to which issues such as insularity, inflexible hierarchy and a decreasing domestic talent pool inhibit timely and effective corporate responses.

The matrix of global and Japan-specific issues is both complex and daunting, but it is hardly a steeper challenge than what the global champions faced in the postwar decades. To move past these issues, challenges must be faced head-on.

## An appetite for change at the top?

Japan's CEOs in PwC's 15th Annual Global CEO Survey said...

- The yen's strength is leading more Japanese firms to seek overseas acquisitions—outbound M&A amounted to a record USD \$80 billion in 2011, up from USD \$34 billion in 2010.<sup>1</sup>
- Fully 86% of Japan's CEOs reported their intention to change their strategic plans—as opposed to just 62% of CEOs in North America and 64% of CEOs in Western Europe.<sup>2</sup>
- Japan's CEOs are focused on emerging market opportunities—69% of CEOs reported a desire to spend more time developing business in new markets.<sup>2</sup>
- Japan's traditional approach to workforce management might be changing—78% of Japan's CEOs are planning to change their company's approach for managing talent.<sup>2</sup>

Unleashing Japan's full transformative power must start by accepting that the path forward is neither simple nor obvious. This endeavor requires study and introspection, dialogue and debate. In this effort, Japan's friends around the world—by now stakeholders in the success of Japan's global champions as employees, investors and suppliers—have an essential role.

### Japan's bedrock strengths

Engineering is the core strength on which Japan's postwar economic miracle was built. Historically, Japan's global champions have built their success on this famed engineering prowess—decades of unrivaled excellence in product development, manufacturing efficiency and quality in the automotive and technology industries. That skill base is the power behind what Japanese call *monozukuri bunka*: the culture of making things. Although much manufacturing will continue to move offshore, the

*monozukuri* knowledge base should be evolved as a fundamental strength.

As evidenced by the postwar experience, shared catharsis can trigger a powerful collective response from the Japanese people. This may well be the outcome of the March 2011 disasters. In the course of rebuilding, with a reconstruction budget estimated to exceed USD \$300 billion, Japan has the opportunity to innovate solutions in fields well-suited to Japan's historic strength in engineering, such as energy security, smart cities, sustainability, and disaster resilience.

Education is another bedrock Japanese strength that must evolve to meet new challenges. The postwar economic miracle was arguably a triumph of universal education in that a nation with limited resources succeeded in graduating tens of millions of skilled workers within two decades. Educating the youth of today and tomorrow is an

even more critical task given Japan's rapidly aging population. To provide for ever more elderly, tomorrow's smaller workforce will require high-value global skills that are in short supply.

The domestic talent gap on the horizon highlights a key question for Japan and its global champions. Will corporate functions migrate overseas, closer to markets and workers? Or will doors open to the world's top talent, bringing the best and the brightest to work at head offices and research centers in Japan?

In many respects, Japan offers an outstanding environment for global, knowledge-based business. And yet, Tokyo's prospects as a global financial center have dimmed in recent years as activity has shifted to Hong Kong and Singapore, reacting in part to a less-than-welcoming tax environment for foreign business; at 39.5%, Japan's corporate tax rate is significantly higher than the international average of 25% to 30%.

Ultimately, though, Japan offers an outstandingly efficient living and working environment in the world's most vibrant economic neighborhood. Trains run on time. Service levels are exceptional. People do their jobs even when no one is looking. Contracts are enforceable. Streets are safe, day or night for men and women alike. Public health standards are impeccable. Tap water is drinkable. Urban air quality is generally high. Japan's cities are clean, vibrant and brimming with amenities such as Michelin-starred restaurants.

These are among many bedrock strengths that can support the reinvigoration of Japan's global champions. With an outstanding base of skills, knowledge, social stability and infrastructure, Japan has assets other nations can only envy. Given shared insight and collective will, its future challenges can surely be overcome.

<sup>1</sup> Dealogic, *Wall Street Journal*.

<sup>2</sup> 2012 PwC 15th Annual Global CEO Survey.

*The need for fundamental change among Japan's global champions is evident. What is not yet clear is how they need to change. How can they maintain their native strengths while adapting to meet the needs of global markets and a diverse workforce? How can they regain their track record of innovation? What changes are needed in corporate governance to restore the confidence of global investors? These are just a few of the key questions to be explored.*

*Here's where we start ...*

### **Innovation**

- How can today's global champions build on their legacy of innovation and quality?
- Can Japan leverage an increased focus on energy, sustainability and healthcare to innovate in areas of growth?
- How are companies leveraging technology, including social media and mobile devices, to link their customers and suppliers into their development process for new ideas, products, distribution and services?
- How much innovation do Japan's global champions need to survive in today's competitive landscape?

### **Globalization**

- How should Japan's global champions develop strategic models in response to new global imperatives?
- As manufacturing and other activities move overseas, what functions should remain in Japan?
- How can companies bridge the language and cultural gaps given an increasingly global business environment?
- What role will outbound and inbound foreign direct investment play in the Japanese economy in the future?
- With foreign investors now holding more than 30% of the shares in many Japanese public companies, what must be done to build investor confidence?
- Does Japanese corporate governance need to evolve to match international norms?

### **Talent**

- What are the implications of Japan's rapidly aging and decreasing population as companies lose a huge reservoir of skills as baby boomers retire?
- How will the workforce change as companies compete for an ever smaller crop of graduates each year?
- Will mid-career hiring increase?
- How will the role of women change?
- Will more foreign workers come to Japan?
- Can Japan harness the dreams and imagination of its youth to drive an economic resurgence?

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