

Interview with Kobayashi Yotaro Chairman of Fuji Xerox Co., Ltd.

Interviewer – James C. Abegglen

Abegglen: *Perhaps we might begin by asking, since we are in turbulent times, and difficult times for Japan in particular, what do you see as the main outcomes over the next year or two? What trends in the economy and what trends in Japan itself? For example, the reports are that the Japanese public is taking a very pessimistic view of Japan's future.*

Kobayashi: Yes.

Abegglen: *Understandable in a way, given the turmoil in the world and the problems of deflation and all. From your point of view, from a notably international point of view, how do you see the prospects for the next few years?*

Kobayashi: There are two aspects of how we view Japan in the next year or two. How we in Japan view Japan is one, and the other is how others view Japan. This latter is probably more important in many respects, particularly for the stock market and particularly after Sept. 11 when the world had to discuss the issue, "Has the world really changed?" and if so, "Is America changing?" Yes or no. And even if the answer seems to be yes, is the change permanent or only temporary? Regarding the outside view of Japan, what has interested me particularly in the last month or so, as a possible change, is the view held by our neighboring countries, particularly China and Korea, as told by friends in those countries and other Asian countries, that are more permissive of Japan's efforts to become a "Normal State." I think this is a major change, but some American friends warned me not to take it for granted or at face value. But if it is

permanent, it is a very, very major change.

The other change, which has become more marked, is that the expectations of the world for Japanese economic recovery are greater, and because expectations are greater, frustrations are also bigger. Standard & Poors and Moody's Investors Service recently downgraded Japan's sovereign rating and that is an indication of how disappointed the markets are, in terms of progress in restructuring the Japanese economy. These two views for the long-term and short-term will be very important in shaping public policies and the strategies of Japanese corporations, as well as the view of the Japanese in general. Although it is difficult to define who the average Japanese are, they will influence how the middle of the road Japanese will think and behave in and outside Japan in the next couple of years.

Economically, we really are approaching a very crucial time, largely because of the messages that the markets both domestically and abroad are sending, via policy makers and also corporate leaders. And the message simply is, "Speed up the process of restructuring. Unless you continue with that process, we will not take your efforts seriously. Don't listen to the short-term theorists and don't push us toward another downgrading of your sovereign rating." As we all know, domestically the role of ratings and the results of ratings, particularly the downgrading, have displeased a lot of people. Some even say, "What do they know about it?"

What is important though is that they have told us very clearly that Japan still does not seem to possess

a decisive enough political will as a nation to deal with current problems, for example to deal with non-performing loans.

Abegglen: *There is an assumption here that everyone else moves very rapidly, and only Japan moves slowly – a dubious assumption. But in that context you were saying that policy makers and business leaders are two separate groups, each trying to address these problems. To what extent can the business community in Japan, leaders like yourself, influence policy? To what extent can you help determine the direction of policy and the pace at which policy is implemented? How does that work in Japan, as you see it? You are in a particularly advantageous position to judge the process.*

Kobayashi: Most business leaders, I think, are in a good position to influence policy in positive ways, because their views are taken seriously and followed by Prime Minister Koizumi Jun'ichiro. Often the Tokyo Chamber of Commerce and Industry will take a different position simply because of its constituency – small and medium-sized businesses, now in a difficult situation. But the Japan Federation of Economic Organizations (Keidanren) in particular will voice support more openly, and is basically behind his restructuring plan. We are aware that even within the Japan Association of Corporate Executives (Keizai Doyukai) there are people who claim that if Koizumi continues with his plans, the Japanese economy will be doomed from which no recovery is possible. I don't agree with that view and most of our mainline people don't agree with that for a couple

of reasons. One is that it is totally unfair to say that all of Koizumi's predecessors did nothing. They did some things, but the process was very slow for both good and bad reasons. And at the same time, while the process was taken up with wrong timing, the need for Japan's restructuring did not wait. Koizumi found the timetable pretty tight; he knew he had to move fast; he knew if he did that it would make a lot of people unhappy, or at least uncertain and afraid. But I have a good source close to Koizumi that makes me believe he is no restructuring fundamentalist. He is concerned with the outcome of his programs. He does not intend to break the Japanese economy all the way down to nothing.

I mean he does not want to commit suicide when he has to call the last shot if necessary. He also knows that his predecessors somehow succumbed to the pressures at the last moment. So the restructuring process, which should have been done at least several years before, has been delayed to Japan's disadvantage, putting Japan at a terrible disadvantage in international competition.

So people support him, and at the same time, because a lot of Japanese working people are long used to stable employment, it is difficult for each employee and for workers in general to adapt to a new situation where mobility becomes the norm. Also a lot of firms are going down. So it is necessary to have a thorough safety net, even at the risk of being more costly of government funds. It is also important that the safety net programs are known, and that people know they work.



Chairman Kobayashi Yotaro giving an interview at his office

At the moment, the money side of the safety net – how much money is being spent – is broadcast. But how it will be used, how it can benefit people who are out of jobs and who are willing to try for new jobs, what is available and so forth are not really well understood. This is very, very important.

Abegglen: *That leads to an interesting issue that follows directly from this matter. That is, to what extent will the management systems change under all this restructuring? In a sense, you are speaking to the issue of employment security and employee compensation, the trade-off between the shareholders' and the employees' interests – the issues around corporate governance.*

Kobayashi: That is a very crucial issue. What are going to be the basic values on which the Japanese company will build its corporate governance systems? The mecha-

nisms are being discussed a lot here, but the key issue is what for?

My belief is in the stakeholders-management model. I personally believe that there has never been anything else, but of the multiple numbers of stakeholders at any time there may be a slightly different emphasis placed by management. Now, for the Japanese at least up to the bursting of the bubble, shareholders have not fared well at all, particularly compared to their counterparts abroad in other markets, so shifting the emphasis to the shareholders is important, as unless we do better shareholders will take their money away. But the way some shareholder value maximization fundamentalists hold forth, that is to put shareholders' interests above anything else at all times, their views are often, and wrongly, put down as "typical American." Actually, I don't think it is really typical of the blue-chip American companies. If you take Johnson & Johnson (J&J)

for example, the company has a long-standing credo that put customers first, then employees, community and shareholders. Not that shareholders enjoy the least importance. These are J&J's stakeholders, and their belief is that unless you have a satisfied customer in the first place, there will be no business for others to share the fruits. One particular fact about the popular market view about shareholders now is that unless you take actions which will immediately improve your salary and returns, your stock price will go down. Of course management is well aware of that particular fact and try to accommodate their wish. But I challenge that notion as not all the analysts are that ego-centric. The management has to beef up its intellect and real weapons to tell the market what he/she and his/her team are planning to do. My company will still have to go with the present employment, but we have plans to reequip them and help them retrain themselves, so that they will be useful in those areas where we are investing for future growth. For the short term our profits might not be what you would like, but I don't think it is right to let employees go, when we have spent so much money in training them and when they are valuable employees. This model is a viable one, but unfortunately a lot of management people are afraid to face the market with such a story.

Abegglen: There is a question here. I think some of what you are describing, and I have no disagreement, has been in the context of the American bubble. As the American bubble bursts, perhaps some of the enthusiasm for "maximizing shareholder value," which can be a very short-term concept, will drop back into proper perspective.

Economic Forum) in January, that tone was already emerging visibly and it had gone too far. The market had gone too far and we had accepted them as the American model too easily.

Abegglen: So the Japanese fundamental values will regain their currency at least to some degree as the markets go back to normal?

Kobayashi: Yes, but I think the danger on the other hand for the Japanese side is that we should not take it for granted, claiming, "Oh, our model was right after all." No, our model was not right. Balancing is always very important. We in Japan have to pay more attention to the shareholders, but not at the expense of other stakeholders, particularly employees. I still remember your book in 1956, and you did say already some forty-plus years ago that the Japanese employment system is more humane, but it is viable only when growth is guaranteed, and that when growth stops it suddenly becomes a burden. You were so right.

The Japanese employment system in many ways valued job security the most, and valued or encouraged developing specific organization-oriented skills, which may not be viable in the open market. That model worked when mobility was not necessary. However, today, where the outlook for population growth is limited, logic tells you that we have to encourage mobility, particularly of younger people. Young people today are a little more impatient and it is more interesting for them to have more opportunities. Therefore, it is wrong to tell them, "It is important to work for one company." Maybe not for life, but for a long, long time. Sometimes people have

long run, both workers and companies will benefit, but still a lot of companies are being captive of a very static sense of corporate loyalty in their policies.

Abegglen: Let me ask this question. Certainly the population diminution over the next few decades affects the market growth potential. In this context and referencing back to your early remarks about increasingly close interaction between Japan and China, it seems to me that China has the labor supply and the markets that Japan needs, while Japan has the technology and capital that China needs. There are political hazards obviously, but I notice that in your annual report you speak very directly to the prospect of Fuji Xerox making China a manufacturing and marketing base. How do you see relations with China developing from Japan's point of view?

Kobayashi: In the long term, of course, we have to develop a much closer relationship, easier said than done. We still have to overcome some of the historical background, but younger people in general are more forward looking, so the chances of our developing a much closer working relationship between Japan and China are great and growing. I am no China expert, and I am simplifying the whole thing. But China really has developed on an even bigger scale than Japan in the '50s and '60s; they have doubled their system's scale already. The top end of the economy is the Coastal Zone and it is being mobilized very, very fast. But supporting that top end are huge inland areas of poverty, much like the part that used to be called a "rabbit hutch" in Japan. It is no secret that Japan for sometime took full advantage of that particular

are doing. I think we have to accept this even at the risk of creating a hollowing out situation at home, because China has great competitive advantages as the world factory. And that is the reason why we Fuji Xerox are going into China aggressively. Because we invest a lot of money to be in China, we have to make the most of that investment. At the same time, as you say, there are a couple of ways in which Japan and China can really cooperate. And of course the pressure and threat from China becoming real makes a working pressure for us to think and develop something new, something different with high-value added.

Regarding the environment-related market, it offers many opportunities due to a great deal of progress we made, and interesting technical developments with products being wanted in this area both in and outside Japan. Now when we talk about environment, China is often placed in a class below us as the American press says, "Unless China and the other developing nations join, we will not sign." The Kyoto Protocol for example. But what I hear is that there is a lot of technological progress being made. Because of their political system, they can do a lot of trials that we cannot do as a democratic country. The technology may not even be their own technology, but instead may be Japanese. But a lot of interesting trials are being done for a large scale eco-community design and creation for their own sake, and for our own sake. This area offers a tremendous opportunity for China and Japan to work together.

Abegglen: *Does this suggest that Japan should play a larger role in Asia in general, that if the Chinese relationship can be resolved adequately and constructively, then you could see the two countries together really bringing Asia into a more effective kind of economic area?*

Kobayashi: Right now, because a lot of concern about trade is voiced in Japan, and we have been talking about the safeguard of small items, I think realistically speaking domestic issues are always important for relations between Japan and China. But of course as a nation that respects free trade and open markets, we should not rely on safeguards unless it is absolutely necessary. But then in the future, there may be times when we will have to call for utilizing something like safeguards within the permissible rules of the World Trade Organization (WTO). What I think is very important for Japan is that Japan becomes tough, smart and shrewd.

Abegglen: *And outspoken.*

Kobayashi: Outspoken which Japan has not been particularly good at in the past, a new skill which Japan has to learn.

Abegglen: *And it would help the world if Japan were more outspoken.*

Kobayashi: Absolutely. We all know that Great Britain and America, while advocates of free trade, have of necessity also used the so-called managed trade. But their strength really has been in that, in most cases, their trading partners or competitors knew that they will be after all reasonable, and that they are doing managed trade for certain reasons. In reality, you have to understand it is not an ideal and fair trade and, now and then, there will be managed trades. But with that political ability, those diplomatic skills and even statesman-like skills in the private sector as well that make up the total political ability, we will be able to manage the Japan-China situ-



Interviewer James Abegglen

ation quite well. Chinese leaders are both quite smart and realistic.

Abegglen: *To switch topics for a moment, I have been looking at some numbers recently that have been really dismaying, on the diminished incidence of the formation of new companies in Japan. Over the past couple of decades there has been a distinct decline in the number of start-ups, of new ventures, in contrast to the United States and some other economies where if anything there has been a tendency toward increase. What can we in Japan do to remedy this, and to encourage more entrepreneurial efforts on the part of younger people in particular? Your business is very much in this changing technology sector so you must be sensitive to this. What can we do to make this work better?*

Kobayashi: I wish I knew the answer, and wish you would tell me. This question of the need to encourage venture businesses and venture capital has long been discussed. Many people have challenged this issue within Keizai Doyukai, such as Mogi Yuzaburo (President and Chief Executive Officer of Kikkoman Corp.) and Kitashiro Kakutaro (Chairman of IBM Japan Ltd.). At our annual seminar, the guest speaker Horiba Masao (Chairman of Horiba, Ltd.) was very outspoken and interesting, and he was address-

ing the cultural side of the problem. He was saying that in the United States you may fail twice, but you came back and you try three times. But in Japan if you fail once, that's it. There is no second time, no third time. He was exaggerating, but was really not so far from the truth.

I think part of the problem is the attitude of big business toward small ventures, particularly when they come to do business. It has to be reflected in a new and different system within the organization which will encourage people, for instance, the man in charge of purchasing for taking risks. But, in fact, the system discourages the man in charge of purchasing from trying something new. He knows that there are lots of interesting technologies. "I would like to try, but if I fail, I may lose my job. So let's go with the safest and/or the weakest. I can put the pressure on and come out with the lowest price." Now, this really has to change. Even today, because of this culture, we have a system that is very strange, even funny. The purchasing manager asks a new person who has been introduced by someone and who has an interesting technology that has been tested. But the first question usually asked is: "Do you have a business record with our firm?" "No sir, this is the first time." "Oh, in that case, I am sorry, we cannot help as we have other candidates who have been..."

The problem is not just this man's attitude. How he is being viewed, and how he is being evaluated is all the more important. The system in big business really has to change to encourage trying something new. However, we have now the Japanese version of Nasdaq, and the Mother's market as well. Stock options are still at their early stage but these markets are slowly developing.

Abegglen: *I get the impression that the Kansai region – Kyoto and environs – has in fact been more of a*

source of entrepreneurial companies than the Tokyo area. I am thinking of recent major successes like Murata Manufacturing Co., Rohm Co. and Keyence Corp. as examples. Companies that have come out of obscurity to leadership. Perhaps there is a cultural aspect to this issue of venturing. Tokyo is where the monolithic institutions are.

Kobayashi: I think there is a cultural aspect too. As still another example, Kyoto University produced more Nobel laureates than the University of Tokyo, so there must be something to it. I am encouraged by the fact that the national universities are being forced to become a sort of corporation. There is no denying that there are lots of talents. A new system may force these talents to flourish, especially in the technology sectors, and encourage them to bring up the new ventures and new businesses.

I think we are undergoing a very crucial short-term and a long-term period of crises. Koizumi is a good leader, the kind of leader we have not had for a long time, although there are still some aspects that we cannot fathom. I will personally vouch for him. The private sector in general is like the position of the Tokyo Chamber of Commerce and Industry, that we need to develop specific policy programs addressing the small businesses' sufferings. But there are a couple of fundamentals. One is the certainty that we have to look after those who suffer from losing jobs, but at the same time we cannot afford to have the same number of businesses forever. Some of them have to go. There is a huge overcapacity.

And the labor market problem is real. We have to develop a system to encourage mobility. In that sense the current discussion of work sharing is important. In the long term, it probably is a fit to the Japanese system, better than other situations

where there may be some labor population growth potential. We do not have that potential in Japan, and there is a certain limit as to how many non-Japanese we can bring in to that. The labor market and mobility situation is critical, along with putting more emphasis on positive aspects of personnel rather than just the job security aspect, or passive side. And here the issue of corporate governance becomes important. Not just the mechanisms of corporate governance. What is important is the full purpose and the objectives of corporations and how those objectives are valued and protected. Both the fundamentals and the mechanism have to be attacked at the same time. My concern is that, in Japan, discussion of corporate governance has become almost totally an issue of mechanisms, which is important but is only fifty percent of the picture.

Abegglen: *Well, thank you very much.*

Kobayashi: Jim, always nice to see you.

Abegglen: *Good to see you.*

Kobayashi: Always something new for me. JTI

Kobayashi Yotaro is the chairman of the Board at Fuji Xerox Co., Ltd. and the chairman of Keizai Doyukai (The Japan Association of Corporate Executives). He is also an Advisory Council member for JP Morgan's International Council and Stanford University's Institute of International Studies.

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