

An Interview with Shintaro Okuno, Managing Director, BAIN &amp; COMPANY JAPAN

# How Can Japanese Businesses Survive the Labor Shortage?

By Japan SPOTLIGHT Editorial Section

BAIN & COMPANY JAPAN Managing Director Shintaro Okuno talks about how Japanese businesses could reform themselves to meet the challenge of the decline in the labor force.

## Assessment of Current Japanese Business Given Background of Labor Shortage

**Q: Could you please briefly introduce your company and yourself?**

**Okuno:** BAIN & COMPANY was founded in 1973 by Bill Bain and some other partners in Boston as a management consulting firm. We aim to help companies get out of critical situations by providing practical solutions, and do not try to be just an advisor. We are a global firm with 5,700 professional staff and 51 offices in 33 countries. Our Tokyo office was founded in 1981 and, like the others, we help a variety of clients, not only Japanese companies but also multi-national corporations. I used to work for Central Japan Railway Company and joined Bain 12 years ago.



*Shintaro Okuno, Managing Director of BAIN & COMPANY JAPAN*

**Q: Japanese business is in a critical situation in terms of profitability and competitiveness. A labor shortage due to the continuing aging of society is one of the challenges they face. How do you assess the current situation of Japanese business?**

**Okuno:** We cannot be too optimistic about the future. In comparison with US firms, the average profitability of Japanese firms in most industries is far lower. In quite a few industries, the profitability of more than 80% of Japanese firms is over 2% less than that of US firms. There are also many industries where the profitability of more than half of the Japanese firms is over 60% less than that of the US.

Another notable fact is Japanese firms' low growth. If it achieves

high sales growth, a firm's low profitability might be acceptable. However, the annual sales growth rate of Japanese listed companies is now less than 1%, which is extremely low. With such low sales growth, they need to make greater profits. In order to achieve this, they had to cut costs. US companies also cut costs to secure profit growth after the Lehman Shock, but Japanese firms have been doing this for the past two decades. It will be difficult to continue with this trend.

Another concern is that Japanese companies' savings have grown significantly, offsetting the decline in household savings and keeping total savings in Japan unchanged. This suggests that they cannot find where to invest their money. They need to invest in order to raise their sales/profits growth, and they also have lots of money to do so. However, they cannot decide where to invest. Unless this is corrected, you

cannot expect any wage increases, one of our important economic policy goals.

**Q: Which industrial sectors are in a serious situation in this regard and which industries are not necessarily so bad?**

**Okuno:** The situation is different more by companies than by industries. Even in industries which mainly depend upon the domestic market there have been companies that were doing fine in terms of profit growth. In particular, many firms in the retail sector are enjoying continuous growth. However, from now on we will see a significant decrease in the population. During the last decade our population has not decreased so much, and with the steady increase of per capita

expenditure our domestic consumer market has not shrunk much. But from now on, we will see an acceleration of depopulation, by approximately 500,000 per year, which cannot be offset by an increase in per capita consumption. In such a situation, we cannot expect the entry of new shops or factories in any local domestic market; instead, even those sectors led by the domestic market will need to move their business facilities into the global marketplace. Not only the retail industry but also the wholesale and construction industries will likely head in the same direction. In this situation, the power of a brand will be a key to winning in global competition. In many cases, the names of Japanese companies are well known, but the product brand names may not be. This could make it difficult for Japanese companies to win the race in the global market.

**Q: Could the construction industry or retail industry also suffer from a shortage in their labor force, in addition to their shrinking domestic market?**

**Okuno:** Yes. They cannot utilize low-cost labor anymore, which is a question on the supply side. The retail sector has been growing by utilizing low-wage part-time workers, and construction firms have been hiring Japanese workers who can accept a tough labor environment. But this cannot work under a labor shortage. Today, Japanese construction companies employ more women with engineering degrees and non-Japanese as well. Retail firms are changing their employment strategy from having non-permanent workers to permanent ones. Otherwise, they cannot secure a sufficient number of resources. But as a result, their average wages increase, and this pushes up production costs and squeezes profits.

## **Labor Market Reform Under “Abenomics”**

**Q: The key to “Labor Market Reform” under Abenomics is to raise the ratio of women and non-Japanese in the total labor force. Will this improve the situation?**

**Okuno:** Yes. That works on the supply side, but it won't solve the issue on the demand side: a shrinking domestic market. In addition, companies should fulfil the expectations of women and non-Japanese employees to get promoted to management level. Otherwise, they cannot feel engaged with their firms, and will not be considered as stable resources.

**Q: In that case, perhaps it would be necessary for Japanese firms to change completely their working customs, such as promotion based upon seniority or salaries based on working hours, wouldn't it?**

**Okuno:** Yes. We will need to apply a new “company operating model” to the new situation in which we employ more women and non-Japanese. This requires design principles for organization structure, accountability and corporate governance. Above all, a firm's

compliance and ways of working would have to be redesigned as well, and a performance assessment system or job allocation in accordance with each employee's capacity and other issues related to management would need to be addressed.

Under the seniority system, employees, especially those in their twenties or thirties, cannot get promoted until they reach certain age requirements. As non-Japanese employees tend to have different expectations about promotion, they would be reluctant to join a Japanese company if they cannot be a head of department until they turn 50. Needless to say, we will have to change this system.

**Q: Salaries in Japan are based on the seniority system, aren't they? Just as in a salary system based on working hours a worker expects an automatic salary rise in accordance with working hours, Japanese workers expect a higher annual income in accordance with the number of working years, don't they?**

**Okuno:** This has already changed somewhat. If you get promoted to executive director, you will get a high salary, which makes a big distinction from your colleagues in the same field who have not been promoted. The seniority system does not work in this context even now. As you get older than 55 or so, the base salary would not be raised much, and it may even decline in many organizations. But it is certainly true that there are still many firms where the seniority system holds good for promotion and base salary among those in their twenties or thirties.

**Q: One of the measures to be adopted for labor market reform is the introduction of a salary payment system based upon job performance assessment rather than working hours. In order to attract as many non-Japanese employees as possible, this reform should be inevitable. What do you think about this?**

**Okuno:** I think this is ideally a pretty good way to achieve the objective of the reform, but I think we need to define what the job performance or achievement should be in order to make it truly effective. Clearly, contribution to the company's sales or profit growth cannot always be applied as a measure of any employee's job performance, since not all employees necessarily work directly for such a purpose. We need an objective criterion to assess the job achievement of each employee working on different missions.

Another concern about Japanese firms is that, in many cases, they have only a modest goal as a whole company. For example, in China or Southeast Asia you can find companies with business plans targeting double-digit sales growth or even 20% growth, while we see very few such companies in Japan. If a company is not assuming high growth, any salary payment system, requesting only that its employees raise their own contribution to sales growth, would be inconsistent with its goals. This salary system would not work unless a company's growth target is raised.

## Encouraging Innovation & Raising Productivity

**Q: A company's performance will depend upon how it can raise its productivity. In order to do this, innovation would play a key role. What organization would be best to achieve innovation and enable companies to create new products that would attract investment?**

**Okuno:** It may depend upon the sector, but I'd like to mention the following three points.

The first point is that they would need to find a product segment with high value potential, and try to sell products at higher prices regardless of a deflationary economy. For example, even a beef rice bowl restaurant, which is famous for its low prices, introduced a new menu at higher prices with some specific high added value. A beer company has created "a premium beer" as a brand, and sold it at a higher price. Such efforts to find a segment with high added value will become inevitable.

The second point is innovation to raise labor productivity or reduce production costs. In order to achieve this, a large enterprise's solo efforts will not be sufficient, but it will need to collaborate with external partners (e.g. venture firms) on the seeds of new technologies. Integration of those seeds into a large firm's business and realizing innovation together would be a key to success.

Thirdly, there is the question of globalization of a company. There are still many business firms in Japan that could be more globalized to raise their productivity. Some companies, for example, earn more than half of their sales outside of Japan, and thus are global companies in terms of sales. But they are still producing their goods in Japan to sell overseas. There are still quite a few firms in Japan producing goods at the cost in Japan and selling them at Asian prices. In such cases, their productivity tends to be low. If they switch to production at Asian costs and sales at Japanese prices in the Japanese market, their productivity would be significantly higher.



**Q: So the Japanese industrial production system would need to be integrated into Asia?**

**Okuno:** Yes. Of course, there will be a negative impact upon the Japanese labor market on the whole because of this, since the industrial base would be moved to Asia. But a labor shortage will happen in Japan without a doubt. In this light, Japanese firms will have to move to Asia not only because of lower labor costs but also because of the lack of sufficient resources in the domestic market.

**Q: As you have said, it will be important for large firms to take advantage of ventures with the seeds of new technologies in encouraging innovation. IT would be a key to this but in Japan we are not ready yet to take full advantage of networking through IT in our corporate culture. Japanese businessmen would have to be more prepared to communicate with people outside their companies by using IT networks rather than their colleagues inside the company, wouldn't they?**

**Okuno:** Yes. There must be two ways of such networking. One is to take a new technology or idea from outside, and the other is to give our own technology or ideas to someone outside. In taking something from outside, we should get rid of the NIH (not invented here) syndrome, meaning "We won't use anything here unless we invented it ourselves." In giving their own technology or ideas to someone outside, in the case of large Japanese firms, in selecting and concentrating on specific products or technologies they should try to bring out ones that are not for use in their own operations, and ask other firms if they are interested in using them.

## Old Japanese Management Model

**Q: Some people may say there is a risk of the benefits of the Japanese management model, such as its humanistic and egalitarian aspects, being eroded as a result of the introduction of diversity-oriented management with more women and non-Japanese workers. For example, some Europeans would say that the Japanese management model far excels the US model in terms of its humanistic aspects, such as more egalitarian treatment for all employees. Should we abandon this humanism and move to a more capitalistic system?**

**Okuno:** This is an important issue. The question is how "the Japanese management model" is defined. In our understanding, what is currently sought after in management philosophy should be very close to the original Japanese management model. We often say now that "sustainability" is an important concept when talking about the goals of economic or business policies. This is very similar to what Japanese management originally pursues: a management

model from a long-term perspective pursuing values not only in short-run financial terms but also in non-financial outcomes, respecting a consensus decision-making process in management and a well-considered communication model with all production sites. Assuming this can be defined as “the Japanese management model”, I believe it is still a very relevant management philosophy for realizing “sustainability” in business performance.

Ironically, many Japanese companies seem to have forgotten this philosophy today. As I said at the beginning, Japanese firms have gained profits by cost cutting for the past two decades, having achieved very little sales growth. With low economic growth, no innovation, and a variety of issues related to labor market reform still unresolved, they seem to be unable to achieve any reforms in management from a long-term perspective.

There are, of course, some new business leaders who have had success with their long-term business visions in Japan. But we should warn people that it may be the traditional Japanese business leaders who have forgotten the fundamental philosophy of Japanese management.

**Q: Smooth and high-quality communication inside a company is certainly one of the important benefits of the Japanese management model, and according to a management expert this has enabled Japanese firms historically to create new ideas and technologies. Such benefits of Japanese management are disappearing today.**

**Okuno:** Yes, that is true. The Japanese firm’s organization today seems to be highly specialized and divided into a number of small sections and groups with little communication with each other. For example, people at each of Bain’s offices enjoy a short company trip every year. When we mention this to our Japanese clients, they say that their companies have not arranged such trips to boost camaraderie for the past 20 years, though they did so previously. This episode suggests that the high value Japanese management placed on having close ties among employees has been lost.

**Q: That means that apart from networking with people outside the company, competency in communication among colleagues inside the company would have to be raised.**

**Okuno:** Yes. Besides horizontal communication among colleagues, I think vertical communication between management leaders and frontline employees is important. There are only a few business leaders who aim to spend a certain amount of time on direct communication with their clients, or to visit production sites or factories every year. So, vertical communication will decrease inevitably.

As the number of management layers increase, it will be much more difficult for a president to hear from a production site or a retail shop directly engaged in business with their clients, compared with a



situation in which there is only a president and his employees. If non-Japanese employees join such a firm as we all expect now, the language barrier would make it even more difficult to have smooth communication between the management team and the frontline staff.

### **Human Resources Development Program**

**Q: We have a number of challenges facing management such as how to respond to globalization and IT or how to improve communication among increasingly diversified human resources, and how to raise creativity for innovation. These might be up to the education system of a nation, but to some extent also they are a matter of a firm’s human resources development program. What kind of human resources development program do you think would be relevant to deal with these issues?**

**Okuno:** I think there are two points to be considered. First, a Japanese company’s training system mostly highlights an average employee’s competency and how to raise it. In addition, I think it would be critical to maximize the potential of the top 5-10% performers.

Secondly, although there are a number of training programs to develop specific business skills such as accounting or personnel management, there seem to be very few programs to develop decision-making skills. When you get promoted to manager, you have to make business decisions. Therefore, decision-making competency must be developed and utilized. In some cases, good decision-makers can be promoted to managers regardless of their selling abilities. We should focus on training programs to develop decision-making capabilities when we think about the future of business in Japan.

