Division of Research
Graduate School of Business Administration
The University of Michigan

October 1985

MANAGEMENT PRACTICES AND BUSINESS STRATEGY IN
JAPANESE MANUFACTURING FIRMS

Working Paper No. 445

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To appear in R. Tung (Ed.) _Strategic Management in U.S. and Japan: A Compararive Analysis_, Cambridge, Mass: Ballinger, 1986.

In the past five years, the success of many Japanese manufacturers in penetrating markets around the world, in particular the United States, resulted in an explosion of interest in Japanese management practices. In many cases, Westerners were exhorted to adopt Japanese methods as quickly as possible, but there are also some who still dismiss Japan's record as some kind of conspiracy which should be fought against with all available means. In contrast, this paper does not attempt to cast any moral judgments on the merits or limitations of Japanese management practices. Rather, it will attempt to illustrate how internal management practices influence the competitive strategies of Japanese manufacturing firms. The paper analyzes the principal characteristics of Japanese competitive behavior and discusses their implications for U.S. firms.

The notion that structure follows strategy (Chandler, 1966) still dominates the literature on business strategy, though some doubts are being raised in this regard. In the Japanese case, however, the strategies of Japanese manufacturing firms are clearly driven by structural conditions derived from their basic managerial paradigm: focus on human resources as the key corporate asset. This paradigm translates into specific management practices and techniques, such as the development of an internal labor market, intensive socialization, and long-term appraisal (Pucik and Hatvany, 1983), all supporting a pattern of strategic behavior that challenged typical American expectations about competitive behavior in the marketplace.

The focus on human resources implies that the survival of the firm is the ultimate strategic objective. The environment is viewed as essentially hostile and competition all pervasive. Market share dominance, pursued through aggressive pricing and shifting market segmentation, is indispensable to the long-term survival of the firm. Internal diversification is the sole

avenue to growth. Rapid introduction of new products and new technology are essential to remaining in the race.

COMPETITION AS A WAY OF LIFE

Contrary to the popular image of "Japan, Inc." where the government and private industry support each other and where oligopolistic collusion of dominant firms is tolerated, if not encouraged, competition among Japanese firms is very keen. While large firms seldom go out of business because of their strong ties to the financial community, the bankruptcy rate in Japan is still twice as high as that in the United States. Most formal and informal cartel arrangements are established to prevent firms from pursuing strategies of mutual destruction which could bring havoc on the entire economy.

In this environment, it is fair to say that the principal purpose of a Japanese firm is to survive a social group, a task possible only through "besting" its present and potential rivals, both in Japan and overseas. The world outside the firm is perceived in terms of friends and foes, and of markets to be captured or defended. As such, there is no contradiction between survival and profit-oriented strategies. Profits are essential for survival in order to attract and reward investors and to provide resources for continuous growth.

The need to survive is an economic imperative driven by the characteristics of the Japanese labor market. A loss of jobs resulting from a business failure is very costly to most employees, particularly for those at the higher levels. In general, the higher the status, the bigger the potential loss. Managers have more at stake than rank and file employees because alternative job opportunities at similar wages are generally not available since most large employers who offer the highest salaries prefer to hire only new college graduates. Mid-career job openings are limited and are generally

concentrated in low paying small- and medium-size enterprises and in subsidiaries of foreign firms.

This survival orientation is constantly reinforced through an intensive socialization of all employees. The socialization process begins when they enter the firm and continues throughout their working lives. As a result, the organization develops a distinct identity based on a clearly articulated company philosophy and a strong corporate culture which emphasizes all pervasive competition as a way of life.

Japanese employees, and managers in particular, are brought up in an atmosphere of competitive rivalry that eventually permeates every action and decision they make. The activities of the firm are continuously scrutinized with respect to its impact on its major competitors. Intensive defensive and offensive scouting is built into all external operations and gathered intelligence, accompanied by summaries highlighting its consequences for future market battles, is distributed widely throughout the organization.

Often, the foreign market strategies of Japanese firms are products of the competitive circumstances at home. For example, the heavy emphasis on exporting by relative newcomers in their respective fields, such as Sony in the case of consumer electronics and Honda in the automotive industry, was due, in large part, to the difficulties encountered in competing with established domestic producers.

Business strategy is often driven by a desire to prevent rivals from gaining market position, regardless of the broader consequences of such competitive tactics. A situation where no one makes any money is preferable to losing market share to competitors. As a result, over-capacity is endemic in a number of Japanese industries, leading to a severe price war and export expansion. The motorcycle, video recorder and memory chips industries are recent examples of this type of situation.

LONG TERM PERSPECTIVES

The concern with survival of the firm in a very competitive environment determines the time frame of long-term corporate strategies. In this respect, the term "long-term" does not stand for any explicit time period as determined by a strategic planning framework. Rather, it reflects an implicit assumption that the function of business strategy is to enhance the firm's chances for survival. This is the ultimate long-term measure of success, one which is understandable to all.

It is not, as often thought, superior long-term planning per se that enables the Japanese to execute successful investment strategies. In fact, planning methodology used by a typical Japanese firm is generally not very sophisticated by Western standards. Most Japanese firms do not use planning tools, such as discounted cash flow analysis. Financial criteria, other than desired payback period, are seldom used for decision making. While expected cash flow and return on investment are used for purposes of financial planning, they are considered of secondary importance in strategy selection (Nonaka, and Okamura, 1984).

In Japan, the strategic objective is expressed in terms of market position or introduction of new technology (Kono, 1984). The investment selection process is guided primarily by a qualitative evaluation of potential gains in market position compared with the costs of weakened position in case of no investment. This allows for considerable flexibility in the implementation stage. For example, in the early 1960s, Honda's initial strategy for the U.S. motorcycle market was the introduction of large models. Because of quality problems and marketing mistakes, the initial sales campaign was unsuccessful. Within months, the strategy was shifted to emphasize small motorcycles. However, the overall mission, which was to obtain a 10 percent share of the U.S. market, was not changed.

The commitment to long-term strategic objectives is encouraged by an absence of short-term incentives that may distract managers from the pursuit of long-term goals. Strategy implementation is not tied to short-term financial criteria, even though financial discipline is tight. Long-term compensation plans for executives and managers are not used. Bonuses computed as a multiple of base salary are distributed among all employees as a form of quasi profit sharing. While the total amount available for bonus payouts is linked to current corporate performance, the competitive conditions and long-term trends in the marketplace are also considered. Since most employees are expected to remain in the organization for most of their working lives, one cannot escape the consequences of one's decisions. This tends to minimize the danger that an employee will take advantage of current circumstances at the expense of future goals.

In addition, the reliance on the future well being of the company to provide for individual welfare, coupled with the future-oriented appraisal system, makes it easier to incorporate long-term strategic objectives into the management of every day operations with a minimum of formality and complexity. There is no need for sophisticated reporting systems which attempt to use complex formulae to direct executives and managers in the proper direction. In this respect, "perseverance" and commitment" are equal to "harmony" and "team spirit" in the arsenal of desired and rewarded corporate values.

EMPHASIS ON MARKET SHARE

It has often been said that the aggressive market behavior of Japanese firms is enforced by their high fixed costs of production due to a policy of stable employment and a heavy dependence on debt financing. Wages of employees and interest on loans have to be paid irrespective of the sales volume. It follows, then, that in times of business retrenchments, it may be more

attractive to slash prices and keep output high, rather than follow the strategy typical of Western firms which is to protect profit margins by trimming output and consequently employment.

It was pointed out recently that the high debt-equity ratio in Japan, relative to other industrialized countries, is more a reflection of the differences in accounting practices and definitions. It was further noted that if market values of debt and equities are used for calculations, the difference between Japan and other industrialized countries is perhaps much smaller than generally thought (Kuroda and Oritani, 1980). In a similar vein, there is evidence that while employment in Japan is relatively stable during recessions, the actual labor costs exhibit greater flexibility than those in the United States (Gordon, 1981). In a typical Japanese firm, when demand declines wages and hours worked are adjusted accordingly, before any lay-offs are considered. Besides the labor market and financial structure of a firm, the aggressive market behavior characteristic of most Japanese manufacturing firms can be attributed to several other factors, such as the rivalry among industrial groups and competitive strategies which emphasize market share over short term profits.

The emphasis on market share fits in well with the Japanese management system as it supports the emphasis on survival as the key strategic objective. Market share, protected by economies of scale in production and distribution, is seen as more defensible than high margins in limited markets that may be vulnerable to a price attack by a determined competitor. Market share also provides an objective measure of competitive standing, independent of current investment and R&D strategies or changes in depreciation and tax rules, that is clear and understandable to anyone in the organization. At the same time, it has been shown that market share over the long run is a good predictor of

corporate performance as expressed in more traditional financial terms (Buzzell, Gale, and Sultan, 1975).

Market share strategies are supported by careful market segmentation. However, the purpose of segmentation is not to identify niches where returns higher than the industry average can be achieved. Rather, the objective is to identify a logical sequence of market penetration that leads from one market segment to the product markets as a whole. As many American manufacturers have already painfully learned, the Japanese penetration is high-volume, low value-added segments is only the beginning of a long march to take over other market segments later. The consumer electronics and automobiles industries provide the most obvious examples. Furthermore, the market segmentation strategy is not limited to low-end entry only. Several Japanese camera manufacturers, for instance, decided to challenge Kodak's dominance by attacking the high end of the camera market first, then pushing into Kodak's territory by lowering prices through cost reduction based on technological innovation.

Aggressive market penetration is possible because Japanese managers are free to pursue short-term market share gains through incremental or variable cost pricing. Sale prices are dictated by what a new customer is willing to pay. As long as such a price covers incremental costs of the new order, the new business is accepted. The assumption is that continued cost reduction programs, on the one hand, and product improvement efforts, on the other hand, will gradually result in profits on a full cost basis. However, this is not a strategy based on a simple experience curve effect. Volume-related reduction of costs is expected, and the objective is to push the slope of the experience curve down to lower the cost faster than competitors with a similar market share.

A strategy driven by market share considerations also calls for a new look at the product life cycle. Product maturity is interpreted not only in terms of market growth, but also with respect to the potential of additional market penetration. In the Japanese view, even a mature product market is attractive if market share expansion can be achieved at the expense of current competitors, by introducing products with more advanced features or by investing in low-cost production technology. Bridgestone's entry into the U.S. tire market through investment in local manufacturing at a time when most U.S. procedures are reducing capacity is a good example of the latter strategy. In two years since Bridgestone acquired and rebuilt an obsolete manufacturing plant from its U.S. owner, the plant production is at all time high and growing.

From another perspective, Japanese firms are reluctant to divest from existing low growth/low market share situations with the same speed as their American competitors for several reasons. First, such markets are potentially useful to check expansion of a powerful competitor or to launch products not yet invented. Second, the avoidance of disinvestment is also motivated by its negative implications for employment stability. Third, as traditional financial ratios are secondary in importance as measures of performance, divestments for the sake of improving the balance sheet generally do not occur. As a result, Japan lacks the spectacular low-tech/high-tech transformation undertaken by Gould or IC Industries in the U.S., but also avoids the failures of diversification experienced by Exxon, Mobil, AM International and numerous other firms addicted to mergermania.

GROWTH THROUGH INTERNAL DIVERSIFICATION

As noted previously, the organization culture in Japanese firms places a premium on maintaining the corporation as a group of individuals tied together

by lasting bonds. For that reason, divestitures, mergers and acquisitions (especially those involving firms from unrelated industries) are unusual in Japan; and hostile takeovers are, for all practical purposes, next to impossible (Clark, 1979). The strong barriers to mergers and acquisitions may, perhaps, be detrimental to the efficient allocation of resources in the economy. However, once it is clearly established that the only way to grow is from internal competitive strength, the strategic implications are clear: there is no short-cut, no other way than concentrating on making a product which meets the needs of the customers, is cheaper, and of higher quality than that of its competitors. A further advantage of this aversion to acquisitions is that top management can be closely involved with operations, as they and their staff do not have to spend time planning takeover strategies or putting together defenses against them. Given the constraints these takeover planning sessions place on executive time, the acquisition route to growth, which is popular in the United States, may entail substantial opportunity costs which their Japanese counterparts do not have to contend with.

Under such conditions, it is natural that engineering and manufacturing become a major strategic concern in the organization, resulting in an emphasis on continuous product and process innovation, on upgrading quality, and on lowering costs. There is also a direct correlation between operations-oriented competitive strategies and human resource management practices. In contrast to many U.S. firm, the operations area is viewed as a key to corporate survival and is thus staffed by high-quality managers with good chances of advancing eventually to top executive positions. Among 314 new corporate CEO's appointed in 1984, more than 29 percent advanced through manufacturing and/or engineering and 30 percent through marketing (Japan Economic Journal, 1985).

In addition, the focus on internal growth permits the organization to pursue strategic changes incrementally so that they can more easily be absorbed by the organization. The "logical incrementalism" advocated by Quinn (1980) is a concept familiar, in practice, to managers in many Japanese firms. Moreover, internal growth allows the organization to satisfy the career aspirations of many employees by creating vacancies in new areas of business that can be staffed from within. In Japanese industry, growth implies the spin-off of affiliates and subsidiaries, not the building up of a centralized empire.

Many Japanese manufacturing firms today operate as quasi-conglomerates. The parent company maintains direct control over key business groups and divisions, and has equity interest in a family of vertically- and horizontally-integrated subsidiaries and affiliates created through spin-offs from the parent and some of the key subsidiaries. Several of the large affiliates are usually independently listed on the stock exchange. In the case of large firms such as Hitachi or Matsushita, the number of affiliates can reach several hundred, arrayed in several layers of intra-family hierarchy.

The degree of control within the corporate family is flexible, depending on an affiliate's performance. The faster the growth, the larger the degree of autonomy given to the spin-off firm. It is not uncommon for some spin-offs to outgrow their parents and then become the new center of the corporate family, as in the case of Toyota and Fujitsu. The management of the affiliates has, therefore, a great incentive to push aggressively for new areas of business while being protected from at least some of the risk by their intra-family ties. However, in case of failure, the parent firm will not hesitate to intervene even after years of laissez-faire policy. The change in Yamaha Motors' top management under the guidance of Nippon Gakki is the most recent example.

An additional point concerning corporate families in Japan has important implications for market competitiveness. In the case of integrated affiliates, the cost of control is kept at a minimum by avoiding coordination through parent company staff and relying instead on marked-enforced discipline and direct coordination among line managers involved in the intra-family transaction. The cost savings from the elimination of a large number of divisions, groups, sectors and lead office staff can be substantial. In a comparison of U.S. and Japanese automotive firms, such savings reached nearly $200 per car (Pucik, 1984).

AGGRESSIVE INNOVATION

As noted elsewhere, the nature of the appraisal system in Japanese firms and the rapid reception and dissemination of new ideas in Japanese firms should encourage innovation (Pucik and Hatvany, 1983). When long-term behavior, rather than short-term "bottom-line" performance is the focus of evaluation, means as well as ends may be assessed. Aversion to risk is minimized and creativity facilitated both by the assumption of stable employment and by tolerance of honest mistakes in the evaluation process. This combination of security and incentive for challenging assignments creates what Pelz (1967) characterized as a "creative" challenge, an environment suitable for nurturing of innovations and rapid sharing of new ideas. This notion is contrary to the stereotypic image of the Japanese as poor innovators constrained in their exploration of new frontiers by a group desirous of maintaining consensus and harmony. In this respect, the evidence is clear: The Japanese do innovate as fast as, if not quicker, than most businesses in other countries (Moritani, 1981).

One reason for the discrepancy between the stereotype and reality is the misunderstanding of innovation processes in the organization. It is not only

the bright idea that counts, but the process of introducing the product, based on the new idea, to the market. In the competitive game, the origin of the idea is often secondary. After all, computers, jet engines and scanners were not invented in the United States, although U.S. firms enjoy a commanding lead in these product markets. It is in the implementation process that the Japanese have an advantage because of their carefully built, worldwide monitoring systems, on the outside, and the high level of interface, coordination and teamwork, on the inside, involving everyone concerned with development, design, and manufacturing.

A second reason for the erroneous stereotyping of the Japanese as poor innovators stems from the widely held belief that there is a shortage of venture capital, thus limiting innovation. Because external capital is not available, it is very difficult for Japanese R&D personnel to leave their employers and strike out on their own, a pattern common in the United States. However, a closer look reveals that this limitation may actually work to Japan's advantage.

While their research teams kept from the temptation of windfall profits as independent entrepreneurs, Japanese companies are well poised to capitalize quickly on newly acquired knowledge. Rather than working in the secrecy of the family garage, the Japanese engineer is working on new inventions in the corporate laboratory and has regular communication with those responsible for its future commercial adaptation. Then, once an innovative idea is proven to be potentially promising, the organization can move very quickly to the adoption phase, as everyone concerned is already familiar with the new product's characteristics. In other words, while the Japanese may lag behind in the "discovery" stage, they more than catch up during the phase of product commercialization.

A closer cooperation and communication between the research engineers, on the one side, and production and marketing personnel, on the other, is built into the Japanese management system. This greatly facilitates the communication of new innovations and assures the integration of research and development with other critical corporate functions. A steady feedback of market information to the research personnel enhances the likelihood that research and development will result in products that meet market needs.

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