Publisher's Note

Evolving Japanese Management
Lessons from Toshiba's "Window Dressing"

By Kazumasa Kusaka

A few decades ago many opinion leaders in Japan, as well as around the world, were convinced that the Japanese economy would continue to grow strongly, just as many firmly believe today that the Chinese economy will do.

There is an old saying in Japan that the winners in a war or a competition should be considered as always doing the right thing. This saying suggests that we tend to jump to the wrong conclusion that business firms making good profits are always conducting themselves properly.

It is true that in the past, when Japanese industries were so competitive, they believed their strength should come from traditional Japanese management practices, characterized by lifetime employment, employees' readiness to sacrifice their personal interests for the company, long-term management vision that highly prized job security even in a deficit-producing section, and R&D that did not necessarily result in profits in the short term. This was certainly not an objective view but rather an extreme one.

At the beginning of the 1990s, the bubble economy burst in Japan and the so-called "lost two decades" followed. Then the Japanese lost confidence in their economy and reverted to an inward-lookingness, postponing corporate structural reforms to preserve their vested interests.

When the global financial crisis hit, it was only Japan that did not adopt a QE policy. Thus the yen began to appreciate. With the yen's appreciation and the emergence of its strong rival China, two crucial changes in the external business environment surrounding the Japanese economy, a Japanese firm could not help but concentrate on some selected business lines in which it had a true competitive edge. Structural reforms to make companies' activities more lean and streamlined had been in progress during the previous decade in Japanese business. It is said that what we call the "three excesses" – "excess production facilities", "excess employment" and "excess debt" – had disappeared by around 2005 because of these structural reforms.

This means even job security is now not considered a supreme objective anymore for Japanese businesses. In this structural reform process among Japanese companies, it is also notable that the money borrowed from their "main banks" for investment decreased significantly and thus a main bank's governance over companies was no longer effective. Survival of firms through such reforms could benefit labor and capital as well. Anyhow, the transformation of "Japanese management" has begun in such a way, and above all the Japanese system of lifetime employment has started to collapse.

We are now in the midst of economic reforms led by "Abenomics". The government has already done lots of work on reforms as part of its growth strategy: deregulation, labor market reform, etc. Now it is the turn of private business to lead further structural reforms of the nation.

In this context, reform of corporate governance in Japan is playing a critical role. Thanks to initiatives by thinkers such as Prof. Kunio Ito, author of the report of an advisory council on corporate governance to METI, and Prof. Keiichiro Kobayashi, co-author of a book in Japanese on "Return on Equity" (Nikkei Publishing 2014), we are starting to see a new productive relationship between companies and their shareholders. The newly adopted Japanese Code of Stewardship and Code of Corporate Governance would make ROE a critical target for a firm to meet its shareholders' interests. An ROE-oriented management could raise the productivity of capital and promote corporate growth through a dialogue with shareholders.

However, we have recently heard about Toshiba's "window dressing" scandal. The top executives of Toshiba, a renowned company in Japan, recently admitted they had been engaged in concealing losses to enhance the company's profits, apparently for several years. When faced with "challenges" from their head office to squeeze out higher profits at results season, the executives at Toshiba responded by helping the bosses to hide the damage. At first glance, it may appear that competition with rival firms was behind such deception. Nevertheless, if ROE is a major criterion for judging the essential performance of the management of a company, instead of either sales amount or corporate profits, figures showing only a company's superficial performance, it could encourage anybody in the company to try to minimize the business losses or waste of resources as soon as possible. Such scandals must obviously be avoided.

With better understanding of shareholders' interests by management and productive dialogue between them, a Japanese firm would stand a better chance of increasing earnings and growth, both of which are of crucial importance for management and shareholders.

As I have noted, new measures such as the Code of Stewardship and Code of Corporate Governance in Japan are invaluable infrastructures for revitalizing Japanese business through more mutually beneficial relations between management and shareholders. The introduction of independent directors is a crucial part of this reform and the key question for Japan in facing the Toshiba case should be how to take advantage of independent directors in order to avoid such scandals in the future and how to raise such people to be qualified as independent directors. The recent reforms in Japan expect independent directors to play the role of monitoring the overall business, including finance and accounting.

In the light of my personal experience as an independent director at a company with a long history in the US, independent directors there – a majority of the board members – took the initiative in many important managerial decisions. There were also lots of opportunities provided to enhance the capabilities of those directors in the company. The company itself was a sort of business school as well as a business venue where practical managerial decisions were made. I recall that many of the candidates for CEOs in major US companies were given an opportunity to serve as an independent director for some other companies to improve their management skills there.

Japanese business firms are now in the process of drastic reforms, and we look forward to seeing a wide range of constructive advice not only from within Japan but also from outside the country.

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