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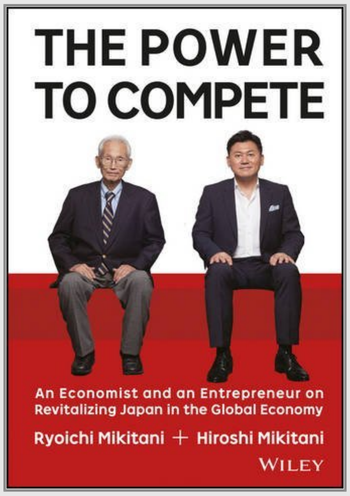

The Power to Compete

An Economist and an Entrepreneur on Revitalizing Japan in the Global Economy

Hiroshi Mikitani and Ryoichi Mikitani
Wiley © 2014
240 pages
Book: getab.li/27372

Rating

9

8 Importance
8 Innovation
9 Style

Focus

Leadership & Management
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Small Business
Economics & Politics
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Concepts & Trends

Take-Aways

- Japan finds itself directionless and isolated from the rest of the world.
- Japan protects its markets from foreign competition but excessive regulation relegates innovation to an afterthought.
- Lifetime employment ensures Japanese workers jobs for life, regardless of individual performance or broader company priorities.
- Japanese firms can’t fire workers; this policy creates a lack of worker mobility.
- Japan applies a steep corporate income tax rate of 35.6% and imposes a special tax, making its corporate taxes the highest among developed nations.
- The economy is “extremely inefficient” and suffers from a weak currency, an unbalanced labor market and low overall workforce participation.
- Every Japanese company is too big to fail; poor performers don’t disappear.
- Each year, only 2,000 foreign technical workers enter Japan with visas. In the United States, the aim is to grow that number to 300,000.
- Japan’s inflexible work rules lead to chronic worker shortages in such areas as nursing.
- The country could better integrate with the world by embracing the English language.

Relevance

What You Will Learn
In this summary, you will learn: 1) How regulations stymie Japan's economy, 2) How lifetime employment hampers growth and 3) Why Japan needs a dose of "creative destruction."

Review
With its technological inventions and its people's legendary work ethic, Japan once seemed poised to dominate the global economy. But since the early 1990s, Japan has lagged while the United States, China and other nations have surged ahead. This overview of Japan's woes explains a litany of ill-informed policies, such as lifetime employment and excessive regulation. The narrative is crafted in the form of a dialogue between father and son: The father is the late Ryoichi Mikitani, once professor emeritus of economics at Kobe University and president and chairman of the Japan Society for Monetary Economics, and the son is Hiroshi Mikitani, founder, chairman and chief executive of Rakuten Inc. Their conversation makes this study of Japanese economic policy an accessible and intriguing read. *getAbstract* recommends this informed exploration of Japan's economy to businesspeople and policy makers seeking insight into the limping tiger.

Summary

A Stifling Regulatory Regime
Today Japan finds itself directionless and isolated from the rest of the world. Yet, Japan protects its markets from foreign competition. Innovation, hampered by regulation, is an afterthought. Japanese leaders demonstrate their lack of eagerness to embrace change, especially regarding the innovation revolution. A sclerotic bureaucracy chokes Japan. As the country has shifted toward state-run rather than free-market capitalism, public debt has swelled, followed by tax increases.

"I knew early on whom I would ask to be my coauthor: my father…my debate partner and sounding board as I explored issues around the Japanese economy. [Before] he passed away in late 2013…we engaged in a series of discussions about the future of Japan and the global economy."

In 2013, the Shinzō Abe administration sought to reform Japan's economy and return the fallen tiger to its former glory. Abe formed councils to suggest fresh ideas. Private sector representation on the Industrial Competitiveness Council ballooned from four people to ten, an apparent pretext for muddying the recommendations and diluting suggestions from reform-minded business leaders. Abenomics has good points but it's larded with examples of state capitalism, especially hefty public investments in government-favored industries. Japan remains technologically advanced, but its leaders seem determined to squander that advantage.

Japan suffers under a staggering public debt load of about one quadrillion yen [approximately $8.9 trillion] – twice its annual GDP. Japan's thrifty citizens – not foreign investors – purchase most of the government's bonds. The nation limps along under crushing debt, stifling regulatory schemes and a lack of managerial leadership. In a notable exception, CEO Carlos Ghosn rescued Nissan Motors from the brink of failure. Generally, though, clear-eyed managers pushing bold strategies prove rare in Japan.

"Japan doesn't have abundant natural resources. Our people are everything. I actually think it is more important for us to invest in people."

Generations of workers enjoy lifetime employment, but the country needs more flexible labor markets so firms can fire poor performers, hire more women and bring in foreign workers. Japan must repeal rules limiting working hours for white-collar employees.

Japanese Innovation Stalls

Japan's economic leaders mistake invention for innovation. The iPhone, for instance, was a combination of existing inventions but a revolutionary innovation nonetheless. Economist Joseph Schumpeter argued in the 20th century that economic expansion and prosperity come not just from growth but also from innovation. Schumpeter wrote of "patterns of innovation," including producing new goods, creating novel manufacturing methods, developing fresh markets and finding new supplies of raw materials. Recent decades have seen all too little Japanese innovation. Japan's risk-averse system of funding start-ups is just one pitfall. In the United States, venture capitalists and other private lenders provide financing for new companies. In Japan, business loans come primarily from banks – which, by their nature, are simply too cautious to fund start-ups.

"Few Japanese political, business or governmental leaders understand where we are and where we are going."

Samsung

As Japan tries to compete in innovation, meeting international standards is a challenge. Japanese technology doesn't fit global norms. For instance, Japan's television format and system are out of step with the rest of the world. As a result, South Korea's Samsung commands 30% of the global TV market, outpacing previously dominant Japanese firms such as Panasonic and Sony. Japan could learn from Samsung's engagement with the world. For instance, the company sends employees abroad to study new markets. In some cases, Samsung doesn't expect workers to produce anything while on these assignments. It sends engineers to top US schools for advanced degrees and brings them home to worthwhile employment. Author Hiroshi Mikitani explains that his technology corporation, Rakuten, grew by hiring engineers from abroad, primarily from Europe, but this is an unusual strategy in an insular society.

"Industrial policy [is] led by the government bureaucracy, which doesn't do anything except stifle competitiveness in the private sector."

Brand Decline

Japan faces a headwind from the decline of its brands' reputations. The world once subscribed to the notion that Japanese products were distinctive. Brand cachet can create surplus profits, but that source of differentiation has eroded, along with Japanese innovation. Sony's brand, for instance, no longer holds the power it once did. Sony was the Apple of its day. Its Walkman, released in 1983, was a worldwide sensation that underscored Japan's position as a purveyor of cool products. The death of founder Akio Morita played a role in Sony's downturn. As the firm lost its groove, it seemed incapable of profiting from new innovation. Sony's electronic payment service, Edy, lost money until Rakuten bought it and made it profitable. Competition also caught up with the once-mighty Toyota. Once renowned for quality and efficiency, the firm's reputation today barely exceeds that of competitors like South Korea's Hyundai.

"The bureaucracy, industry and financial sectors are basically all intertwined. The megabanks use their vast sums of money to buy favors from the government."

Abenomics

In an effort to spur a moribund, deflating economy, Abe offered his Abenomics reform package. These policies have good points and bad, although the Japanese power structure discourages dissenting views about Abenomics. One newspaper editor complained he was pressured to kill a column criticizing the policies. Abenomics derives in part from the Keynesian concept of fiscal stimulus. Building bridges and roads, the theory goes, will reverberate throughout the economy. In theory, an investment of 100 million yen should create a multiplier effect of four to seven times the initial amount, because government spending provides income for Japanese workers and investors. And, those who earn from the stimulus spend the money.

"We have gone from simpler times, in which products were made entirely in Japan and then exported, to a period of globalization in which production is stretched across different borders."

In reality, because of "fiscal leakage," stimulus typically creates an economic impact of only double the actual spending. Fiscal stimulus was a powerful tool in Keynes's day of high unemployment. But in a rich country like Japan, fiscal stimulus is bound to yield disappointing results. The multiplier theory assumes the stimulus circulates through the economy as consumption. But in difficult times, people tend to save rather than spend. Keynes didn't distinguish between effective and ineffective stimulus. A new road built in a congested area is more economically useful than a road constructed in the middle of nowhere.

"We have seen the emergence of populism that panders to public opinion…no matter how large the national debt grows, the party that improves the economy will win."

An "IT Autobahn"

Government spending often focuses on physical infrastructure, but "soft infrastructure" can generate a more robust multiplier. Communication infrastructures might prove a more powerful stimulant for Japan's economy. For instance, an IT autobahn, named for Germany's vaunted highway system, could create a national framework of free, open communication networks. Education spending – another form of stimulus – focuses on people rather than construction. Japan desperately needs to make its school system more like its competitors' in the West – starting with smaller classes and less "rote memorization."

"To develop new industries, we have to move the factors of production and… without the movement of workers, industries themselves will not change."

English

English is the international language of business, and many nations emphasize it as an economic development tool. Turkey is spending the equivalent of 100 billion yen to teach English to its residents. South Korea has embraced English instruction, but using English as a competitive advantage requires more than school-based training. In Sweden, many people speak to each other in English. That's not the norm in Japan, though many students spend some 2,000 hours studying English during their 12 years of primary education. Despite this apparent focus, Japanese students post abysmal scores on a standardized test: Japan's average in 2010 was just 70 out of 120 points, barely above Laos's. Talented foreigners cannot work in Japan unless they speak Japanese.

Japanese teachers focus on memorization, and class sizes are larger than in the United States. Japan needs to increase its spending on education to offer students a more interactive experience. Hiroshi Mikitani's English grades and proficiency improved after a "cram school" teacher tutored him. A tutor gauges a student's strengths and weaknesses and provides individual instruction that's not possible in Japan's tradition-bound schools.

"When foreign nationals work in Japan, it increases the feelings of affection that people overseas feel toward us."

Lagging in Education

Japanese students rarely use computers in class. The nation's universities specialize in courses that students find mundane. Perhaps as a reflection of their closed society, Japan's young people seem to be "increasingly inward-looking." The number of Japanese students traveling to America continues to decline. In 2010, South Korea sent 72,000 exchange students to the US, while Japan dispatched just 20,000. The nation seems to be withdrawing from the rest of the world just as global engagement becomes more crucial than ever.

"The world now requires that we speak English."

Not Allowed to Fail

Japan doesn't allow struggling firms to fail. Instead, the government props them up. Japan Airlines is an example of a troubled company that should have been allowed to collapse. The demise of the dominant carrier would have created new competition and low-cost carriers. Instead, Japan Airlines survived due to public investment. Its failure would have freed its workers to take positions at the companies that would have emerged to replace it.

Joseph Schumpeter spoke of "creative destruction," explaining that businesses should cast aside tired, no-longer-profitable ideas. Japan's economy suffers because the nation doesn't allow that creative destruction.

Lifetime Employment

Japan's GDP per worker is $44,500, which ranks 23rd in the world. The country is "extremely inefficient" and suffers from a weak currency, an unbalanced labor market and low overall workforce participation.

"The lifetime employment system is producing negative effects and is restricting the development of a fluid workforce."

Nursing and agriculture face labor shortages. Firms promote managers based on their longevity, not their skill or effectiveness. Japan's rigid labor rules worked in a growing economy, but decades of stagnation have revealed their flaws. Lifetime employment extends from factory floors to office towers. Public sector workers never experience wage cuts or firings.

Japanese law and inflexible work rules mean companies can't fire incompetent workers. A violinist hired by the Tokyo Philharmonic Orchestra in his 20s can remain employed there until retirement. Musicians must have talent to get their positions, but after that, they have little incentive to improve. The musicians can't be fired, and with few openings at other orchestras, they aren't striving for a new job.

"We should prioritize freedom of choice over a uniform education. We need to reconceptualize education. It should not be thought of as an expense but an investment."

Once hired, university professors need not publish a single research paper to stay in their jobs. Japanese workers' productivity and performance remain a matter of personal choice. They face no threat for poor work and have little hope of promotion for performing well. Lack of worker mobility plagues short-staffed sectors like nursing. A mid-career worker in another industry can't leave that position to become a nurse.

Immigrant Antipathy

Japan's antipathy toward immigrants slows its economic growth. Each year, only 2,000 foreign technical workers enter Japan with visas. In the United States, the aim is to increase that number to 300,000. Qualified science and technical workers ply their trades in the US, China and other welcoming nations. Japan's orderly, advanced society could attract foreign workers.

"We need to return to the mind-set they had during the age of discovery. Japan must endeavor to become explorers once again."

Unfavorable Metrics

In 2010, Japan spent 23.1% of its GDP on government services, higher than the United States and South Korea (20.3% each) and Germany (21.2%). Reducing government spending should be a top priority. Japan applies a steep corporate income tax rate of 35.6% and imposes a special tax, making its corporate taxes the highest among developed nations. Japan's power bills are nearly twice those in the United Kingdom and the United States. This results from Japan's system of regional utility monopolies with strong pricing power. With its high gasoline taxes, Japan has some of the world's priciest petrol.

"The Power to Compete"

Japan should deregulate its business environment and allow companies to compete. The Japanese could use their abundant cultural gifts to create an economy that is open to the world.

About the Authors

Hiroshi Mikitani is the founder, chairman and chief executive of Rakuten Inc. His father, **Ryoichi Mikitani**, who died in 2013, was professor emeritus of economics at Kobe University and president of the Japan Society for Monetary Economics, which he chaired from 1994 to 1998. Rakuten is a stockholder in *getAbstract*.