COVER STORY (3)

The Skills of the Best Managers at Superior Companies

By Niihara Hiroaki

What on Earth is Superior Business Management?

In these past few years, Japanese companies have staked their survival in the extended economic slowdown on the introduction of various forms of management reform. Many of these efforts have been termed "American-style management" in Japan, and a great deal of energy has been devoted to altering the form of management at companies, e.g., changing corporate governance methods by introducing the executive officer system and the business company system and switching to performance-based employee evaluations.

The result has been that Japanese companies may appear, on the surface at least, to have accomplished reform. Have these efforts, however, in fact strengthened these companies' competitiveness? The economy remains stagnant, with no signs of dispelling the feeling of impasse pervading the whole of Japan. While many companies have initially attempted to introduce forms of American-style management, they appear to have stopped at superficial reforms without going as far as changing the substance of the company itself.

This is the view of the problem that this author has come to hold for the past three years or so.

On the other hand, more than a few "superior companies" have continued to achieve remarkable results, even under poor economic conditions. Toyota Motor Corp., for instance, realized ordinary profits exceeding ¥1 trillion in the fiscal year that ended in March. What characteristics do these superior companies possess? How do they differ from companies that are not doing so well? What measures have they taken to give their reforms substance and depth? It would seem that, if one were to show these problems clearly, the path to development for Japanese companies would come into view naturally. This was the author's motivation in conducting research on superior companies in Japan.

The author began this task with the selection of superior companies. Data from companies throughout Japan was requested, with attention focused on three elements: the company's profitability (ratio of ordinary profit to total capital), security (ratio of net worth to total capital) and growth (changes in ordinary profits). Figures for the past 15 years were collected and analyzed. Data for a short period of one or two years tends to be highly subject to positive and negative aspects of the external environment, making it probable that one will misread a company's good results as a consequence of structurally strong competitiveness rather than simply riding the currents of the times.

The author chose 30 to 40 companies for further detailed analysis, and decided to conduct interviews with relevant people, beginning with the top management of these companies.

Broadly speaking, company competitiveness can be classified into two types – competitiveness due to operational efficiency, and competitiveness due to managerial skill – and it is the latter that appears to be the biggest problem with companies that do not qualify as superior. The former is competitiveness achieved by a long series of ideas to raise blue-collar productivity, i.e., the productiveness of factories and work sites, as symbolized by Toyota's *Kanban* system. Undoubtedly, Japanese companies are no longer as strong in this regard as they once were, and areas in which they lag were discovered in the information technology industry and the electrical appliances industry among others. More important, though, is competitiveness due to managerial skill, in other words, the ability of top management to devise and implement strategies and to make efficient use of the head office functions.

When the superior companies are listed and examined, one notes that much of what is considered "common sense" by the public does not necessarily apply to these companies. First, the industries to which superior companies belong are commonly held to be cutting-edge industries that are vigorously growing. For example, Mabuchi Motor Co., established in 1954, is the world's top manufacturer of consumer-oriented small motors, with a 55% share of the world market. Numerous Japanese people no doubt have fond childhood memories of inserting a Mabuchi motor in a plastic model of the Space Battleship Yamato and setting it afloat in the bathtub. This company makes technically mature motors with an average unit price of ¥72, and manufactures approximately 1.4 billion of these motors annually. The company is thus a tremendous producer of goods that boasts a double-digit ratio of ordinary profit to total capital.

There is also Shimano Inc. While its bicycle parts, the mainstay of Shimano's business, are "essentially the same low-tech products that blacksmiths made by pounding steel" (President Shimano Yozo), the company is number one worldwide and head-and-shoulders above other competitors. Hence, an excellent business model can even be realized when the industry itself appears old-fashioned and regardless of the growth of the industry as a whole.

Another piece of conventional wisdom that does not apply is that companies exposed to international competition through trade are strong, while those depending on domestic demand are weak. Both Yamato Transport Co. and Seven-Eleven Japan Co. are com-

panies operating fundamentally within the framework of the domestic market, and Kao Corp. also does business focused on domestic demand, with only about 10% of its profits deriving from overseas sales revenues. What about Toyota, Honda Motor Co. and Nintendo Co.? These major export companies are indeed thriving, but one must not overlook the fact that these companies ventured overseas only after establishing a solid business model to meet the high standards demanded by Japanese consumers.

Broadly speaking, there are six points that can be found in common among superior companies. It should be noted that the introduction of American-style forms is not included as one of these six. An examination reveals that companies which have introduced American-style management methods and management indicators are not necessarily predominant. Some companies were doing well while others were not and, contrarily, there were also companies producing favorable business results that had not introduced such methods and indicators.

The first characteristic is that the top management has a clear understanding of the scope of business in which the company is engaged.

It is especially important that companies clearly recognize the businesses they should not be undertaking, and that they refrain completely from lines of business that the top management does not understand.

When asking the top management of superior companies about the concept of their companies, a lucid explanation was immediately forthcoming. The company as a whole has become a single concept in the minds of these managers. At the same time, a key point to note is that this concept serves to narrow the scope of the business that the company should undertake. This differs substantially from the flowery language used to decorate the first few pages of company brochures. When these top managers were presented with the name of a new line of business and asked if their company would be branching out to this new line, they rejected straight out any line diverging from their company's concept as "not our company's job." In a certain sense, the fields in which they compete are exceptionally restricted.

On the other hand, when the author read out a series of unconnected businesses in which companies not doing well are presently engaged, the managers from these companies quite often brought that line of questioning to an abrupt end with a curt "this is our company's concept." Many venture companies that had initially achieved remarkable results with a strong business model used the capital obtained through this success to depart from the original concept of the company, and this diversification ended in failure. Though the majority of companies today intone the mantra of selection and concentration, it is difficult to put this idea into practice. Narrowing the focus of a company depends on the managers having a clear company concept for making the selections on hand. In other words, the top management needs to have a physical sense of what their company's strong suit is.

Mabuchi Motor provides an extreme example of limiting the range of one's business. This company's concept is to direct all its efforts into one type of product: small (200-watt or less) consumer-oriented steel-core direct current magnetic motors with brushes. Starting from motors for toys, the company expanded the use of its motors to electrical appliances, audio equipment and automotive equipment, but it has never diversified its product line beyond such motors. Even when presented with an attractive proposal from the German company Braun, the world's leading manufacturer of electric razors, to develop a motor without a steel core, Mabuchi boldly and flatly turned the offer down. Instead, the company suggested that Braun take a closer look at the true capabilities of the company's steel-core motors and made a counteroffer to develop a new motor priced at about one-tenth of the one Braun had been using. Mabuchi Motor is now the exclusive supplier of motors to Braun.

With regard to top management having a sense of conditions on the ground, Shin-Etsu Chemical Co. also merits special mention. In the chemical industry, an area in which Japan is said to be not very proficient, Shin-Etsu ranks fifth worldwide – behind DuPont, Dow Chemical, BASF and Bayer – in terms of total market value of the company's shares. The company holds the top share globally in chloroethylene, used in such goods as water and sewage pipes and the interior fittings for cars, and silicon wafers, the base for semiconductor devices. A well-established firm, Shin-Etsu concentrates its business efforts in those fields in which it leads and to this day maintains the positive features of a small company.

One of the strengths of Shin-Etsu Chemical is that managerial decision-making rights are concentrated in the distinguished manager, Kanagawa Chihiro, the company's president. Making this possible is the fact that business has been restricted to a scale on which Kanagawa can understand all aspects of the business, including that of consolidated subsidiary companies.

The second element shared by superior companies is that the top management is logical, i.e., they think about things long and hard themselves. Managers in Japan have all studied and become well versed in management theories from Japan and abroad during the extended economic slowdown. The divide is whether one simply crams in knowledge or thinks for oneself after gaining the knowledge. Managers at superior companies never unconditionally accept conventional wisdom, commonly accepted views or the examples of success of other companies, instead they question the conventional wisdom and think long and hard for themselves. The result is that, in contrast to the view that management is fact and not theory, these managers can actually explain the logic behind every one of their decisions, without exception.

Suzuki Toshifumi, Chairman of Seven-Eleven Japan, the largest convenience store chain in the country, remarked that observing other companies in the same industry and reading books will lead to failure as one ends

up imitating someone else. Human beings often get caught up in their own experiences and examples of success, and when examining too great a variety of information they tend to extract only the positive aspects, producing a patchwork approach. Good managers are familiar with circumstances, think foremost of the customer, develop hypotheses by themselves, and implement and verify these, all as a regular part of their job. If they were to imitate others or make their decisions based on other people's opinions, Suzuki says, the present Seven-Eleven could never have become the success it is today.

While Director at Ito Yokado Co., Suzuki met with fierce opposition from both inside and outside the company when trying to conclude an agreement in 1973 with Southland Co. in the United States in regard to convenience store operations. The majority opinion, supported by owner Ito Masatoshi, advocated a cautious approach, claiming that small-scale stores would not be able to compete with the supermarket chains expanding as they were throughout the country, and these critics were unable to distinguish between convenience stores on the one hand and general stores or old-fashioned five-and-dime stores on the other. Suzuki refuted this position by pointing to Japan's export industries such as electrical equipment. At that time, Japan's electrical appliance manufacturers were overpowering much larger European and American manufacturers and extending their market shares worldwide. Japan's export industries won out, not because of scale, but because of productivity. Even small stores can overcome competition if productivity is improved. Suzuki thus used logic to open the way to the first full-scale convenience store business in Japan.

The introduction of American-style forms mentioned at the beginning of this paper will also see completely different results if one is not content to simply introduce the form, but rather to use the introduction as an opportunity to think about these forms.

In 1999, Kao was the first large company in Japan to introduce the Economic Value Added (EVA) index, an economic indicator created in the United States, but President Goto Takuya did not adopt this indicator simply to keep up with the latest fashion. The Andrew Jergens Co., Kao's U.S. subsidiary, had earlier introduced this indicator, and an awareness of capital costs and a sense of vigor emerged among the employees. Seeing this, Goto chose to bring this approach to Japan intending to raise employee awareness of capital costs, with EVA to be used as no more than a starting point.

The third element is that many members of the top management of superior companies seem to have spent some time on an offshoot during their careers. Those who have faced hardships while working in peripheral departments or subsidiaries have generally been more successful in carrying out reforms than those who were swept along in the company's mainstream and moved smoothly up the ranks.

One example is Mitarai Fujio, President of Canon Inc. Mitarai Hajime, the eldest son of the company's first president, Mitarai Takeshi, succeeded his father's position. Hajime was a talented engineer, having received a doctorate in electrical engineering from Stanford University, but in 1995, only two years after being appointed president, he passed away at the young age of 56.

Following his sudden death, Chairman Kaku Ryuzaburo led the deliberations on a successor, and Hajime's cousin Fujio was singled out for the position. Although Fujio is a member of the Mitarai family, a glance at the list of past presidents shows that Canon is not a family company, and he was not groomed for the position from the outset. In 1966, his fifth year with the company, Fujio was assigned to Canon U.S.A., Inc., and he was named president of that company in 1979. He has spent the majority of the 23 years since, working in America. Only an emergency led to the appointment of someone outside the mainstream to head Canon.

He made use of his "outsider" experience in the United States, however, after assuming the post of president. Fujio noted: "When I returned to the head office, I noticed there were certain inefficiencies there. I might not have regarded them as unusual if I had been groomed for a long time in the Japan head office."

The first step he took was to sell off unprofitable businesses. Believing strongly that the company should even be able to produce a profit when revenues decline, he pulled the company out of personal computers, word processors and ferroelectric liquid crystal displays. The company consequently lost a total of ¥73.4 billion in revenues but managed to cut its deficits by ¥26.2 billion, thus the company was reformed into a more profitable one.

Successful examples of "outsiders" are not limited, of course, to relatives of the company founder. President Goto of Kao came not from the Household Goods Division, the company's principal line of business accounting for more than 80% of sales revenues, but rather from the Chemical Business Division, in a sense an offshoot organization. In addition, he spent two assignments spanning a total of 11 years working outside the Kao head office. Unlike earlier extroverted and flamboyant presidents, he is a practical business type. Upon assuming the post of president in 1998 he made a bold cut by withdrawing completely from floppy disks and other computer-related businesses. The eight sales companies divided by region were consolidated into one company in 1999, the same year the company began sales of the hit product "Healthy Econa Cooking Oil," a vegetable oil that helps to prevent fat deposits. These successes were, of course, built upon the efforts of predecessors, but both Mitarai (3.5% to 9.9%) and Goto (7.9% to 14.6%) have achieved startling improvements in the ratio of ordinary profit to total capital during their terms.

One reason "offshoot" experience is so valuable for top managers is that they were able to make bold decisions because their operations were not tied to the company's core or existing busi-

Six points that can be found in common among superior companies
1) The top management has a clear understanding of the scope of business in which the company is engaged
2) The top management is logical
4) An indomitable spirit among top managers to "turn crises into chances."
5) A management policy of directly examining business risk while aiming for growth suited to the company's stature
6) The managers impart to the company a sustainable culture of discipline

nesses. Another is that such experience gives them an opportunity to examine the company objectively from the "outside," dispassionately study the naked truth about the company and uncover inefficiencies that need to be corrected.

The fourth element is an indomitable spirit among top managers to "turn crises into chances." Many superior companies have a history of uncovering new directions to turn to when pressed by circumstances and transforming that crisis into a golden opportunity.

In 1957, only its third year in business, Mabuchi Motor faced a crisis that threatened its very survival. The lead contained in the paint used on metal toys manufactured in Japan became a problem in the United States, and the toy industry faced a disastrous halt to 90% of the Japanese-made toy shipments to the United States. At the time, motors for toys constituted 100% of Mabuchi Motor's business. Inventory piled up, bringing home to the company the risk of depending on single-item management of motors for a single industry.

Had the company chosen this moment to diversify into other businesses besides motors, it probably would not have grown beyond the extent of an ordinary company. Mabuchi Motor did not think in that fashion, believing instead that what had gone wrong was the use of its motors only in toys. If the company could discover demand in other industries as well, it could avoid being sucked down again by a sinking industry, while it was in danger of being swept around by conditions in one particular industry if it could not find multiple uses for its motors. The keys to expanding the uses of its motors were improved functions and low cost. If those could be achieved, the company's products would see a broader range of use, stabilizing the company's operations despite single-item management.

Hair driers, for example, used to be quite large, with most people associating them with professional hair salons. The introduction of Mabuchi's small motors, however, reduced the size and lowered the cost of hair driers, which became regular household items. The tape loading motor for video decks (the motor that pulls an inserted tape into the interior of the deck) frequently made electrical noises and caused flickering on the screen. Mabuchi developed a motor with reduced electrical noise and, despite its late start, it soon acquired a 70%-80% share of the market. As described earlier, Mabuchi also skillfully turned a crisis into an opportunity by providing Braun steel-core motors for its electric razors at a surprisingly low price.

The remarkable achievements of Mabuchi Motors are simply the results of having turned a pinch into an opportunity, and some companies attempt to arouse a sense of crisis even before any real problems occur to prevent complacency and to maintain a degree of tension among employees. The employees at companies that are not doing well are often convinced, even in the face of a genuine crisis, that their companies cannot possibly fail.

To this day, Toyota Motors maintains a culture of regularly inducing a sense of crisis among its employees. When the current president Cho Fujio joined Toyota, then president Ishida Taizo welcomed him and his fellow new employees with the comment: "Toyota itself will disappear if you all are not sharp and on the ball." Cho, too, quickly finds small problems popping up in day-to-day operations and converts these problems into numerical figures to encourage a sense of urgency within the company as part of his policy of making management visible. As has been mentioned, Kao also has a culture that qualifies it as an "anti-status quo company."

Moving on, the fifth element is a management policy of directly examining business risk while aiming for growth suited to the company's stature. Superior companies generally feature a financial independence unhindered by capital markets, but this is a matter of cash-flow management. In other words, these companies engage in investment, and research and development suited to their stature within the scope of the cash flow that they themselves generate. These companies can afford to make bold investment decisions because they are able to carry out risk control should these investments fail.

President Mitarai Fujio of Canon

sang the praises of cash-flow management in the reform program he put forth when taking office. At the time, his company had total investments of ¥130 billion, with ¥80 billion in depreciation, thus Mitarai believed that, with ¥50 billion in net profits, net profits and depreciation alone could cover all of the investments. Net profits of ¥50 billion roughly corresponds to ¥100 billion in ordinary profits. A target of ¥100 billion was set, and this objective was achieved as early as 1996.

The final element shared by superior companies is that managers impart to the company a sustainable culture of discipline. Superior companies have discipline, and have corporate cultures that emphasize constant discipline among both company managers and employees.

Discipline in a company immediately brings to mind the one imposed by the capital markets, i.e., the valuation of a company by the stock market. The author has come to the conclusion over the past three years, however, that discipline by the capital markets is a necessary, but not sufficient, condition to produce a durable superior company. Truly superior companies also display discipline in non-financial matters, specifically in a sense of mission and an ethical code.

Some may object to this assertion by declaring that the principal job of a company is to make money and that this is not accomplished by uttering high-sounding ideas. Profits are naturally very important. Profits are a necessary means for a company to continue contributing to society, and looking down on profits is essentially the same as looking down on a continued contribution to society. A one-time contribution to society can be made adequately through a donation, without going to the trouble of forming a company, but a continuing contribution to society cannot be made this way.

On the other hand, superior companies do not think that anything goes as long as it makes a profit. If the purpose of a business is just to make money, then that business is not any different from gambling or speculation, and companies seeking to secure profits without making a contribution will fail to become durable superior companies and will go under at some point. The recent bankruptcies and scandals at Enron and WorldCom Inc. offer clear evidence of this. Superior companies view their organizations as having the purpose of contributing to society over the long term by making profits.

Another feature of superior companies is the simple belief that the key to corporate governance is a sense of mission and not the system. Companies will not turn their businesses around by introducing an outside director or executive office system. Only with discipline in non-financial areas – a sense of mission and an ethical code among employees – can people and companies be motivated to work. Such a company enjoys a strong resilience in crises because declines in business and even pay cuts will not set off an avalanche of talented personnel fleeing the company. The most durable companies are those staffed by employees who feel that they are part of a group that shares the same destiny.

In this regard, companies under the influence of a founder's family have an advantage. From a capitalist standpoint, the family members see the company from the broader prospects of long-term growth and continued contribution to society. Nintendo's rapid growth and its steadfast business policies are due in great part to the centripetal force of the Yamauchi family, and the Ogura family of Yamato, the Mabuchi family of Mabuchi Motor and the Shimano family of Shimano play similar roles. Even at companies as large as Toyota, where there is no direct influence, the idea that the "Toyoda family is watching" exerts a considerable impetus to maintain discipline.

Six elements common to superior companies have been considered here. Summarizing in his own way the conclusions to be drawn from these on the conditions for a superior company, the author would consider the best managers to be:

"Those who adhere to, and do not go beyond, the business they best understand, who think long and hard themselves with simple honesty and seriousness, and who tackle their jobs with passion."

This could be seen as an overly simplistic and exceedingly obvious conclusion. However, with companies having grown bigger since World War II and having passed through the bubble period, might it not be the case that many have lost sight of their starting points? Canon, Honda, and Sony Corp. were all companies founded during or after the war when the country was impoverished, and the founders of these companies all held to this conclusion. When establishing Tokyo Tsushin Kogyo (which later became Sony) in 1946, Ibuka Masaru included the following comments in the company's prospectus:

"We shall eliminate any unfair profit-seeking, persistently emphasize substantial and essential work, and will not merely pursue expansion for its own sake, and shall endeavor to the best of our abilities to select products and develop them independently."

It would be a mistake to think that Japanese companies do not have management strategies. Regardless of the forms or systems adopted, be they American-style or Japanese-style, it is important to once more return to the starting point. Could it be any simpler?

Someone once said, "Don't act the part of a president, act as a president," and this does not apply only to company presidents. "Don't act the part of a company director, act as a company director" or even "Don't act the part of a legislator, act as a legislator" and "Don't act the part of a bureaucrat, act as a bureaucrat." If everyone would call up the discipline within himself or herself and return to his or her starting point, Japanese society will see a much brighter future. JJTI

Niihara Hiroaki is the director of the Information Economy Division, Commerce and Information Policy Bureau, Ministry of Economy, Trade and Industry.