The Stakes and The Statistics

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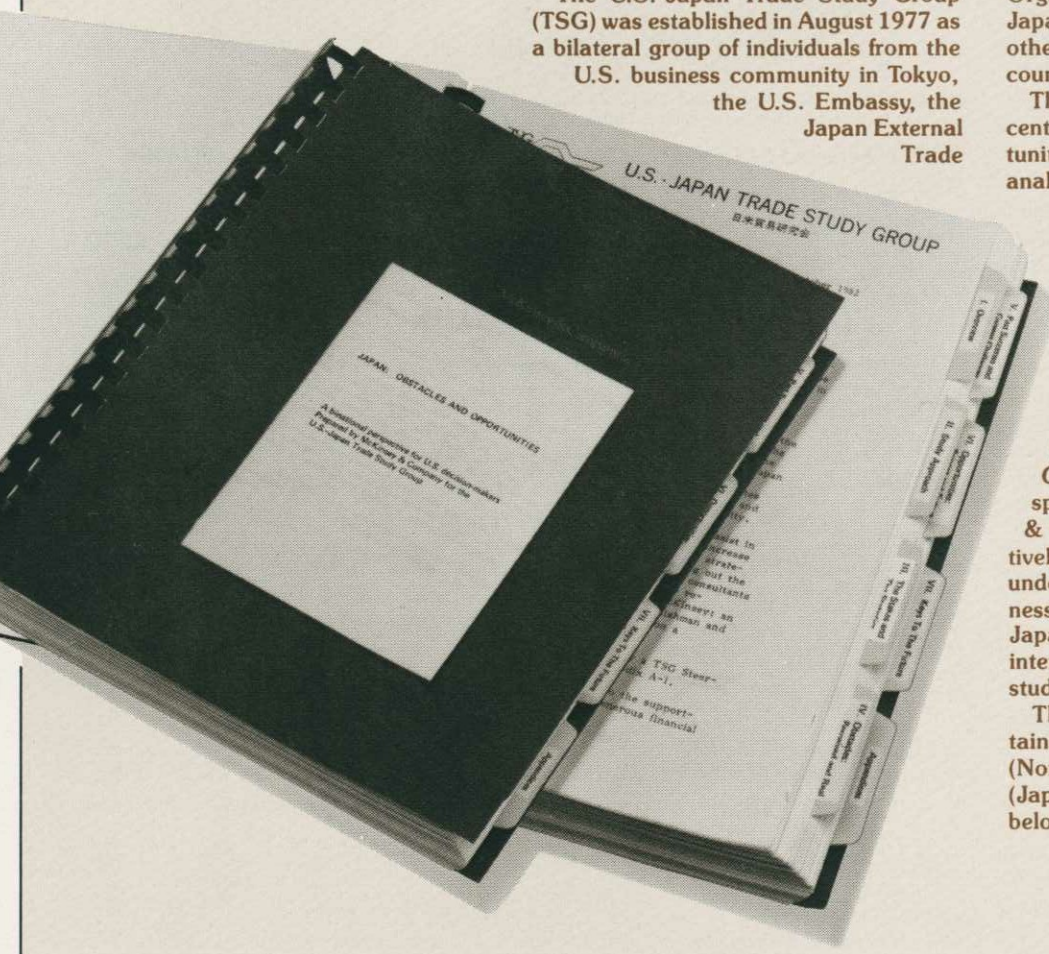


The U.S.-Japan Trade Study Group (TSG) was established in August 1977 as a bilateral group of individuals from the U.S. business community in Tokyo, the U.S. Embassy, the Japan External Trade Organization, Keidanren, MITI, the Japan-U.S. Economic Council, and other organizations interested in the two countries' bilateral trade relations.

The TSG's main efforts have been concentrated on studying marketing opportunities for U.S. products and services, analyzing various impediments to increased sales of U.S. goods and services in Japan, and recommending ways in which these impediments might be overcome and trade expanded in the context of a free trading system.

The group has met frequently and productively. One result is the compilation of a 200-page report entitled *JAPAN: Obstacles and Opportunities*. This report, jointly sponsored by the TSG and McKinsey & Co., is intended to address objectively the highly debated and usually misunderstood issues in America's business presence in Japan. Numerous Japanese and American executives were interviewed to give the report a "case study" substantiation.

The full text of the report may be obtained from John Wiley & Sons, Inc. (North America) or President, Inc. (Japan), but a special summary is given below for *JOURNAL* readers.

Japan is the free world's second largest market. Its 1981 GNP of $1,127 billion was slightly less than half that of the U.S., almost double that of West Germany, and equal to the combined GNPs of France and Britain.

Despite the impressive size and apparent potential of this market, there is strong evidence to indicate that exporters and investors are being needlessly discouraged by misleading assumptions about Japan's business prowess and domestic market.

The report highlights two findings:

— Overall, the U.S. presence in and penetration of the Japanese marketplace is greater than is generally perceived.

— Although the U.S. remains the single largest direct foreign investor in Japan, its share of the total has been declining.

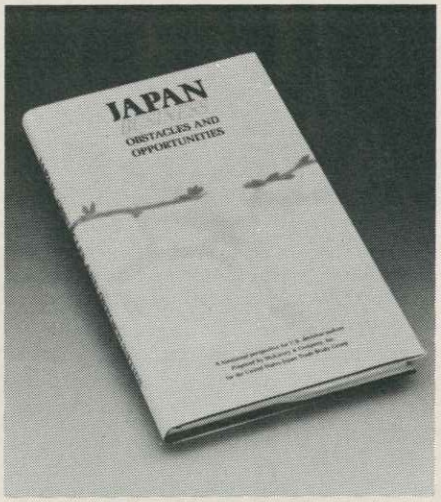
U.S. Exports to Japan

The highly publicized U.S.-Japan trade imbalance ($18 million in 1981) tends to overshadow the substantial inroads American goods have made into the Japanese marketplace, both in value ($22 billion in 1981) and in variety. According to data prepared by the U.S. Embassy in Tokyo, more than 5,000 agents trade approximately 50,000 U.S. manufactured products in Japan.

Moreover, balance-of-payment accounting focuses primarily on the movement of tangible goods and does not include services traded. In services, the U.S. lead in 1980 was between $1.8 billion (Japanese data base) and $3.3 billion (U.S. data base).

In fact, over the past decade, U.S. service exports to Japan grew at a rate equal to or higher than Japanese service exports to the U.S. Licensing receipts from Japan—included as part of the service trade statistics—were $809 million in 1980, reflecting an average growth of 22.1% a year since the 1970s. Fees and royalties from technology agreements and other royalty-rich market sectors such as proprietary soft-drink concentrates, records, printed materials, and movies represent one of the most frequently found forms of participation in Japan by U.S. firms and create substantial wealth for U.S. companies.

If total U.S.-to-Japan export volume is greater than generally perceived, so, too, is the penetration of U.S. exports into the



200-Page TSG report has just been published in Japan.

Japanese market, as illustrated by Fig. 1, which presents imports in terms of total GNP. Although U.S. imports accounted for slightly less than 2% of Japan's GNP in 1981, this figure is almost 50% greater than Japan's penetration in America (1.3% of U.S. GNP).

Japanese penetration in the U.S., however, has been far more visible. Sectors where it has a 5% or more market share have been concentrated in volume-driven industries (e.g., steel, consumer electronics, cameras). In addition, Japanese inroads into America's subcompact auto sector (which equal the dollar value of all its other exports to the U.S.) have had a powerful emotional impact.

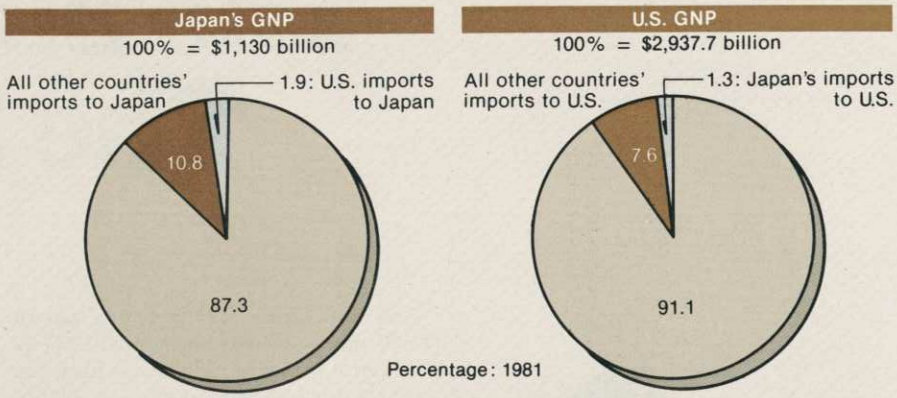
By contrast, U.S. penetration into Japanese manufacturing sectors has been broader but less obvious, encompassing a wide range of industries. Japan is America's number one foreign purchaser of commercial aircraft, organic and inorganic chemicals, pharmaceuticals, and photographic supplies, and the second largest purchaser of medical and scientific supplies, measuring and testing devices, pulp and wood products, and semiconductors.

U.S. Presence in Japan

Another measure of American "presence" in Japan is the number and size of its sales and manufacturing facilities in the country, which are significantly larger than for other foreign countries. Of the 1,986 FACs (foreign affiliated companies) operating in Japan in 1981, 671 (34%) were American. A sampling of a significant portion of the FACs revealed that America's ratio of participation parallels that of other FACs across many major industry categories and is not concentrated in primary or resource-rich sectors (Fig. 2).

In terms of rank, share, sales, and profits, many FACs have established a strong position. Of the approximately 700 FACs for which market rankings could be identified, 85% ranked among the top 10 in

Fig. 1 Comparison of U.S./Japan's GNP and Import Penetration Ratios



(Sources) Customs and Tariff Bureau, Ministry of Finance; "Survey of Current Business," U.S. Department of Commerce, 1981

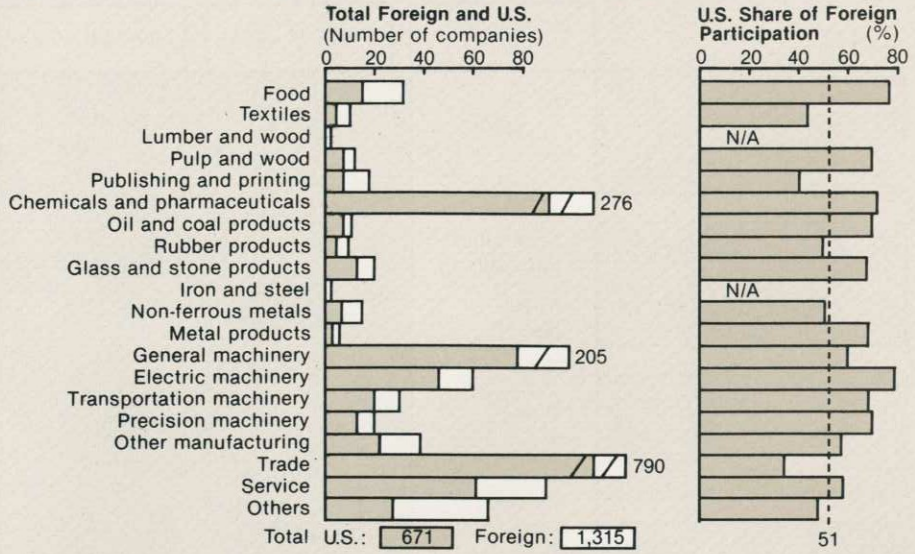
Table 1 Selected FACs with Leading Positions in Their Market Sectors (1980)

U.S. nationality

Sector Rank	Market Sector	No. of Companies in Sector	Name of Local Company	Foreign Investor	Foreign Capital Ratio (%)
1	Miscellaneous wholesale goods*	4,958	CBS Sony	CBS	50
1	Tea and coffee	1,989	Nestlé Japan	Nestlé Alimentana S.A.	100
1	Wholesale precious metals and jewelry	1,401	Hirako	Kamlesh Kamchard Panjab Family	65
1	Misc. fabricated metal products	497	Yokohama Aeroquip	Aeroquip International Inc.	35
1	Miscellaneous textile apparel	441	Toyobo Petcord	Goodyear Tire & Rubber	50
1	Plastic film	358	Mitsubishi Monsanto	Monsanto Company	59
1	Retail precious metals and jewelry	289	Oriental Diamond Kogyo	De Beers European Holding	50
1	Electron tubes and ICs	257	Matsushita Denshi Kogyo	N.V. Philips' Gloeilampen-fabrieken	35
1	Ship engines	131	Sanshin Kogyo	Marinpower Corp.	38
2	Wholesale petroleum	2,938	Shell Sekiyu	Shell	100
2	Restaurants	3,714	McDonald's	McDonald's Corp.	50
2	Miscellaneous retail goods	2,245	Britannica Japan	Encyclopaedia Britannica	100
2	Miscellaneous professional services	551	Manpower Japan	Manpower, Inc.	100
2	Electrical measuring equipment	551	Yamatake Honeywell	Honeywell Inc.	50
2	Office and household machines	422	Fuji Xerox	Xerox Corp.	50
2	Paper products	415	Toppan Moore	Moore Corp. Ltd.	45
2	Electron tubes and ICs	257	Texas Instruments Japan	Texas Instruments	100
2	Records and music tapes	89	Toshiba EMI	EMI	50
3	Wholesale petroleum	2,938	Mobil Sekiyu	Mobil Oil	100
3	Tea and coffee	1,989	Ajinomoto General Foods	General Foods	50
3	Wholesale special industrial machinery	1,897	Printing-Machine Trading Co.	East Asiatic Corp. Heidelberger Druckmaschinen A.G.	70.46
3	Oils and fats; dyestuffs and waxes	1,550	Nippon Paint International	Charoen Pokphand	36.75
3	Wholesale fruits and vegetables	1,432	Kyokuto Fruits	United Brands	88.8
3	Miscellaneous industrial machines	652	Max	Textron Inc. and others	50
3	Construction and mining machinery	633	Caterpillar Mitsubishi	Caterpillar	50
3	Measuring and testing equipment	572	Tokyo Keiki	Sperry Rand Corp.	31.5
3	General trading	565	Sansei Japan	Samsung Moolson Co.	100
3	Underwear	453	IFG Japan	Triumph International	100
3	Office machine rental services	386	Fuyo General Lease	Citicorp Person to Person Inc.	33.3
3	Tar products and dyestuffs	142	Nippon Polyurethane Industry	Imperial Chemical	25
3	Liquified petroleum gas	99	Teikoku Sanso	Société l'Air Liquide	64.4
3	Records and music tapes	89	Polydor	Polydor International	51
3	Aluminum and alloys	65	Furukawa Aluminum Kogyo	Aluminum Co. of America	35.3
4	Wholesale petroleum	2,938	Esso Sekiyu	Esso Eastern Inc.	100
4	Valves and related parts	446	Eagle Industries	Sealol and others	30.8
4	Processed paper	436	Gotenba Tetra Pak	Tetra Pak International	100
4	Automobile transmissions	312	Aishin Warner	Borg-Warner Corp.	50
4	Plastics	165	Asahi Dow	Dow Chemical	50
4	Records and music tapes	89	Warner Pioneer	Warner Brothers Records Inc.	51
4	Glassware	86	Nihon Glass	Owens-Illinois	30
4	Agricultural chemicals	68	Nihon Tokushu Noyaku Seizo	Bayer A.G.	50
5	Wholesale office and service industry machines	3,266	Burroughs	Burroughs Corp.	100
5	Cosmetics and soaps	1,465	Procter & Gamble Sunhome	Procter & Gamble	100
5	Retail drugs and cosmetics	1,237	Shaklee Japan	C.R. International	100
5	Miscellaneous electrical machinery	167	Toshiba Ray-o-Vac	ESB International Corp.	43.3

*Music tapes, records and films
(Source) "Imperial Company Yearbook," Imperial Data Bank, 1982

Fig. 2 Presence of Foreign Affiliated Companies(FACs) Operating in Japan* (1980)



*Companies with more than 25% foreign capital participation; excludes branches
(Source) MITI

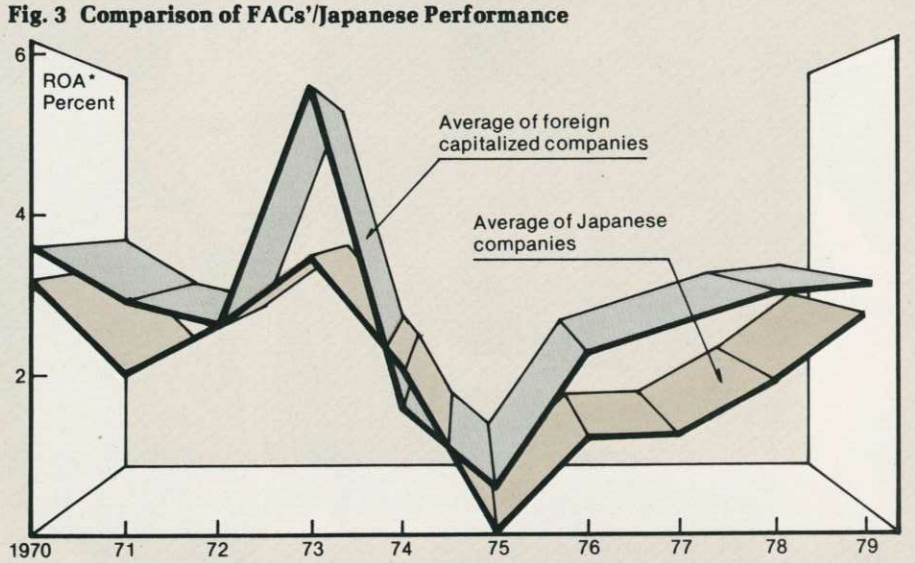
Table 2 Top Foreign Profit-Makers in Japan

U.S. investor

Profit Ranking Among All Companies in Japan	Pre-Tax Profit* ($ millions)	Company Name	Foreign Investor	Capital Ratio (%)
26	319	IBM Japan	IBM World Trade	100
51	183	Nestlé Japan	Nestlé Alimentana S.A.	100
54	182	Toyo Kogyo	Ford Motor	25.7
59	169	Matsushita Denshi Kogyo	N.V. Philips' Gloeilampenfabrieken	35
74	136	Toa Nenryo Kogyo	Esso Eastern Inc. and Mobil Oil	50.1
82	129	General Sekiyu	Esso Eastern Inc.	49
92	117	Fuji Xerox	Xerox Corp.	50
121	93	Mobil Sekiyu	Mobil Oil	100
125	89	Esso Sekiyu	Esso Eastern Inc.	100
142	77	Isuzu Motors	General Motors	34.2
177	63	Coca-Cola Japan	The Coca-Cola Export	100
193	58	Caterpillar Mitsubishi	Caterpillar	50
216	52	Mitsubishi Sekiyu	Getty Oil	50
255	45	Yokogawa Hewlett-Packard	Hewlett-Packard	49
263	44	Taito-Pfizer	Pfizer	95

*Based on tax bureau returns
(Source) "10,000 Corporations' Profit Ranking" (special issue), Toyo Keizai (research conducted by Tokyo Shoko Research), June 3, 1982

Fig. 3 Comparison of FACs'/Japanese Performance



*PBT/total assets of manufacturing industry total
(Sources) "Trend of Foreign Affiliated Companies in Japan," MITI, 1981; "Quarterly Financial Report for Manufacturing, Mining and Trade Corporations," Federal Trade Commission

their industry sectors, and U.S. firms accounted for more than half of the top-performing FACs (Table 1).

Using the yardstick of profitable returns, in fiscal year 1981 the top 15 foreign profit-makers earned a total of nearly $2 billion, according to Japanese government statistics; 13 of these 15 were U.S. investors. Overall, FACs performed better in terms of return on assets than did their Japanese counterparts (Table 2 and Fig. 3).

The significance of these earnings figures was reinforced by the interview survey. Some U.S. executives claimed that Japan is their most profitable operation; a few admitted their Japanese operations were more profitable than their U.S. domestic businesses.

Obstacles: Perceived and Real

Study findings indicate that Japan, although a difficult, fiercely competitive market, is not more closed or controlled than some Western nations. Although wide cultural differences exist, so do significant commonalities: a political democracy, a capitalist system, and a pattern of universal product consumption (e.g., Gucci bags, Sony Walkmans, McDonald's hamburgers, Xerox copiers). Evidence suggests that imposed trade barriers (e.g., quotas, tariffs, customs clearance, product certification standards) continue to be successively liberalized, with relatively few formal controls remaining in effect. There have been a number of forces for change at work in Japan's labyrinthian distribution system, disrupting and shortening traditional channels. Evidence suggests that the greatest hurdle U.S. firms face may be the perception gap between their expectations and the reality, i.e., internal (self-imposed) barriers.

Three categories of barriers confronting foreigners were examined: imposed regulatory restrictions, cultural constraints, and a company's own internal inhibitors.

Between 1976 and 1981, total direct foreign investment in Japan grew at an annual rate of 17% ($196 to $432 million), but the U.S. rate of investment slowed, resulting in a 26% loss in share (1976: 60%; 1981: 34%). Thus, while America's direct investments in Japan far exceed any other nation's, they no longer represent an overwhelming share of the total.

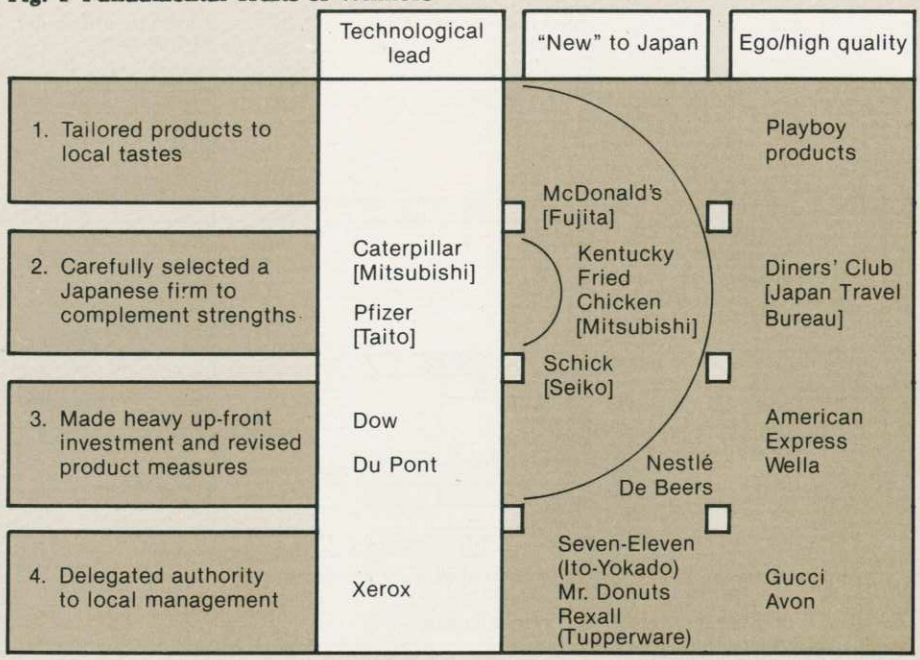
U.S. investment in Japan in 1980 represented less than 3% of its total offshore investment. According to U.S. Commerce Department data, U.S. direct investment in Japan was equal to that in Belgium, whose economy is only one-tenth as large, and America's investment was four and a half times greater in Britain, which has only half Japan's GNP.

Table 3 Selected Product Examples of Japan's Tariff Reduction (%)

	May 1982	April 1983	April 1987
Agricultural products (e.g., oranges)	20 — 40		20
Specialty plywood products	20	18.8 (84)	15
Mainframe computers	7	4.9	4.9
Computer peripherals	9—10	6.0	6.0
Photographic film	6—9	4—8	4.0
Eyeglass frames	16	5—7	4.9
Pens	12	10—11	7.5
Lighters	9—11	6—7	5—6

(Source) Japan Tariff Bureau, February 1980; MITI

Fig. 4 Fundamental Traits of Winners



(Source) TSG/McKinsey team analysis

1. Imposed Barriers

Quotas: Quotas have been greatly reduced over the past decade; currently 27 product groups (representing 2.5% of all marketable products as identified by 1,042 industrial categories) are subject to quantitative restrictions, of which 22 are agricultural and fishery commodities.

Viewed in perspective, Japan restricts fewer than half the number of product categories limited by France (46), and only 5 nonagricultural items, compared with America's 6, West Germany's 11, and France's 27. Nevertheless, Japan's meat and citrus quotas have come to symbolize a closed marketplace, in spite of the fact that, like many other nations, Japan strictly controls agricultural imports for reasons that are more social and political than economic.

Tariffs: Substantial progress has been made in accelerating tariff reduction. In the spring of 1982, tariffs on 1,635 items were reduced by some 35%, with further reductions scheduled over the next five years (Table 3).

Customs Clearance: In April 1982 the Japanese government adopted five measures aimed at simplifying customs examinations, making valuation uniform, and reducing documentation requirements. Earlier the same year an Office of Trade Ombudsman (OTO) was established to settle grievances related to the openness of the Japanese market, including import inspection procedures, through a Tokyo Customs Center to be fashioned after the U.S. national import specialist program in New York City.

2. Structural/Cultural Barriers

Standard Certification: In terms of standards and testing, Japan's market is not as open as America's. However, based on a major agreement made between the two governments in May 1982, standards criteria are expected to be relaxed and foreigners allowed to participate in standards development.

Problems in this area include:

— Limited use of internationally accepted standards and a "positive" list ap-

The participants of the TSG meeting held in Tokyo.

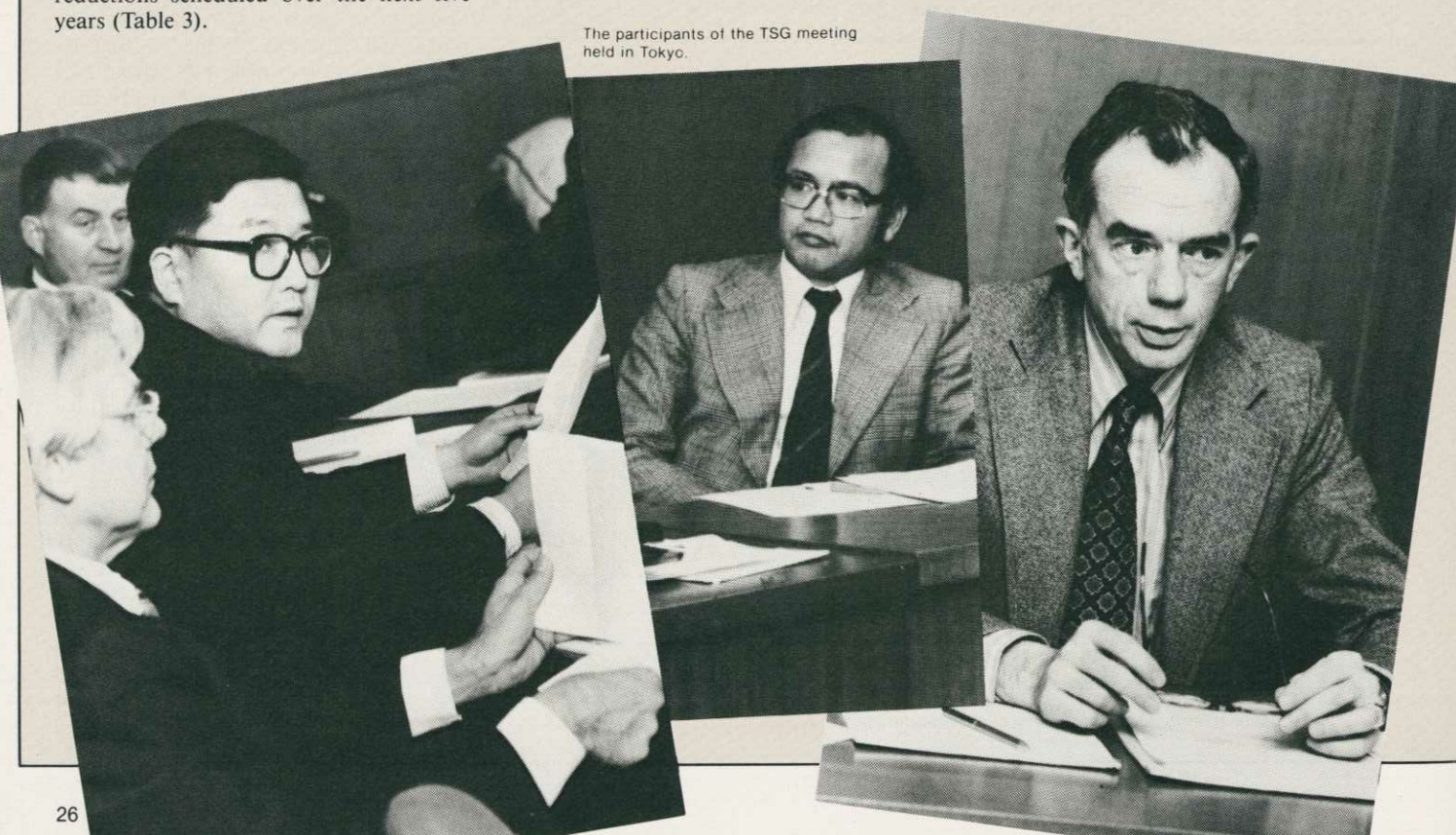


Table 4 Competitive Indicators of Selected FACs in Japan

Product	Participants (A)	Participants (B)	ESTIMATES Japanese Position (A) : (B)	ESTIMATES U.S. Position (A) : (B)
Disposable razors	Schick	Gillette	5 : 1	1 : 3
Soft drinks	Coca-Cola	Pepsi-Cola	10 : 1	1 : 1
Donuts	Dunkin' Donuts	Mr. Donuts	1 : 10*	7 : 5
Fast food (outlets)	McDonald's	Kentucky Fried Chicken	1 : 1	10 : 3
Make-up	Max Factor	Revlon	5 : 1	1 : 2

*Number of outlets
(Sources) MITI; US. Embassy; *Chain Store Age*, Lebhar-Friedman, Inc.; *Chain Restaurant Operators' Directory 1982; Advertising Age*, Crain Communications, Inc.

proach to additives.
— Incomplete disclosure of "informally" approved ingredients. The study found that a list of hundreds of informally approved cosmetic ingredients has not been made available to foreign manufacturers. In the summer of 1982 the government promised to provide a comprehensive list of previously used ingredients to foreign companies.
— Lack of reciprocity in testing; nonacceptance of foreign test data.
— Nontransferability of product approval rights. Such rights, which can be held only by approved Japanese entities, cannot be automatically transferred if a foreign exporter changes agents.
— Limited access to standards-setting procedures and standards authorities by foreigners.
— Limited use of performance as opposed to design specifications in the establishment of standards.

Distribution System: Characterized by a high degree of involvement by wholesalers, the traditional Japanese distribution system appears inordinately convoluted to foreigners. The multilayered process, involving two or more middlemen, is largely a financing operation in disguise and has its historical roots in the fact that commerce and industry developed on a relatively small scale in Japan.

The study team found that the system is undergoing major evolution. Sony, Sanyo, Pioneer, and other assertive Japanese companies have challenged traditional distribution channels in home appliances and consumer electronics, and maverick Japanese merchandisers are disrupting other long-established links. Opportunities to participate appear open to entrepreneurial U.S. corporations also.

Preferences and Peculiarities: Real and significant barriers to success may stem from a foreign corporation's inability to recognize and deal with
— the Japanese market's special needs and conditions (e.g., office equipment without *kanji* capabilities; appliances not adapted to lower voltage), and
— traditional Japanese business customs and mores (e.g., the rebate system).

3. Internal Inhibitors

Overall, many local managers regard headquarters' misperceptions as the single largest bárrier to success in Japan. An American firm's financial criteria in many cases may be inappropriate for Japan, since the rate of return on total assets and sales for U.S. companies is about twice that of Japanese corporations. As one FAC executive stated: "Home office criteria are sales and profit growth; Japanese criteria are market share versus other foreign companies." Moreover, few organizational hierarchies reflect Japan's potential or profit contribution; frequently it is on a par with a branch office in Hong Kong.

Famous "brand products" are common sights on Tokyo streets.

Past Successes and Current Challenges

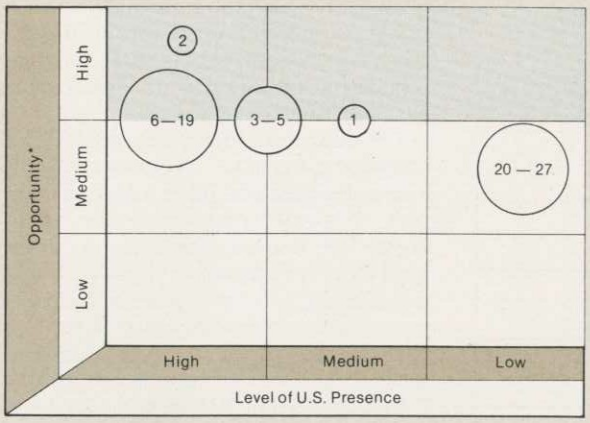
Despite real constraints and red tape, a number of FACs hold a leadership or strong market position in Japan; U.S. firms account for more than half this group. The study determined that successful FACs entered the market with a strong "plus" and exhibited a high degree of commitment as reflected in long-term investment, high-caliber people, and strategic attention to Japan.

Keys to Success

Analysis disclosed four basic successful product/service entry modes: (1) a resource-driven product; (2) a technological lead; (3) a "new-to-Japan" concept; and (4) a differentiated marketing strategy (see Fig. 4).

Leading FACs exhibited three common characteristics:

Fig. 5 Relative Attractiveness of 126 Business Areas

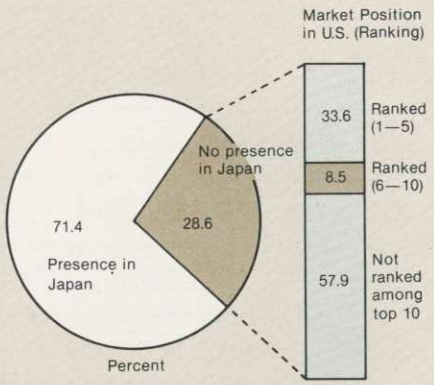


Screened Most Attractive Opportunities for U.S. Businesses in Japan

1 Meat and miscellaneous livestock products
2 Canned and preserved fruits and vegetables
3 Noodles, macaroni and spaghetti
4 Miscellaneous seasonings
5 Railroad vehicles
6 Other food and related products
7 Printing and publishing materials
8 Compressed and liquified gases
9 Medical products
10 Surface active agents
11 Explosives and fireworks
12 Petroleum and coal products
13 Lead
14 Nuts, bolts and fabricated wire products
15 Miscellaneous metal products
16 Miscellaneous fabricated metal products
17 Pumps, compressors and hydraulic equipment
18 X-ray equipment and miscellaneous electronic equipment
19 Cameras, microscopes and optical lenses
20 Knit fabrics
21 Carpets and miscellaneous textile mats
22 Veneer wood and plywood
23 Furs
24 Leather products
25 Coke and briquettes
26 Porcelain and pottery products
27 Precious metals

*Combination of Japanese market attractiveness and U.S. competitiveness
(Source) TSG/McKinsey team analysis

Fig. 6 Analysis of U.S. Presence in Japan's Tertiary Sectors



(Source) "55,000 Largest U.S. Corporations," Baldwin H. Ward Publications, 1981

Success Criterion No.1—Commitment

Research suggests that commitment of time, money, and effort is probably the single most critical factor. Successful FACs have made substantial commitment, apparently adapting their short-term performance expectations accordingly. One food-industry leader deemed his firm's initial investment "low" but considered a five-year wait for profits "acceptable."

Success Criterion No.2—Creativity

Winners shared the ability to look at obstacles as creative challenges. In one example cited, a firm used the nationwide distribution system of a Japanese cutlery wholesaler to market its injector razor and change the country's shaving habits.

Success Criterion No.3—Competitiveness

As Table 4 illustrates, willingness to take the plunge ahead of market leaders was determined to be of particular significance for the Japanese market, where the first entrant attains a status that few "imitators" can later match. The distinctive Japanese "me-too" psychology helps to assure a tremendous competitive edge to the first one "in."

Corollary Criterion—Well-Matched Joint-Venture Partners

On the positive side, several cases demonstrated how the right partnership can enhance a firm's competitiveness and creative ability to adapt to the idiosyncracies of the Japanese market. On the negative side, conflict between partners was the second most frequently specified cause for foreign firm withdrawals between 1979 and 1982.

Future Indicators

FAC executives expressed a number of strategic as well as market opportunity reasons for being in Japan, among them tapping Japan's huge market potential for technological industries, channeling its technological strengths, and protecting a domestic position from Japanese competition by encountering potential challengers in their own backyard.

Opportunities: Present and Future

The study team developed a screening process from which a base of 126 core manufacturing classifications evolved; they then evaluated these core industries on a two-dimensional, nine-box matrix.

The analysis revealed that:

— On a macro level, virtually all types of manufacturing businesses that exist in the U.S. already exist in Japan.
— The highest opportunity areas in manufacturing are already being explored by leading U.S. firms.* One of the top five U.S. market leaders is physically present in 66% of the sectors. Nevertheless, there did not appear to be any factors prohibiting other U.S. companies from establishing profitable niche positions in the sectors.
— The U.S. does not have a strong presence in several major Japanese manufacturing areas (7%). Leading U.S. firms in these sectors were identified as possible contenders for the Japanese market (Fig. 5).

Since the expressed chapter of the study was to focus on market sectors that appeared to be relatively untapped, there seemed to be greater leverage in concentrating on the tertiary sector, where 71% of all Japanese segments have no U.S. presence (Fig. 6).

The tertiary sector analysis revealed several successful FACs participating as wholesalers and traders, which gives the tertiary sector a stronger representation than is usually perceived.

The most successful foreign participants in the tertiary sector—the vast majority of which are U.S. firms—are in fast food services.

Tertiary sector businesses that the screening process singled out as promising because they were far more advanced in the U.S. included: (1) truck leasing, (2) furniture stores, (3) retail drug proprietaries, (4) grocery stores, (5) retail building materials stores, and (6) wholesale drug proprietaries.

The study team's service sector screening for high-priority opportunities where U.S. firms have a strong competitive edge revealed several industry/business classifications that exist in the U.S. but not in Japan. This gap was interpreted to mean that in Japan the business has not yet developed to the stage where it warrants an official classification.

From this listing, the team pinpointed six basic service groups that appear to have high potential for experienced U.S. firms:

1. Financial services
2. Health-related services
3. Computer services
4. Leisure-related services
5. Educational vocational services
6. Business services (collection agencies, merger/acquisition specialists, etc.)

Five of these areas were chosen for more detailed assessments of potential opportunities: (1) financial services (where U.S. firms have a fairly high numerical presence but low penetration), (2) computer software services, (3) medical services, (4) leisure-related services (e.g., video-tape rentals), and (5) truck leasing.

These "case studies" serve to illustrate how one might assess a market sector's attractiveness in general and confirm (or negate) identified potential. ●

* Since the core classification of industries used was highly amalgamated, U.S. companies should be invited to review more carefully their specific market sectors within these categories.