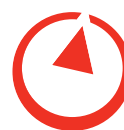

REENERGIZING JAPAN, INC.'S GROWTH, COMPANY BY COMPANY

A prescription for transformation through manageable structural changes

By Vernon Altman, Toshihiko Hiura, Jim Verbeeten and Shintaro Okuno

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"Japan, Inc.," considered worldwide in the late 1980s as a leader in business expertise, has within it the seeds of a profound regeneration that could restore Japan's economy and businesses to their former prominence. Despite two decades of economic stagnation, the problems that Japanese business leaders face today are not rooted in some inherent societal or economic inhibitors, although elements of both have played a major role. Rather, the main barrier to new growth, as we see it, is structural; a situation that can be remedied—company by company—by a strategic reexamination and pruning of individual business portfolios to enable the generation of strong new platforms for superior performance.

The essence of such a transformation begins with an understanding of core competencies within a company and its available profit pools. According to Bain & Company research, the majority of consolidated sales for many Japanese companies comes from areas of both low growth and low relative market share.

What's needed is an alternative vision—one that is growth oriented and will energize Japan's companies. Such a vision must inevitably focus on growing market segments, sometimes those that are adjacent to—or hidden inside—their current core.

Where are those major new segments for growth? Geographically, they're largely in the emerging markets of the East—places ideally suited to allow Japanese companies to manage their structural transformations by aiming new strategies, and in many cases old technologies, at customers who are only now moving up the consumption curve. Japanese companies also need to look within their own competencies for "hidden assets," out of which they can create strong new core businesses. We will explain these processes in depth. The larger point is that, as Japanese companies make that transition, reallocating resources for robust new growth, they will produce funding and allow time to find answers to the challenges in their existing portfolios of businesses.

Using a framework for transformation, we estimate that by increasing the current average sales growth rate of 2 percent to 5 percent and earnings before interest and taxes (EBIT) margins from 4.5 percent to 7 percent—along with improving the level of capital efficiencies by 10 percent—Japan's market cap could triple its current level. Japan can attain the peak it reached in the boom years, but without a bubble economy.

What follows is Bain's thinking on where Japan is today—the starting point—and our recommendations for a methodology of transformation to bring the country into a brighter future—the point of arrival. Here, as we see it, are the logical steps along the way.

The primacy of relative market share (RMS)

Today, Japanese companies are at a turning point. Having endured a 20-year recession, hit by the recent global credit crisis and facing future systemic socio-economic issues such as an aging population and a declining birth rate, they understand the need for change. And while it's true that some positive signs are emerging, many Japanese companies are still underperforming.

A global economic slowdown, of course, would seem to be beyond individual companies' control. However, we argue that the root cause of this lingering underperformance lies in the structural problems that Japanese firms have been facing since the 1990s; indeed, the economic slowdown only accelerated and deepened existing issues.

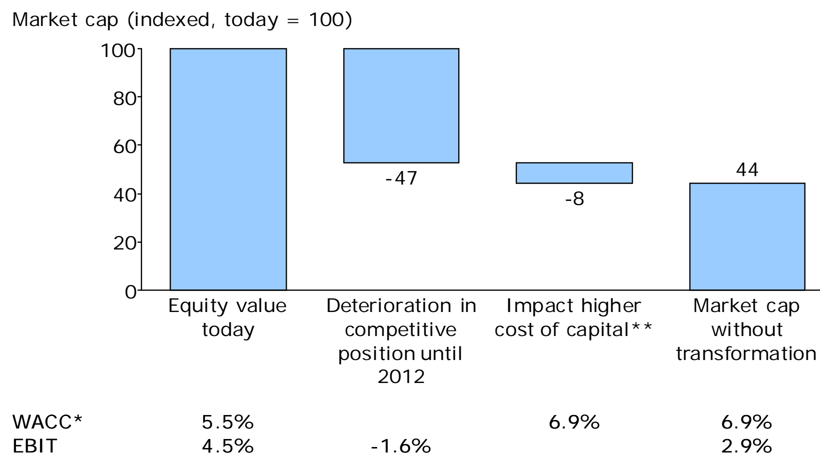
In other words, even before today's recession began, many Japanese companies had been experiencing low growth in sales and profits for a decade, and today Japan's labor productivity has become less competitive. While unit labor costs have been higher than the US since the early 1990s, Japanese companies have not been able to keep up their competiveness in terms of productivity.

In the past decade, Japan's productivity improvements have lagged not only the emerging Asian nations but also most Western ones. Japanese businesses have also fallen behind emerging Asian nations and the West in operational improvement initiatives, an area where Japanese companies traditionally excelled. Beyond those factors, though, the key reason for low sales and low profit growth lies in the decrease in global market share by Japanese players. Since 1996, the share of Japanese firms within the global top 50 companies involved in manufacturing, retail, healthcare and financial services industries has been cut in half or even more.

Why is that significant? It is because relative market share (RMS) is *the* single most important profit driver in most industries; any decrease automatically widens the gap in profitability between Japanese companies and their global competitors. Global RMS leaders use cash generated from profits to nurture new products and technologies; and they invest in strategic mergers and acquisitions (M&A) to increase their relative market share with new capabilities and offerings that support and expand their cores.

The consequences of a continued decline in relative market share of Japanese firms are stark: We estimate that, at the current rates of market share erosion, the value destroyed three years from now could equal 50 percent of current market capitalization. Simply put, Japanese firms need to look beyond near-term initiatives to thrive. What Japan, Inc. collectively needs is to stage a massive transformation of its business practices ***(see Figure 1).***

Figure 1: Without a transformation, market capitalization of Japanese companies could decline by more than 50%



*Assumes 20% current offshoring, with split 50% to China, 25% to Mexico and 25% to Poland
**Assumes 50% offshoring, does not include potentially higher risk-free rate
Sources: Reuters, JP Morgan, Kabuka.com, company disclosures, Ministry of Treasury, CoTax, Bain estimates

Time is critical and change will be difficult. Yet at least the means for achieving such a national economic transformation is no mystery. Methods have been proven in other developed nations by companies facing similar systemic erosion in their markets. These firms have decreased in size to grow—exiting from and divesting businesses that are better suited to other players' core competencies—to enable significant new growth in segments where they have distinct advantages.

Can Japan, Inc. learn from transformation examples elsewhere?

In the past, one of the greatest strengths of Japanese firms has been to adopt and perfect business practices from anywhere in the world. Bain & Company has supported numerous successful corporate transformation projects in Europe, the US and Asia. One might think that Japanese firms could simply apply the best practices that have worked in the rest of the world. But, from Bain's long experience supporting numerous restructuring initiatives in Japan, we have learned that, although the strategic framework for transformation can be imported, one needs to apply a Japan-specific methodology. Nevertheless, examples from other countries are useful. Consider a large US manufacturer that truly shrank to grow.

US Heavy Industry Co.: A dramatic turnaround through divesting 70 percent of its businesses

In the 1980s, a company we'll call US Heavy Industry Co. was a world-class manufacturer in multiple technology and defense-related businesses, with more than $10 billion in sales. It had enjoyed expansion across almost all its major businesses. At the peak of its growth, however, as the Cold War was ending, sales orders from its biggest client, the US government, suddenly fell. As a result, US Heavy Industry Co. posted a large loss in 1990. In a crisis atmosphere, a new CEO was appointed, and the company began its transformation for survival.

Among its first steps, US Heavy Industry Co. closed down production facilities to avoid overcapacity and began instituting major cuts in its cost structure. The cuts included substantial reductions in its research and development (R&D) spending and bold moves to slash overhead. It also took aggressive action to reduce its working capital. These restructuring moves were combined with a strategic analysis of its core capabilities.

After carefully examining its profitability, technological competitive advantage and market growth in each of its lines of business, the company's senior leaders decided to focus on a small number of truly core businesses. They divested 70 percent of the company's other businesses in just two years. The company could have held on to them, since they were not all unprofitable, but it found purchasers with a better strategic fit that were willing to pay for those units. As an immediate result, its $10 billion in sales fell to just $3 billion, while employee levels dropped by 70 percent, with most workers following their units to new owners. On the positive side, EBIT improved—going from in the red to $300 million.

US Heavy Industry Co. then went on to increase scale in its core and adjacent businesses, acquiring nine businesses in seven years. The results were genuinely transformative. Sales rebounded from $3 billion to close to $20 billion (which was an annual 15 percent increase); EBIT increased from $300 million to $1.9 billion (an annual 18 percent increase); and market cap increased at an annual 20 percent rate. By shrinking to grow, US Heavy Industry Co. became the market leader in more than 75 percent of its new businesses.

US Heavy Industry Co. is an example of a company that quickly reacted to a collapse in its profit structure; it reinvented itself by divesting non-core businesses and concentrated its investments in promising businesses in which it already had significant core advantages.

Consider, now, how another firm handled a similar challenge.

European Chemical Co.: A recovery based on building regional scale while focusing on profitable customers and products

European Chemical Co., a European-based longtime market leader, lost significant market share due to a series of acquisitions made by competitors and the emergence of Middle East firms that had an overwhelming cost advantage. As the situation worsened, for the first time European Chemical Co. recorded a net loss, combined with an unsustainably high debt load. By 2004, it was close to breaching debt covenants and declaring bankruptcy. Rather than simply conceding that it had to find a way to struggle in a mature market, European Chemical Co. decided to narrow its focus on its most profitable products and customer segments. It launched a series of innovations to differentiate its products and pursued an aggressive M&A strategy to increase its share in key core segments.

Simultaneously, European Chemical Co. undertook a number of operational improvements to build profitability and generate cash quickly. More than $100 million in savings were realized by cutting overhead, rationalizing sourcing procedures and reducing redundant headcount. European Chemical Co. also honed its sales management strategies to increase its share of wallet among key customer segments. As part of this effort, it reviewed pricing strategies and launched initiatives to improve salesforce effectiveness. For instance, it found that its salesforce spent only 20 percent of their time face to face with customers, and little of it with new customers. Among other remedies, European Chemical Co. created administrative procedures to keep its salespeople in the field, and trained them in different skill sets for different key sales segments. It also began linking bonuses to specific performance indicators. The salesforce's efficiency and sales improved dramatically.

European Chemical Co. also streamlined its organizational structure, clarified its decision-making processes and accountability, and defined the role of the corporate center in determining M&A strategies. In its narrowed customer segments, European Chemical Co. was able to generate a profit in the first year after the launch of its transformation and has improved its profit record ever since.

Closer to Japan, Korean Financial Services Co. represents another core transformation.

Korean Financial Services Co.: Creating major profit improvements by focusing on core customers

Korean Financial Services Co. is one of Korea's insurance giants, which covers 70 percent of that nation's market. In 2002, it experienced large losses after a series of missteps stemming from unclear strategies and internal company turmoil. With its brand image suffering, it also suddenly found itself facing the entrance of foreign competitors into the Korean market.

Inheriting this crisis, the newly appointed CEO began by enforcing strategies aimed at going back to the basics. Chief among those was to provide the right product to the right customers with the right sales strategies.

How? Korean Financial Services Co. started by conducting customer segmentation analysis based on customers' purchase behaviors; it prioritized key customer segments, and identified the types of products and sales approaches it needed to attract those customers. Based on that work, Korean Financial Services Co. optimized its operations by serving certain segments with call centers. That freed its top sales teams to concentrate on the most profitable customers. And that wasn't all. Korean Financial Services Co. also moved to strengthen its product-design capabilities, improve service quality and optimize its overall financial structure.

Korean Financial Services Co. completed its transformation in just two years. The result: The company recorded a profit in the very first year after its transformation. Today, it has the highest profit level of any company in the Korean financial services industry.

Criteria for transformation

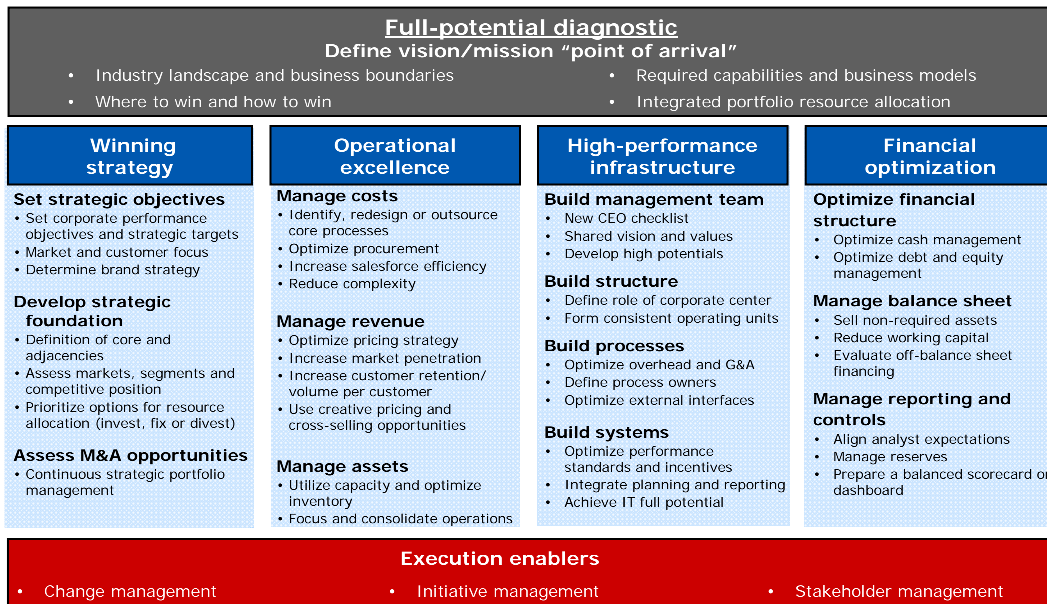
Successful transformations don't just happen. While a theme of fewer-but-better lines of business emerges in these examples, there is a set of specific practices that each company pursued.

In our experience, leaders set four key priorities to create change.

- They establish a winning strategy
- They pursue best-in-class operational excellence
- They build a high-performance organization to execute the strategy thoroughly
- They look for financial optimization to support the strategy execution

Successful transformations do not need to take a long time. They can be executed in a comprehensive and coherent manner within two to three years. But they must be driven by strong leadership ***(see Figure 2)***.

Figure 2: Bain's full-potential transformation approach



Each of these three companies gained extraordinary results in a very short time. However, they paid a price, one that employees and other stakeholders shouldered, at least in the short term. The price—lost jobs and abandoned lines of business—is precisely the reason why Japanese managers have been reluctant to commit to such drastic measures.

But Japanese firms' market share in the global arena has been declining even as the domestic market continues to shrink—all of which requires structural changes to survive. Japanese companies' senior managers often perceive the ability to change as limited by their responsibilities to employees and regional economies. As a result, they tend to focus on the two least disruptive techniques for a successful transformation: operational excellence and financial optimization.

A methodology for transformation that is not based on reform

Many Japanese companies—such as Nissan Motors, Canon, Mitsubishi Electronic, Toshiba and Panasonic—have restructured their management styles and dramatically improved their operations during the long economic downturn that began in the early 1990s.

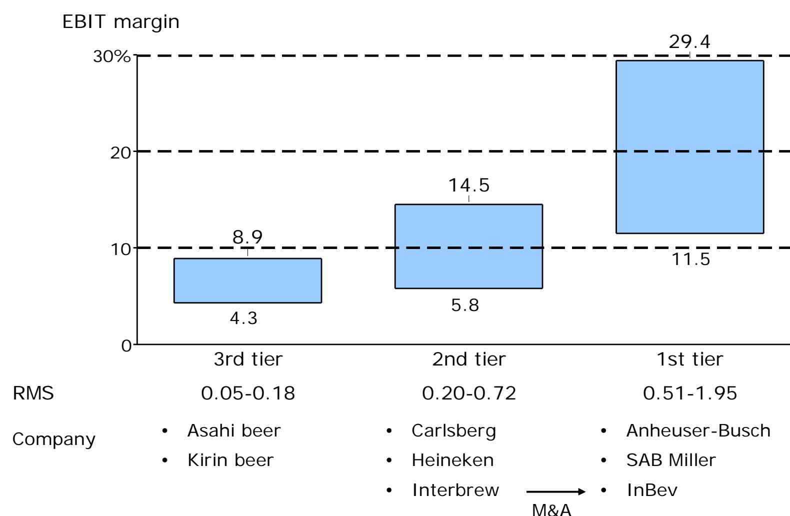
For example, Canon improved its EBIT margins from 9 percent in 1995 to 16 percent in 2005 while continuing to show sales growth throughout the period. It defined printers and digital cameras as its core businesses. It also strengthened cash flow management and introduced its well-known cell production system. Through these performance-improvement tactics, Canon's stock price increased five times faster than the Nikkei Stock Exchange average.

Likewise, Nissan Motors improved its EBIT margins from 1 percent in 1999 to 10 percent in 2004, and also increased sales volume with a 7 percent annual growth rate. And Mitsubishi Electric succeeded in restructuring its portfolio and improved its EBIT margins from a negative 2 percent in 2001 to nearly 4 percent in 2004, all without a significant reduction in sales. These successes involved many of the key elements of a transformation.

However, even these laudable efforts by leading companies fall short of what we'd call a full-fledged transformation, particularly when analyzing their actual long-term growth in sales and profits. Moreover, similar reforms enacted by other Japanese companies have been even less effective over the long run. Why? Some may argue that ineffective leadership is the root cause. However, even the best leaders cannot overcome deep structural problems by avoiding them.

A look at the market for beer allows for a deeper examination of such core problems.

Figure 3: Profit range by relative market share in global beer market (2001-2008)



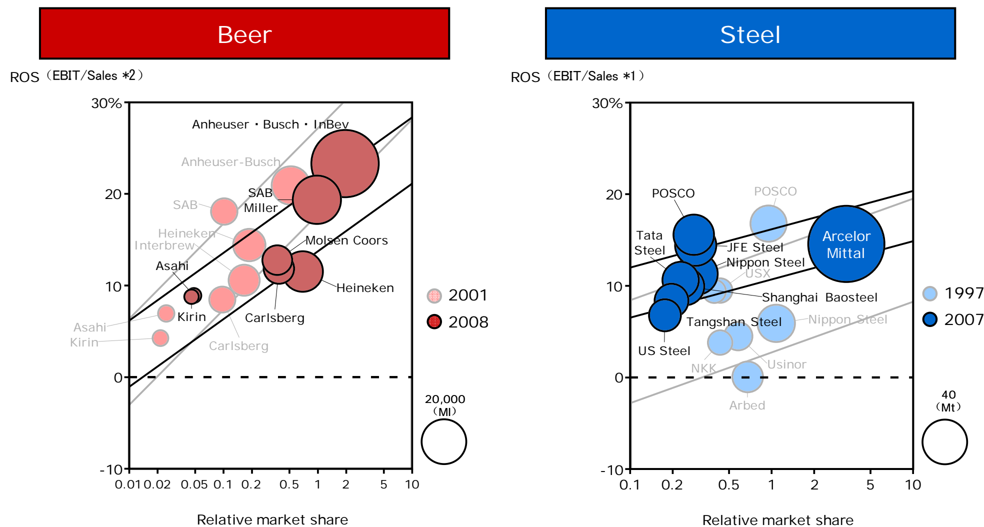
1. Larger relative market share is even more important in global competition

The beer market reveals some compelling data: We traced the relationship between global relative market share and EBIT margins in the beer market over nearly a decade. As shown in ***Figure 3***, EBIT margins ranged between 4 percent and nearly 9 percent during the 2001 to 2008 period for major Japanese beer companies such as Kirin and Asahi, each with less than 0.2 RMS. They managed to improve profitability by 5 percent through various operational initiatives, such as inventory reductions and logistical improvements. That alone is a tremendous achievement. However, EBIT margins of global market leaders with more than 0.5 RMS ranged between 11 percent and 29 percent during the same period.

The ramifications of that difference in profitability are unavoidable: Even after a series of painful cost reductions and profitability improvement initiatives, companies with insignificant RMS will never be able to achieve the profit margins of players with market-leading positions. In contrast, companies with significant RMS positions can garner higher margins—often without such extraordinary efforts—while taking advantage of their scale when they conduct margin improvement initiatives.

This hard-and-fast rule is applicable not only to the worldwide beer market. For example, the relationships between RMS and EBIT margins in crude steel production are shown on the left of ***Figure 4***. The gap has grown larger in RMS and profitability among top companies and the rest of the players over 10 years.

Figure 4: The correlation between relative market share and profitability



*1 Calculated based on crude steel production amount
*2 Recurring margin is used for Kirin (FY08)
Sources: "Steel yearbook" (FY98, FY03, FY08); Thomson One; "Market share report" (FY03, FY06, FY09); "Food marketing handbook 2009 No. 2"; Public record disclosures; *IMPACT* magazine (US)

Traditional Japanese companies have boosted performance mainly through "full potential" operational improvement initiatives. Yet, try as they might, the data clearly indicates that even the most efficient companies can never overtake global leaders just by operational improvements.

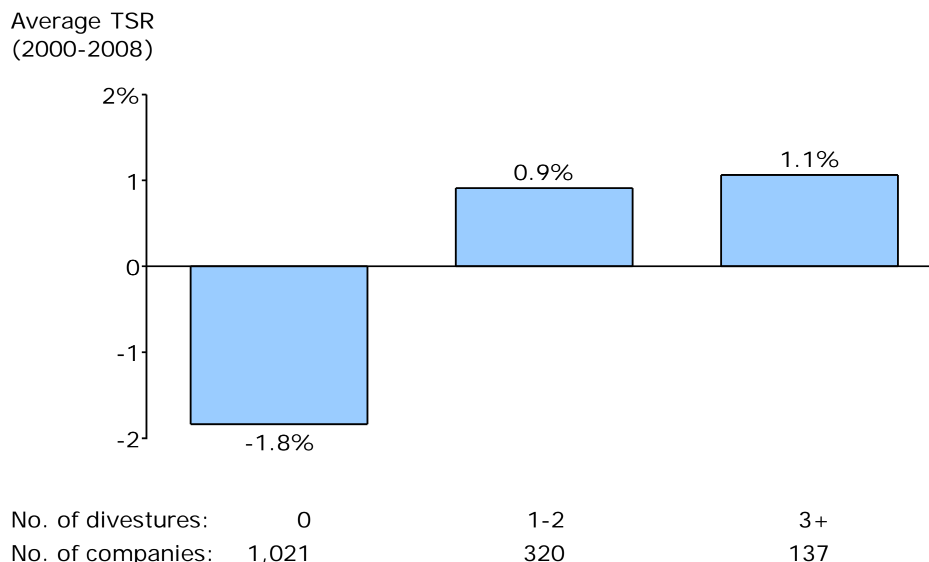
2. The link between core competence and leadership position

There is no substitute for RMS in determining leadership and profitability.

The way to begin gaining a higher RMS is by establishing a "winning strategy." Such a strategy is based on creating a replicable formula for honing and expanding the core business to generate cash for further investments in those areas in which a company is uniquely suited to compete. That also implies that companies must cut investments in businesses with no leadership prospects.

The importance of concentrating on core competencies is clear. For instance, our research shows that those Japanese companies that exited from unrelated businesses, on average, realized 3 percent higher shareholder returns compared with those that did not exit any businesses. That's not all. These businesses also grew employment faster than others, suggesting that, in the long run, making such hard decisions pays off for shareholders and employees alike ***(see Figure 5)***.

Figure 5: Japanese companies that made divestiture decisions outperformed those that did not from 2000-2008



Source: Thomson M&A database

In other words, one of the biggest reasons for underperformance by Japanese firms is their inability to refocus their proven leadership in operational excellence for new strategies that fit their changed circumstances.

That is not to say that Japanese businesses are not trying to make structural changes. The difference lies in defining business limits clearly and making hard choices of what is within and outside of those limits.

For example, one major Japanese company defined three of its business domains as its "core" businesses. But the nature of its definition was flawed. The company selected the three based on the size of sales within the existing company. It didn't understand that even cash cows do not necessarily make a core business. Instead, a core business needs to be narrowly based on a clear business definition, prospects for growth in a current market's profit pool and the company's ability to achieve market leadership.

In this case, there were some units within its core business domains that actually were just that, when based on properly defined criteria. But they were mixed in among the rest, severely limiting the company's ability to focus the human and capital resources they needed to achieve market leadership. By holding on to too many non-core businesses, the company diluted the potential of the units that had the brightest prospects. Indeed, the company's non-core businesses accounted for fully 80 percent of total consolidated sales.

That is all too typical. Another major Japanese manufacturer restructured its traditional divisional system, and consolidated business units to address various inefficiencies. However, it did not undertake a radical restructuring of its business portfolio. It maintained a host of businesses unlikely ever to achieve leadership positions. Having defined its core too broadly, its financial performance and stock price have continued to slump.

3. Finding the seeds of growth is the key challenge

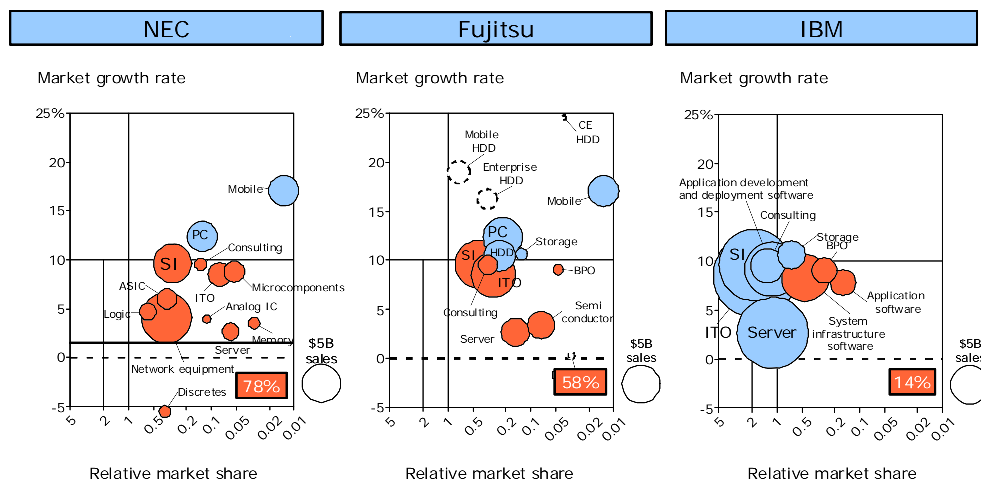
Why do Japanese firms have such a hard time concentrating their efforts on core competencies and businesses? Some believe the reason lies in traditional Japanese business logic, which focuses on the "reasons to keep" rather than the "logic to exit," when companies are considering downsizing or withdrawing from unprofitable businesses. While many Japanese executives understand that evaluation criteria like profitability, market share and growth opportunity would dictate an exit, still very often we hear imperatives such as "keeping the manufacturing know-how and technologies for future growth," or "maintaining employment to meet the social norms." Alternatives are to "utilize what we have accumulated in the past," or "to pursue a step-up with existing strengths, without denying the past."

Sometimes such imperatives can be overriding arguments to maintain a business—for instance, if the company believes that products or technologies

may converge so that what now looks like an orphan business may end up being a key differentiating factor in a new product. However, all too often, these "imperatives" are excuses for not having made difficult and unpopular decisions. That is understandable if management cannot offer an alternative ambitious vision for the future that can energize management, employees and stakeholders alike. Imagine the situation of NEC and Fujitsu versus that of IBM, shown below. NEC and Fujitsu would not be able simply to exit markets in which they have limited relative market share, for there would be virtually nothing left ***(see Figure 6)***.

So how can management develop such a vision from a typical portfolio of businesses in which 60 percent to 80 percent of sales come from low-growth and low-RMS businesses? The answer starts with a thorough diagnosis of profit pools, relative market share and unique core capabilities.

Figure 6: Business portfolio diagnosis based on market and competitive analysis



Note: Growth rate for mobile is based on number of mobile handsets
Sources: Gartner; IDC; Deutsche Bank; Bain estimates

Obviously, companies need to find new and growing markets, with new profit pools, to pursue. But where are they? Bain's research shows that companies with a history of sustainable growth—those that have grown revenues as well as earnings at more than 5 percent annually while also generating returns for equity holders above their cost of equity for 10 years—always generate that performance by doing three things related to their core business over time. First, they invest in their core. Second, they seek growth opportunities around the core by expanding into nearby adjacencies. Finally, they redefine their core as profit pools shift. Note, however, that they neither abandon the core nor stick with dwindling cores.

The first and second steps are precisely what Japanese companies need to take now to revamp their core business for new growth. As to the last—redefining the core—Bain's study of hundreds of companies shows that their odds for success increase as much as four to eight times when they utilize "hidden assets" that are overlooked, undervalued or underutilized within the firm.

Most hidden assets fall into three categories: untapped customer insights, undervalued business platforms and underexploited capabilities. Each can provide the foundation on which a company can redefine its core.

Let's look at cases involving each.

Harman International, a leading company in the high-end audio segment, built its automotive "infotainment" systems business by harnessing its abundant amount of data about its high-end customers' needs. In the case of undervalued business platforms, IBM redefined its core as a services company by using its existing customer services support organization, which it had built to support its hardware sales. Finally, Apple is a good example of underutilized capabilities, as it extended its design and software capabilities honed in the personal computer business to generate a new core music business with its iPod models.

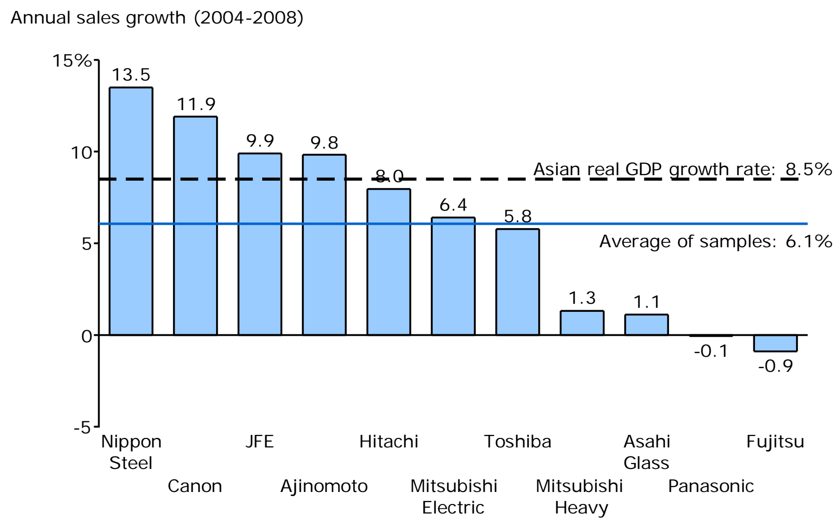
4. Japan, Inc.'s greatest growth potential lies nearby—in Asia

Where should Japanese firms develop and expand their new core businesses? As many executives have already decided, the geographic locus should be in Asia. Not only is it the fastest-growing market, but it is also nearby and has cultural affinities.

Indeed, even before the Lehman Brothers shock, the center of global economic growth had been shifting from the developed countries to the emerging markets, many of them in Asia. The annual real-GDP growth rate in Asia, excluding Japan, was 8.5 percent in the 2004 through 2008 period. Those in the European Union, US and Japan were below the world average of 3.6 percent. Yet developing nations, most of which are Asian, could account for about a half of the world gross domestic product (GDP) in 20 years, assuming all regions continue to grow at the same rate.

However, with the exception of automotive companies, most Japanese companies have not captured the growth potential that Asia provides. The average annual regional sales growth in Asia, excluding Japan, for 11 major Japanese companies was 6.1 percent. That figure lagged annual GDP of the region by almost 2.5 percent ***(see Figure 7)***.

Figure 7: Asian annual sales growth rate of major Japanese companies



Sources: Corporate annual reports

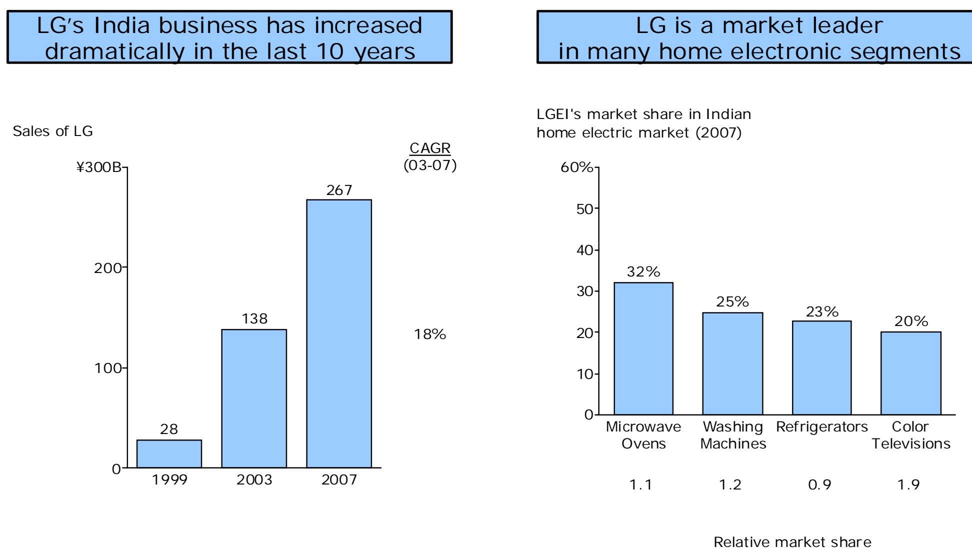
Who are the global winners in Asia? According to market share rankings, Japanese companies have relatively small market share. Interestingly, European and Korean companies have achieved dominance in particular geographic areas and industries. These overseas businesses provide not only substantial profits, they lead the overall growth for these European and Korean companies. Volkswagen in China and LG Electronics in India are telling examples of such successful non-Japanese companies. Suzuki's India business is one good example of a Japanese company. How do these companies succeed?

LG in India, for example, sells color televisions, refrigerators, microwave ovens and other appliances. The company's products have penetrated the nation during its rapid economic growth period. Today, it is a major player in the "mainstream segment," which represents some 90 percent of the Indian market.

LG succeeded by mining its core for hidden assets. Today, it sells less-expensive products developed for the Indian market in addition to premium products that were originally developed for the Korean and other developed markets. LG has pursued a local strategy by building sales networks across India, by developing products in three Indian R&D facilities and by hiring in-country managers who are trained in India. By meeting target customer needs combined with competitive pricing, LG has gained and maintained a high market share of

20 percent to 32 percent, depending on specific consumer electronics products ***(see Figure 8).*** Significantly, these "good enough" products are based on legacy technologies that prevailed 30 years ago in Japan. In other words, that hidden asset needed little development to become the right technology at the right price for the right market.

Figure 8: Sales and market share of LG's India business



Sources: Corporate website, Prowess and Euromonitor

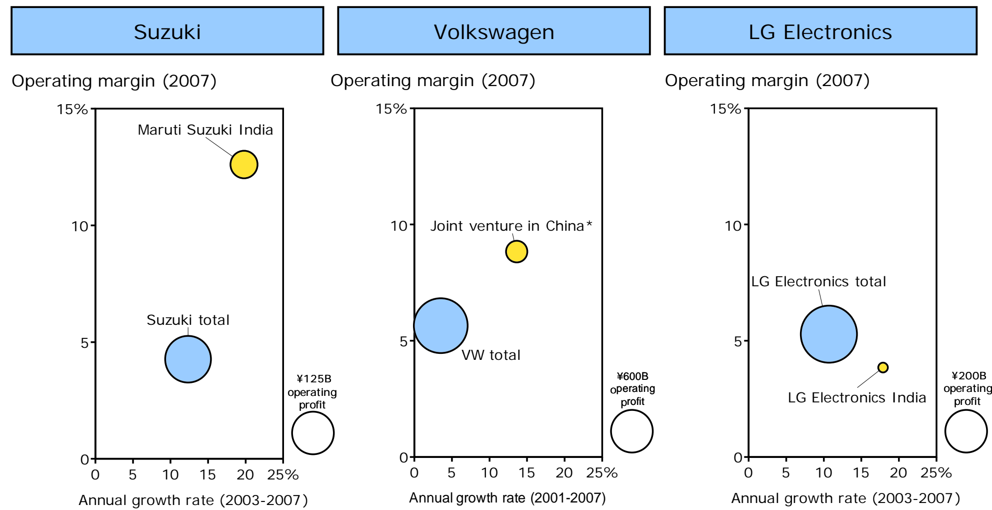
In contrast, many Japanese companies have focused on premium segments. An executive at a major consumer electronic company explained that his company not only aims solely at the high-end segment, it also does not care about the entire market share. That attitude seems shortsighted. The strategy certainly works well in markets where the proportion of profits held by the premium segment is relatively large—such as Thailand, Malaysia, Indonesia and some industries in Vietnam. However, population segments with low disposable income cover the majority of the market in the largest of the rapidly growing markets, China and India.

Numerous cases show that substantial profits are possible in low-income segments, once players achieve overwhelming market share. For example, while LG India's profit margin has declined somewhat in recent years, it remains near the same level as its corporate average. Suzuki does even better. Its profit margin in India reached nearly 13 percent in fiscal year 2007, three times higher than its consolidated EBIT margins of more than 4 percent ***(see Figure 9)***.

Japanese firms need to abandon their typical overseas entry method of simply exporting their Japanese products. While that may have worked in the past when

penetrating equally affluent European and North American markets, in emerging Asia, the largest opportunity is in a different segment. There, Japanese firms must pursue a strategy of serving less affluent customers. And like LG, that may involve revisiting underappreciated, even dated, assets.

Figure 9: Business economics and growth of firms with higher share in developing markets



*Calculated operating margin and growth rate of VW's China business as weighted average of Shanghai VW and FAW VW; sales of VW's Chinese joint ventures are not consolidated into VW corporation due to share of capital contribution

Sources: Analyst reports; corporate IR disclosures; Prowess; National Bureau of Statistics of China

5. Leadership and organizational perspectives

Organizationally, companies must begin this journey from Japan-centric to internationally oriented organizations. Such a transformation starts from within and requires leadership that is both strong and broad. Ultimately, it will also take a transformation of traditional ways of doing business.

Three things are needed:

- The internationalization of company talent, to increase effectiveness in both the local and global spheres
- An attitudinal change at all levels, to reflect a sense of business "ownership" rather than being a representative of line organization and
- Fresh perspectives from the top

None of these changes will be easy, nor can they simply be mandated by current leadership. Some understanding of each is necessary.

The need for an international talent base grows from an understanding of Japanese companies' difficulties, going back to the 1980s, in capturing the full value from overseas acquisitions. Time and again, senior managers were dispatched from headquarters to run these operations to ensure control over this far-away subsidiary. As a consequence, a valuable local knowledge network—of everything from sourcing to customer desires—was often underutilized. That also meant a limited career path for non-Japanese managers, who tended to feel they had little influence on decision making or were limited in their progression to management levels. This has proven an extremely difficult situation to solve. How can headquarters control far-flung operations through guidance, training and support functions—without stifling ambition and innovation? There are no easy answers. But a strong and flexible model, one that enhances rather than restricts foreign operations, is the goal.

Today, attitudes and responsibility roles in traditional Japanese firms dictate a consensus style of management. Outspoken opinions in open meetings are considered challenging and rude. In such a setting, there is no clear understanding about who has the final authority to make a decision. Everyone may appear to agree on a decision, yet none has really been made. Nor, is any particular person responsible for carrying it out. In this situation, "consensus" for one person may not necessarily be the consensus for the other management leaders, and the risk of such miscommunication will grow as the company becomes more global. That is not to advocate an American decision style, where each person in a meeting tries to assert his or her opinion. The point, rather, is that bringing ownership and clear responsibility to the management team in Japanese companies will strengthen the "real" consensus-based management style in the current business environment.

Fresh perspectives from the top are necessary to make that happen. Indeed, high-level openness to new thinking is essential to create a marketplace for competing ideas that will help return Japan, Inc. to its former preeminence. Yet of 15 recent CEO hires for top technology and industrial companies, all came from within their corporations.

A closed system of promotion doesn't necessarily mean a lack of openness. But externally hired managers, by definition, bring with them an ability to "think outside the box." Terumo is a good example. In the early 1990s, Terumo had stuck with its origins as a clinical thermometer manufacturer. It posted deficits for three consecutive fiscal years, primarily caused by competition from imports. Their inroads rapidly commoditized medical devices, such as injectors and transfusion device, which accounted for 70 percent of Terumo's sales.

But then Takashi Waji, originally a banker at Fuji Bank (now Mizuho Bank), was named CEO in 1995. Looking at the business with what some might call "intelligent ignorance," he discovered profitable hidden assets in Terumo's technical superiority in medical device manufacturing and in its strong connections with doctors.

Under his leadership, Terumo decided to focus on therapeutic devices, as opposed to medical technology, as its new core business. It was a stunning insight. At the time, no Japanese companies focused on that core. Terumo set the cardiac-vascular product group as the main pillar of its medium-term business plan, which started in 1999. To ensure success, it collaborated with doctors and researchers to develop the new product line. Aggressively executing M&A strategies, Terumo acquired an artificial heart-lung machine business from 3M to expand that new core. By March 2007, that product group had grown to encompass 40 percent of the company's overall sales and 50 percent of EBIT. In the process, Terumo increased its EBIT margins to 21 percent, with its new core business contributing to gain top market share.

Externally hired CEOs are rare in Japan. But fresh thinking may also come in the form of company executives with atypical career paths—"insiders" who also bring intelligence and creativity to areas in which they have no deep-seated expertise or vested interest. For example, Fujio Mitarai, former president of Canon, spent 23 years—indeed, most of his career—in the United States. Tamotsu Nomakuchi, former president of Mitsubishi Electric, may have brought a more inquisitive viewpoint to the company because his background was in R&D. The lesson is that agents for transformation, even though they are often regarded as mavericks within a company, are able to bring an objective, even outsider perspective to key decisions facing the company.

The rewards from a successful transformation

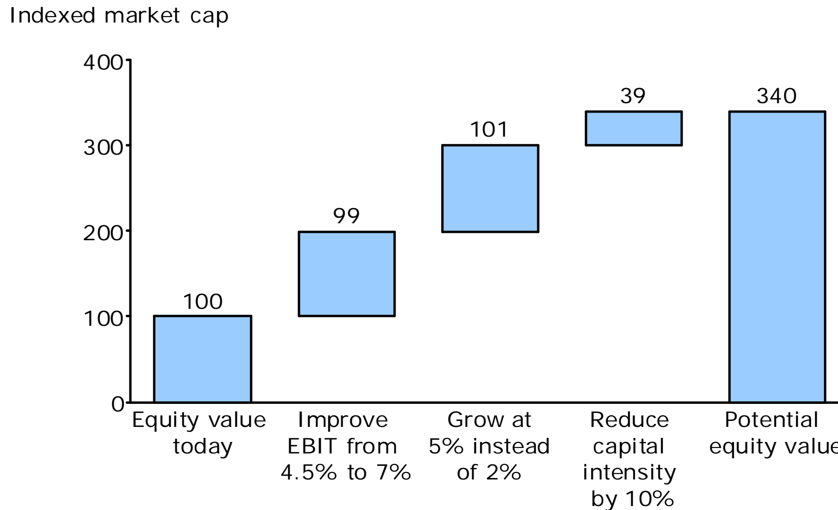
The rewards of a company's successful transformation of its business practices and focus will be truly enormous.

By aligning growth, profitability and level of capital efficiencies to the average of global corporations, it is possible to dramatically expand Japanese companies' value—and break out of the economic slump.

That would mean increasing their current average sales growth rate of 2 percent to 5 percent and EBIT margins from 4.5 percent to 7 percent—along with improving the level of capital efficiencies by 10 percent. The result would be more than a threefold increase in Japan's market cap ***(see Figure 10)***.

Tripling the current market cap would return Japan's stock price average to the level attained in the era of "Japan as No. 1"—but without the bubble economy.

Figure 10: Successful transformations could triple share prices for Japanese companies



Note: Based on averages for Japanese manufacturing companies (65% equity finance, EBIT margin 4.5%, 1998-2008 sales growth of 2%). Enhanced growth assumes multiple expansion by factor of 1.4
Source: Bain analysis

After two decades of economic stagnation in Japan, one might think that another decade or so would be needed to secure such a wholesale transformation. However, for any individual company—based on Bain's experience—we believe the initial phase of establishing new strategies can be completed within half a year. And it would take from two to three years to implement fully, with initial results showing up as early as six to 12 months into the program.

What Bain proposes is indeed achievable, and represents a point of arrival certainly well worth the structural changes needed to get there. Japan, Inc. can indeed be reborn by redefining its companies' cores, by developing focused growth strategies that exploit "hidden assets" and by fully participating in Asia's growth dynamic.

Ultimately, what's needed is a series of bold decisions by CEOs—leaders who can both question and learn from tradition—who will start their companies, and the nation, down the necessary path of transformation.

Getting started

Business leaders have the responsibility of creating a vision for their companies' futures and then making the critical decisions that will ensure it happens. The process begins with a thorough and honest analysis of a point of departure. To help in that determination, CEOs should consider three key questions:

1. Is my company a candidate for transformation? In other words, are some of the structural and performance observations discussed applicable to my situation?

2. Are my management team and I prepared to step up to the challenge and drive the necessary approach and discipline in order to make a difference?

3. Are my team and I committed to do what it takes over a period of two to three years to get to meaningful results and change in the organization?

If the answers are yes to these questions, then the process has already begun.

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We help companies find where to make their money, make more of it faster and sustain its growth longer. We help management make the big decisions: on strategy, operations, technology, mergers and acquisitions and organization. Where appropriate, we work with them to make it happen.

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We realize that helping an organization change requires more than just a recommendation. So we try to put ourselves in our clients' shoes and focus on practical actions.

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