Japan's Changing Corporate Structure

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It's a pleasure to be here, and we had a great morning session. We had different views about where our economy is going from a macro standpoint, and we had an exciting session with new leaders who are creating an extremely interesting part of the economy and business; they are the sources of our hope. I wish I were at least 30 years younger, because I would have been speaking more of the same -- not as eloquently as Mikitani-san or Abe-san did -- but seriously telling the joke of the corporation that is currently going through major difficulties in convincing the market that "we'll be back." It was in 1969, only 8 years after the first Xerographic copier, called the 914, was introduced. Xerox stock, yes -- I forgot what it was -- it was not as high as Yahoo but almost as high. At that time, there was an expression called "Castro money," and there were lots of high flying stocks and Xerox was one of them. The stock made University of Rochester extremely rich because they had financed Xerox when Xerox was struggling in earlier years without really knowing that Xerox stock would become very valuable. Xerox was trying to buy other businesses, using their shares like AOL did with Time Warner, so history sort of repeats itself. What we are seeing now is maybe a little extreme. But we've seen similar days in Japan.

Fuji Xerox was formed as a joint venture with Fuji Photo Film and Rank Xerox; Fuji was probably more solid and seemingly richer than the partner. Financially, in particular, we often talk about Toyota as Toyota Bank, and Fuji Photo can even be called Fuji Film Bank; it has always been an extremely solid company. Fuji Photo and Rank Xerox formed a joint venture in 1962, and the JV was helped by the economy that was really growing very fast in the 1960's. Of course, it was not the internet then, but most Japanese businesses were very interested in modernizing the way they do business. At that time, the keys to modernization, particularly the office environment, were computers or sometimes even crude versions of computers, and copiers. Xerox was on top of the copier market, so Fuji Xerox grew like anything. At that time, Fuji Photo was still struggling to carve out new business areas for themselves. They were also struggling with their own competition, Eastman Kodak. It's really changed: Kodak is struggling with Fuji Photo Film now. But at that time, Fuji Photo was struggling and Fuji Photo even readily accepted that there had to be a negative price premium in order to sell effectively against Eastman Kodak, at least 10 to 15%.

So Fuji Xerox, when it really started to grow, was being referred to as the "golden egg" for Fuji Photo Film. We grew almost as fast as Mr. Mikitani's company, Rakuten Ichiba. We have remained private; we never went to an IPO, and if we had I wouldn't be standing here. I would be vacationing somewhere, having retired a long, long time ago. Unfortunately we didn't have the foresight of going to the market, but we grew and grew. In the early 70's, some publications in Japan ran annual lists of the most popular companies in the eyes of the graduating class of those years. When asked, "Which companies do you want to work for?", embarrassingly, though we were less than ten years old, we were ranked in the top five, and our parent company was way down the list. All of our big customers -- Tokyo Bank, Mitsubishi Bank, then separate, and Hitachi --

they were all way down the list. It was not the stock market, but the young people who were really buying something, saw something in Fuji Xerox. It was a dream, something they did not see in other established companies. And when we ran an advertising campaign in 1971 called “Beautiful,” things went wild, and when we first ran the television series it was interesting. Young people felt, what is this ad? What is this growing company? It featured a hippie going through a street with the placard, but no commercial message was aired at the end of sixty seconds, simply Fuji Xerox, nothing about the products. So all the right decision-makers were saying this company must be crazy; they are wasting their money. On the other hand, young people were saying this is a very strange, interesting, and exciting company. So we started to receive really young, exciting, forward-looking people, despite the fact that we were still a very, very small start up company.

Today, you know the picture has totally reversed. Professor Patrick referred to our company as one of the medium-sized established companies. We have a reasonable rating or assessment from the right decision-makers. They know who we are and they know we are pretty solid -- but in the eyes of young people we have totally disappeared. We are not exciting, we aren’t fun, we aren’t even on the market. Now, the whole point of my coming out with this is that changes have been with us, and we are now once again in the midst of new changes. We don’t know whether the so-called Internet change is fundamentally different from the changes we have gone through. Maybe it is a fundamental change. Yet while it may be a bit different, but fundamentally could be the same as all the changes we have all gone through. We will see what the results will be of the Internet change that is affecting corporate restructuring at Fuji Xerox, and indeed for many companies.

The key topic of this corporate restructuring is the fundamental question: Why do you have to restructure your company or industry? If everything is going well and the outlook is okay, you don't have to change. But in Japan that's not the situation for most companies. Basically, there are two reasons why corporations are going through restructuring. Number one is simply to be more efficient, more competitive in whatever market you are in. That's number one. But the other area is a question of corporate governance. That's a very important area of restructuring for many Japanese companies.

Starting with the first, there is no magical way to be profitable, productive, or competitive. Profitability and productivity are functions of output and input. I know there are many companies in this country, and in Japan, which are not even profitable and yet enjoy a very high market value. I don't know whether that will continue, but basically in the long run you have to make profits to be able to continue to do business into the future, invest into the future, do something interesting, daring. You just cannot continue borrowing from the market. The typical model of many Japanese corporations, even when they were winning the international competition, was that they were winning largely on the basis of their effectiveness in the marketplace. Whether that's automobiles, copiers, fax machines or whatever, their profitability and productivity in most cases have never been higher than their counterparts in the United States.

The rate of productivity increase has always been higher on our part, but in terms of profitability, most leading Japanese companies have never been more profitable, never been more productive than their foreign counterparts. This actually teaches you one thing: you can win the competition without being profitable or productive -- to a certain level. However, the conditions under which we operated really changed drastically in the 80's and particularly in the 90's. The first very important source of our capital is banks. They have had to change their ways of doing things. They just could not go on lending money where a profit was not to be promised. They had to be more selective. They were challenged for their own base of existence.

So, a lot of companies have started to do restructuring very much like the Jack Welch way. Jack Welch is followed very closely by a lot of Japanese executives. Two days ago there was an article, which maybe many of you have read. I think the President of ANA, Mr. Nomura, was being quoted and he said Jack Welch would go for six sigma but that "it's often quoted but never followed, implemented." Actually, this is a very important point and even Mr. Lapin, who represented GE in Japan, was quoted as saying "Well, you just cannot do what Jack Welch did at GE in Japan." Not exactly. And the reason is employment. Over the years, I have never counted the numbers, but the article says Mr. Welch fired 200,000 people. Of course, he was saying it's not an easy decision. He was saying it is only the customers who can actually maintain secure employment for a company. It's a nice way of saying it, maybe passing the buck to the consumers, but still, I look at his record at GE. It's difficult to refute what he has achieved. But it is also true that companies cannot act as aggressively, as boldly, as drastically on the employment situation in Japan.

Let's take NTT. We all agree that the access charge is high. I don't want to be technical because I don't know. Also, partly because I'm a board member of NTT, so although I don't know very much, I cannot disclose to you what little that I do know.

Still, the key question is employment. The NTT group as a whole employs about 220,000 people and its subsidiary DoCoMo is making lots of money, and their market capitalization is top, ahead of its parent company. NTT is the second largest company in market capitalization. NTT Data is also high on the list. Mr. Son's company, Softbank, is the third. The NTT group as a whole is profitable, but really profitable companies within the group such as DoCoMo and Data only employ 30,000 of the 220,000. The nitty gritty of NTT telephone business employs 190,000 people. This is where price reductions, whether in access charges or fixed charges or internet, will have a major employment effect.

Now, I'm not trying to protect NTT's position, but you are businessmen, and NTT is currently enjoying a pretty good share price. In the long run NTT knows it can be competitive; it can beat the NCCs by cutting prices. It has to be careful about the Fair Trade Commission, but NTT has muscle. If I were the president, and if I didn't have the Ministry of Posts and Telecommunications on my back, I would probably talk to my shareholders, and say I've had this problem too long, I'd like to be on my own, I would be aggressive. Of course, we would observe the laws but we will beat the NCCs in the market on an equal competitive basis. We may lose some profits, and you may lose some of your share price for the time being, but we'll come back in two years time. We'll probably be a much stronger player in the market. Your shares will be much healthier. But of course, I'm not the president of NTT and Mr. Miyazu doesn't have the freedom to talk as I do. The big question remains; what to do about employment? In most of the restructuring exercises done in sizable Japanese corporations, this employment question is the most difficult and painful issue. At most companies, therefore, at least in the next two or three years, we will be trying to strike a very fine balance of achieving reasonable profitability, productivity, measured as ROE, EVA. Not necessarily trying to maximize shareholder value all the time, but still increasing in a reasonable time the value to shareholders. But are they going all the way to 20% ROE, 30% ROE? If you know you can cut your employment by 30%, you can probably do it. Would you do it in the United States? Probably the answer is yes and no. There are more yes's in this country than no's, but in Japan there are more no's than yes's. And that process is slow…but it is going in the right direction.

Then, of course, there is a group of companies which really have no choice but to cut their employment. They don't have the luxury of balancing profitability and maintaining employment security. We are seeing it in companies like Nissan-Renault. When they announced their plan to cut employment and sell non-core assets, they shocked the community. Interestingly however, the initial shock is gone. Of course, they still have to go through the difficulties of implementing their plans. Mr. Hanawa, the President of Nissan, is a very decent and very international person. He ran Nissan USA for some time, and he and I served as Vice Chairman of Keizai Doyukai (Japan Association of Corporate Executives) when my predecessor Ushio was the Chairman. I had one occasion to breakfast with him when we had something to discuss; this was after Mr. Ghosn had come and announced Nissan's aggressive restructuring plan. I thought Hanawa-san must be in a very serious phase and agonizing. However, he looked unusually relieved and relaxed. I found the reason was that Hanawa-san had specifically asked for Mr. Ghosn, to Mr.Schweitzer, head of Renault, saying "he's the man we want." Mr. Ghosn restructured Renault successfully in a very short period of time after having come from Michelin. So Hanawa-san said “I want that man” and despite Mr. Schweitzer’s hesitancy, he came. The second reason that Hanawa-san was pleased was that Mr. Ghosn’s arrival and his initial observations and initial rough plans to rationalize Nissan found lots of friends and sympathizers within Nissan’s mid to lower management, the group in the 40’s, and Mr. Ghosn happens to be about 45 or 46. That was interesting. There had been a lot of inner movements within Nissan. They really wanted to change the culture, change the way of doing things: purchasing, manufacturing, styling, advertising, dealing with a lot of vendors including Fuji Xerox. But somehow, those young people just could not find their recommendations implemented as quickly and or boldly as they wanted. So Mr. Ghosn arrives. So this was not the French-born Japanese plan forced upon Nissan. There was some element of that but basically what Nissan-Renault announced was a plan that young people in Nissan had wanted to do for a long time. If they had done it ten years ago there would have been pain, but not as strenuous, not as drastic as the pain that a lot of people who are being effected are now going through…vendors, communities, of course their own employees.

Restructuring is being helped by a couple of factors. Belatedly, but surely, as I said earlier, most Japanese corporate executives have shifted their emphasis from a size obsession, revenue obsession, market share obsession, to shareholder-oriented profitability and productivity. The question of customer loyalty is almost as highly regarded as the question of corporate ethics, and the Doyukai survey of our members clearly indicates this shift. Secondly, there is a changing attitude on the part of young people. For example, Mr. Mikitani of Rakuten Ichiba was introduced as a former IBJ person.

There was a time when there was a very skewed people map of where the highly skilled and talented people went. Lots of talented people went into financial institutions. There was even a time when major banks were even recruiting from science and engineering majors of major universities. They had too many. On the other hand, if you go to small businesses they will complain, “We just don’t have the people!” Now a major shift is underway. A lot of talented people in the major manufacturing or financial institutions, many of them financed by their employers, come to get MBAs from Harvard, Stanford, Columbia. We have many such MBAs, but I’d say about 50% of them have not been fully utilized. They have been told, “You have been chosen for our fast track. Don’t get impatient. You’ll get a chance. Think about those people who never had a chance to go overseas.” But in this world of fast changes, where one business practice learned a couple of years ago can be obsolete, you really have to put what you learn into practice very soon. It’s quite natural that young people get impatient. So, they start leaving their employers and they go join other companies, foreign companies, small companies, even small businesses who are now in the hands of the third generation, fourth generation. They are different from the past. Some of them have MBAs. Even if they don’t, they know the value of good MBAs, people pay quite well for those who come from big businesses. It is a restructuring of not only a single company, but it’s happening across the industries, and across big business and small business. It’s a very encouraging sign.

Fuji has just lost one excellent MBA candidate. She was very bright and talented. She went to Stanford to earn her MBA. But she also had a knack for computers and she wanted to go for the double degree. We don’t have very many who can go for double degrees. Our personnel office said, “No, Mr. Chairman, we’ll be setting a wrong example.” and I said, “Let’s take a chance. If she comes back with the MBA and a computer science degree we will have a super person who will be leading some of our new businesses.” Several weeks ago I received a letter, “Mr. Kobayashi, I must tell you I have an irresistible offer from my classmate. This is my once in a lifetime opportunity, therefore I cannot return to Fuji Xerox.”

Well, this happens, and I regret I had made the decision to let her go through the double degree program. If you try to be a little more philosophical, this is one sign that the Japanese professional labor market is moving, and being productive. One day we will have somebody like her join us. And you know, it’s not just losing, we’ll be gaining some.

This positive labor market and professional market movement is happening. Then even on the legal side, there are certain laws that are being passed to make it easy for businesses to restructure holding companies and the other arrangements. It is unfortunate that the government has postponed the introduction of the taxation system on the consolidated basis. It is really a shame, although I basically support what Prime Minister Obuchi has been doing. This is one of a couple of things that we, Keizai Doyukai, and I personally, criticize him for failing to live up to, not only a promise, but as something that really slows down the necessary restructuring process. As far as Fuji Xerox is concerned, we’re not really at the stage of having our backs against the wall, but we are really pressed against the competition. We really have to do a lot better. We aren’t doing anything magical. We are going through, number one, the changing of our business areas, shifting our resources to business areas which we think are more strategically advantageous for us. We also are cutting down on the numbers of people, not by laying off, but by the attrition process and early retirement; and we are trying to improve our productivity. We are also aggressively looking at new business opportunities where we can actually put our money and other resources. We will certainly welcome any suggestions. Of course, I'll be picking Mr. Mikitani's brain and others for that. But let me come back to the whole restructuring that's going on in Japan.

The other area that I will briefly mention, and then stop, is corporate governance. The board structure is being changed in a number of Japanese companies, some are reducing the board size and inviting outside board members. The direction is right, but I'm not really sure that many of those outside independent directors are given the freedom that many of the independent directors have on the boards of US corporations. Still, I remain positive about the outlook. One thing which is unique in Japan is that we have the company position of statutory auditor; and that's part of the law. There's an argument, a debate as to whether a truly effective audit can be done either by the statutory auditors or by an audit committee made up by independent directors, the US way. My feeling is that we can probably combine the two. We will live with the statutory audit system as it is part of our commercial code, but also we will invite outside board members to the board so that the board, and, of course, most importantly, the management can really benefit from the different views. And, if we can actually combine, that might produce some interesting structure for the Japanese version of corporate governance.

I anticipate this trend will proceed faster, and may be accelerated this year and next because globalization is making it more important for most Japanese corporations, particularly those with global/international exposure, to have that structure, to be able to exercise their businesses effectively in the global market.