Japan's Changing Markets

By Kenji Mizuguchi

Japanese retail markets have grown and prospered hand in hand with the economy. The mass production of uniform goods that characterized the immediate postwar and income-doubling years has long since given way to a non-stop cornucopia of variety. Products that used to come in one-style-suits-all uniformity are now produced in seemingly infinite variations. Industry has gone to custom production, retail markets to consumer tracking, and consumers themselves on a wild binge of picking and choosing.

Part of this quest for variety was consumer-driven as affluence led people to want not just to keep up with the Tanakas but to differentiate themselves from all of the other Taros and Tomokos who were doing the same thing. Part of it also was manufacturer-driven as companies churned out new product after new product in a frantic bid for shelf space and market share.

Mature but unstable

Most of our everyday commodities are now mature markets. The Japanese population is leveling off, and consumption is growing only about 3% a year. Growth is therefore limited in virtually every field, be it milk or bread, cosmetics or toiletries, watches or cars, clothing or housing. There are even some areas where contraction is expected. So these are indeed mature markets in the true sense of the term.

Yet mature markets are supposed to be stable markets. Not in Japan. Here we have great instability as manufacturers battle for market share. These are tumultuous markets.

One of the reasons for this tumult is the product lineup composition. Beer is perhaps typical here. Two years ago we had Asahi's Super Dry come out of nowhere to be a market force. Now all the beer companies have "dry" beers. Last year it was Ichiban-shibori as Kirin regained market share with a full-flavor "first pressing" beer. And this year Sapporo and Suntory have weighed in with Ginjikomi and Ginnama beers using hulled malt. It is a market with new technology and new products every year. Far from being a staid mature market, it is a jungle out there.

Nor is the beer market unique in this. Instant noodles, soft drinks, cosmetics, detergents and all the rest are the same. Even fuzzy-logic washing machines and rice cookers. Refrigerators with "chill" compartments. These are just a few of the markets where we are seeing new products introduced that have the power to shake up and restructure mature markets. This competition is one of the things that makes the Japanese market so demanding and keeps Japanese companies on their toes, but it is hell on the manufacturers.

Distribution is another factor contributing to the tumult. There have been changes in distribution–changes at the consumer interface. For years after the war, Japanese marketing was manufacturer-driven. Companies made what they could, and consumers were glad to have it. At the same time, manufacturers set up their own distribution networks. Japan was a nation of manufacturer-affiliated retail outlets. There were Toshiba appliance stores, Nakamuraya bakery shops, Nishikawa bedding outlets, and Snow Brand dairy product dealers.

Today, these manufacturer-affiliated shops are less and less important. Some of the change is because they are no longer attractive occupations for mom and pop's children. Even more of it is because of the advent of chain stores and franchise retailers.

As Japanese consumers became more affluent and manufacturers expanded their product lines, superstores sprang up to serve far-flung consumer catchment basins. Daiei was perhaps the most conspicuous for its discounting, but Seiyu, Ito-Yokado and others were shoulder to shoulder carrying the full array of foods, clothing and other household necessities. As a result, consumers developed a loyalty not so much to the product as to the store. They stopped by the local 7-Eleven, and they bought whatever kind of mayonnaise the 7-Eleven had on hand.

In addition, there are also increasingly important mail-order catalog houses and other non-store stores. Catalog sales now

Photo: Kirin Brewery Co.

Amid severe competition for market share, this is the range of products of one brewery company alone.

account for ¥1,115 billion or about 1% of total retail sales. Although still small, this 1988 figure is up 17.7% over the previous year.

Frantic to cover all niches, manufacturers produced more and more variety. There were scads of products—all of them differentiated in some minor way. Manufacturers vied to get more different products to more different consumers. Although the supermarkets tried to accommodate by carrying an average of 5,000 processed food items, there were 10,000 new processed food items introduced a year. Even if all the items were replaced every year, half of the new items would never see a supermarket shelf.

It is easy to see why the manufacturers have expanded their product lineups. The diffusion of consumption has made it impossible for manufacturers to just sit back and make what is easiest. They have had to respond to market forces, and this has meant ever-more-diverse product lineups. Likewise with distribution. Customers seemed to want wider choice, and retailers had no choice but to provide it. As a result, we had many companies making and selling a wide range of products in small lots.

Yet with this glut of new products, many of them have started to look alike, and it has become increasingly difficult to establish a separate and distinct brand identity. Everybody is doing and saying the same thing. There are more brands than you can shake a consumer at.

Cutting product lineup

Ajinomoto is known for being alert to consumer trends and for having a strong sales force. They are a role model for the industry. In 1985, they had a 5.1% operating profit on 3,000 items. In 1990, this was 3.7% on 4,000 items. Kewpie is another company with strong products. In 1987, Kewpie had an operating profit of 4.6% on 8,000 items. In 1988, this was down to 2.9% on 12,000 items. All of the manufacturers are seeing their operating profit rates take a tumble. The proliferation of minor-line products has undermined the manufacturers' profit structure.

Not surprisingly, companies have therefore moved to get away from having lots of small-lot lines. In 1989, Kewpie cut back from 12,000 items to 9,000 items. In 1990, they cut back to 6,000. Ajinomoto had 4,100 items in July 1990. In August, it cut this to 3,800, and then down to 2,500. Both of these companies have found that cutting the number of lines does not hurt sales or profits. In fact, it even helps profits. Ajinomoto found that in cutting its product lineup from 4,100 items to only 2,500, gross sales declined only 4% and profits were sharply up. Shimadaya is another one who has pioneered this. In 1987, they cut their product line by half. Manufacturers have found that their sales are not hurt by a pruning of their product lines.

This same trend is evident in distribution. Processed rice and breads accounted for 18% of sales at 7-Eleven Japan when the company decided in February 1989 to cut the number of items handled from 194 to only 93. Ito-Yokado has gone from 6,000 items in 1987 to 4,000 in 1988 and then to 2,900 items in 1990. When it went from 6,000 items to only 4,000, it found its sales up 9.9%. 7-Eleven cut the number of soft drinks it handled from 100 to only 70 and found that its sales shot up 40%.

What has happened? Japanese consumers led the world in their desire for individualized products, and Japanese manufacturers were more than complying with this trend. Yet today, more and more manufacturers are cutting back on the number of products they offer and concentrating on doing fewer things better. Why the turnaround?

For one thing, there were too many look-alike products. Even though there were many, many products on the market, there was not that much perceived consumer choice. The labels looked different, but the differences were too minor to be meaningful to most consumers.

There have also been changes in the consumers themselves. They have graduated from wanting new experiences. They have graduated from dry beer, city-information magazines and other trendy items. This is best seen in generational terms. The product-starved generation that went through the war was eager to try new things and then to move on to other new things. Deprived when they were young, they never got over their kid-in-a-candyshop wonder.

The postwar baby boomers were set in their ways. They aren't going to change. They had decided that Kirin was their beer, and they were going to stick with Kirin. Dependable, no-nonsense consumers. Now the "new breed" generation that came of age in the 1980s and created this overwhelming wealth of products, magazines, restaurants and everything else has moved into positions of corporate and family responsibility. They are tired. And the children of the baby boomers—what might be called the baby boomer II generation—are unflappable. They don't react in the same enthusiastic way that the new breed did. They are laid-back. Cool. They buy the *Pia* entertainment guide, look up what they want to know, and throw the magazine away.

Third are the changes in distribution. POS (point of sales) systems are here. Retailers are now able to track their sales in near-real time. They are able to tell immediately when a product is not selling. And the big chains are able to tell this nationwide. So they can cut the non-performing items immediately.

Connected to this is the lessened impact of mass advertising. No matter how much a company spends on advertising, it is hard to distinguish the product from all the other look-alike products. At the same time, the new information systems have wide-ranging impact. Cash registers are connected to reorder programs, and the POS system separates the wheat from the chaff almost immediately. Unless a product has made the POS cut, it won't be on the shelves even when the consumer goes to look for it. Making the POS cut is all. POS has rendered a lot of mass advertising irrelevant. If it is not on the shelves—and POS data decide this—what is the point of advertising it?

Finally, there is the cost of introducing new products. Of course companies always had development and advertising costs, but there is more today. Computer programs (both your own and the retailers') have to be modified to account for the new product, time and energy have to be spent, and other resources marshaled. Items have to be kept in stock, which creates additional costs. There are inventories at the plant, wholesaler inventories and retailer inventories. All of these inventories have to be kept filled. The items that sell are quickly out of stock. The ones that don't sell pile up until they get returned.

These inventory costs are compounded by the idea of same-day delivery and freshness management. People want the freshest possible item. And the labor shortage means that companies can't find enough drivers for all of their delivery trucks. It is a management nightmare.

Although manufacturers were in the forefront of the drive for greater product diversification, they have found that it is like the arms race–imposing increased costs but offering no greater security. As a result, some of the stronger companies are backing away. And in the process, they are discovering that they no longer need to take part in this race for evermore items. They are discovering that they can safely cut back on the number of items they handle–and that cutting back can even be good for their health. They have found that cutting back cuts their costs, enhances their productivity and their profits, and reduces customer dissatisfaction.

As a result, we have major changes under way in manufacturer marketing. As a result, we have interface marketing and an emphasis on functional innovation.

Three market interfaces

Manufacturers are making an effort to interface with consumers in three areas: their affiliated outlets, the mass-market outlets and the quasi-OEM outlets.

The affiliated or friendly outlets are the stores that were at their height in the 1960s and 1970s. The demand at that time was family demand. Spending was household spending. These are people now in their 50s. They are the people who set up housekeeping when the affiliated outlets were going into place. And the manufacturer-affiliated distribution channel operators are the same age. This is "need" driven marketing, and customers don't even come to the store if they don't think they need the product.

Delivery logistics become more important for just-in-time marketing, while the labor shortage is almost chronic–a major headache for management.

For these outlets, the manufacturers need the kind of marketing where a few flagship products have established the brand identity and product life cycles are long. The distribution is largely through maker-affiliated channels–through wholesalers to independent mom and pop stores. Deliveries are bulk, and conditions favorable because product life cycles are long. Sometimes deliveries can be once a year. Typically, the seller has most of the information and the buyer has little information. A good example here would be the person who buys a pen at the stationery shop. This is still a very important market, and many manufacturers are making money here, but it is not the dominant distribution channel it once was.

By contrast is the person who buys her watch not from a jewelry store but from a discount house. These are the people who buy their light bulbs at the local convenience store. Dominated by retail chains, this distribution channel is characterized by the retailer's effort to minimize inventory and to demand small-lot deliveries to replace what is sold. This is just-in-time marketing. It is an increasingly important channel, but it is so demanding that it is not very profitable for the manufacturers.

These mass-market outlets are wreaking havoc with the manufacturer-affiliated distribution channels. They are making a mess of the orderly structure that was marketing in Japan. Having come into their own in the 1970s and 1980s, they cross, mix, and blur manufacturer and product lines. The shoppers are now in their 40s. So are the retailers. Yet the retailers are not independent retailers. They are parts of chains. Conversely, the shoppers see themselves less as family representatives and more as independent individuals.

This is both family and personal demand, but more and more it is personal demand. Housewives are getting out of the house more. They are not stocking up on things as much. There are more products involved, with less brand identification as each item takes on an independent identity of its own, and product life cycles get shorter. Distribution is less receptive to wholesaler leadership. Delivery is replacement delivery to maintain stocks of products that are selling well. Delivery logistics become more important, and it is more important that each product be delivered in the requisite number at the requisite time and the requisite place. This is just-in-time marketing. And it is subject to strict POS management.

And third is the person who buys the product not as the product itself but as an adjunct to another product. It is the person who does not buy a hamburger bun but buys a hamburger that comes with a bun. This is marketing where the retailer adds product or service value. It is an area where the manufacturer's product is treated like a commodity. Typical here are the salad dressing used at restaurants, the printer that came with your personal computer, and the cosmetics that they use at the beauty shop. It is a rapidly growing market, but one that manufacturers have not really caught up with yet.

The quasi-OEM outlets are characterized by services. The other two are mainly dealing in things. Quasi-OEM outlets are dealing in services. These stores were established in the 1980s and 1990s. They were created as services came to account for more than half of family spending. There was family demand, but there was also considerable personal demand. These are mainly young people. These are stores where the traditional maker accounts for only about 10% of the cost of the product, the rest being added by the retailer. The bulk of the costs are service costs.

Here the manufacturer has virtually faded from view. Far from leading these markets, the manufacturer is subservient to them. There are two ways this happens. One is with manufacturers that produce parts and components for integrated "system" products. And the other is when they produce materials for other services. In both, the manufacturer's output has changed from consumer goods to industrial goods. The final consumer does not even know who has made the parts or what the brand names are. The loyalty is to the system, not the brand. Specs are all. The main distribution is through processors, system producers and service chains. Delivery is only to meet replacement demand.

Three-pronged effort

Any manufacturer who wants to revitalize sales has to approach all three of these markets lest he run the risk of losing consumer exposure. Yet since all three of these markets are fundamentally different, this means that three different approaches must be taken to revitalize marketing. It is not a question of one being better than the other. They are all valid, and all different. There are three different kinds of markets existing side by side in Japan. No manufacturer can afford to concentrate on only one of these marketing channels. They all have to do all three at once.

For the affiliated outlets, manufacturers need to work on strengthening store management and establishing brand identity and brand loyalty. In the mass markets, they need to work on improving the profit ratio and need to make sure the distribution system gets the products where they will be seen by potential consumers. And in quasi-OEM markets, they need to have the courage to fade into the background and to accept the changing industrial structure.

These three interfaces can also be explained in terms of night and day, urban and rural. The urban areas are heavily into mass-market outlets and quasi-OEM outlets, and outlying areas more into affiliated outlets. During the day, the bulk of the demand is at affiliated outlets, but at night it shifts to mass-market outlets and quasi-OEM outlets. This does not mean that any of these is ever nonexistent. It simply means that they have different constituencies and different communication needs.

Focus on functional innovation

At the same time that they are developing strengths in all three of these interface areas, they need to look for approaches that can help them across the board. Functional innovation is one answer. Japanese manufacturers need to refocus on their traditional product development—which does not mean rushing to copy the competition in a flood of look-alikes.

It means developing new products with not just one but three or four startling innovations. Kao says that it will not call a product "new" unless it contains at least three innovations. Sony demands at least four eye-opening features before it will trumpet a product as new. Technology commercialization is needed, and this is different from mere technology. It means getting the technology into the product and out to the consumer.

Better brand management is another important area that can help in at least two of the three marketing areas. The "new breed" that sought out minor differences and stratifications is growing tired. The market leadership is shifting to the unresponsive baby boomer II generation. It is time to hone brand identity. More companies will have to treat their different brands as separate companies, the way Procter & Gamble does. Brand concepts are becoming more important than product specs.

One more thing that can help is a greater emphasis on production to order. Matsushita Electric Works produces kitchens that way. After consulting intensely with the customer on what kind of a kitchen she wants, they draw up the specifications and make it. Every unit is order-made. And now this is standard in expensive kitchens. At Nissan's Oppama plant, each car is different. They are all basically the same, but there is individualization within the production process. This is individualization based not on manufacturer speculation but on consumer specification, and it is likely to become more prevalent.

Manufacturers need to be linked directly with the market. If they can produce on command, they can dispense with much of the reliance on outlets. This is now possible thanks to the advances in electronics. This is expected to work to the advantage of manufacturers and to the disadvantage of middlemen. What are the middlemen to do? They should be set up to add value. In effect, the middlemen should become manufacturers. This is already happening as with bread baked fresh on the premises.

And consistent with this need to be close to the market, there is a new questioning of the hierarchical structure that has concentrated authority at the top, that has divided planning and production, and that has divided line and staff function. Kirin has said that frontline strategies are more important than headquarters strategies if they really want to satisfy the customer. It is, after all, the frontline sales people who are closest to the customer. Ways must be found to enable the frontline sales people to deal directly with the design and production people.

Markets are more than just the consumer interface. Manufacturers need strategic vision at both the head office and the local outlets. Ideally, this would mean that the manufacturer and the retailer would be complementary—that strong manufacturers would be to the retailers' advantage and that strong retailers would be to the manufacturers' advantage. It is still too early to tell, but we may be moving in that direction.

Kenji Mizuguchi is president of the Strategic Design Institute in Tokyo and international chairman of Marketing Communications Executives International.