Not Easy, but Worth the Try

By Roy Garner

James C. Abegglen of the Boston Consulting Group talks with journalist Roy Garner on the problems—and pay-offs—of investing in Japan.

At a time when foreign commentators are so frequently heard denouncing Japan over such issues as its imbalance in overseas trade and alleged protectionism within its home market, it makes a change to hear the positive message of James C. Abegglen, a consultant with the Boston Consulting Group, of the United States. His advice to foreign companies contemplating a possible entry into the Japanese market would be "Run, don't walk." Though that is not to say that he believes the move should be taken lightly, or that it will be easy. Abegglen stresses the need for a major commitment to the market in terms of time, money and advance planning, but believes that once these criteria are satisfied then Japan is "the most attractive place in the world" for investment by foreign business.

And Abegglen cannot be accused of speaking from a position of ignorance or inexperience. His contact with Japan and the Japanese dates back to the immediate postwar period, when he worked with the U.S. Marine Corps as an interpreter. He returned to Japan in 1955 and ever since that time has been involved in the area of bilateral trade, albeit in a variety of capacities.

So what does Japan have to offer for a foreign business? Abegglen quickly runs off a list of advantages which include the fact that Japan is the second largest economy in the world, and one of the more rapidly growing; the nation has a "superb infrastructure," stable government, a stable and moderately priced labor supply and an increasingly affluent population. "By all the criteria I can think of," says Abegglen, it is an attractive proposition.

Reluctance to invest

So where, one might ask, is the catch? If Japan really presents such a promising business opportunity, why do foreign

James C. Abegglen, a consultant with Boston Consulting Group of the United States

firms show a good deal of reluctance to invest here?

Abegglen would argue that there is no catch, and that although Japan has been every bit as attractive for as much as the past 20 years, the major stumbling block has been one of false perceptions. Japan has been seen as not belonging in the same league as the advanced economies of the West, the market has been widely portrayed as exclusive and protectionist in nature and, in his view, the result has been a failure on the part of foreign companies to make the substantial commitment to the market essential for success.

Abegglen insists that in every case one cares to examine, "foreign companies that have made a decision at the very top that they will be in Japan whatever it takes—in terms of effort and time—have in fact managed to establish themselves here in a very substantial way."

Looking back over the postwar period, the conditions which have been imposed on foreign firms wishing to operate in Japan have varied. Before 1964 it was only possible for a foreign firm to enter Japan as a "yen company," meaning that although companies could invest freely there was no guarantee that they could repatriate their earnings or capital. Coca-cola is one example of a firm which achieved notable success after having established such a wholly-owned "yen company." Most companies however were not prepared to invest without a currency repatriation guarantee.

During the next period, between 1964 and 1973, the regulations required that foreign businesses operate as joint ventures with Japanese firms. It was during this period that Texas Instruments decided to invest in Japan, using its expertise in key technological areas to pave the way for what was eventually to become a 100%-owned organization in Japan enjoying a powerful strategic position, especially in the semiconductor field.

By approximately 1973 all the basic controls on investment had been lifted, but no attendant rise in the level of foreign investment occurred.

Over the whole postwar period in fact, Japan had a comparatively low level of foreign investment, punctuated nonetheless by individual success stories such as those cited above. For Abegglen, this low level of foreign involvement in Japan was "the result of two kinds of protection." One form of protection was the aforementioned restrictions imposed by the Japanese government. The other was protection through "the fact that foreign companies were indifferent, were ignorant of Japan, and were unwilling to do what was necessary to establish positions." He maintains that Japan's protection was at least as much a result of these attitudes by foreign concerns as it was a result of Japanese regulations.

Among the advantages gained by such investment is the ability to bring pressure to bear on strategic competitors within Japan itself, rather than "passively wait-

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ing abroad to be attacked by the Japanese winner." A further advantage is the high quality of intelligence which can be gathered, concerning the Japanese market, by a process of actual competitive interaction with rival firms. "If you are here you can exert pressure on your competitors in terms of price levels, and in terms of technology, in a way that you cannot do from a distance."

As if to back up this argument, a recent study by the U.S. Chamber of Commerce suggested that the "return on investment" of U.S. investment in Japan has been about 19% per year, a level almost twice as high as that found in the case of U.S. investment in England and France.

Abegglen believes that the traditional "lever" with which one nation forces an entry into the market of a competitor nation has been technology. He feels that, tragically, many foreign companies, in the past, saw Japan as an unimportant, remote and small market, and sold their technology for short-term windfall profits, thereby surrendering a vital bargaining chip. In the period between 1952 and the mid-1970s this giveaway sale could be measured in terms of over 30,000 technology licensing agreements made between Japan and foreign rivals. By the mid-1970s a large slice of the technology which was of interest to the Japanese had been acquired.

The "ultimate barrier"

Japan's purchase of advanced foreign technology has played a large part in the nation's successful transformation into a highly developed market. And as in the case of any market which has reached this level of maturity, the costs of entry are high and the competition is stiff. It is this problem of financing the initial entry to the market which Abegglen describes as "the ultimate barrier" to foreign investment.

The route of entry which was chosen by similarly placed U.S. companies wishing to enter the European market in the 1950s and 1960s, and by European companies wishing to enter the U.S. in the 1970s, was invariably direct acquisition: by purchasing a successful local company already operating within the market, these foreign firms were able to solve such wide-ranging problems as land costs, staffing facilities, product distribution and community relations at a stroke.

Acquisition is also attractive because it is a capital cost rather than an expense, and thus does not affect the company's current earnings position in the short term.

While their share price tends to be quite high by Western standards, Japanese companies also frequently have understated assets, so that a given share buys a disproportionately large amount of overall assets. Probably most important among these assets is the staff, normally one of the most difficult commodities for a foreign firm to obtain, since good quality prospective employees usually seek the security of a "name" company, and tend to be sceptical of the long-term prospects available within a foreign firm.

Another reason why acquisition could be seen as the "ultimate barrier" however is the fact that in Japan businesses tend not to be bought or sold. Abegglen says that the difficulty of acquiring companies in Japan "may well now be the principal reason why foreign investment in Japan remains at a low level."

However one recent event has led observers to believe that foreign companies may in fact be pushing against an open door on this issue. The event in point was the recent acquisition of Banyu, a Japanese pharmaceutical company, by Merck Co. Ltd. of the U.S., a leader in the industry.

Despite fears that there would be opposition to the purchase from such bodies as the Ministry of Finance and the Ministry of Health and Welfare, Japanese industry and the press, Merck succeeded in acquiring a majority of shares in the Japanese firm. This was the first time in history that a Japanese company on the first section of the Tokyo stock exchange had been acquired "majority" by a foreign company. Abegglen describes this as a symbol of openness in the Japanese market and an event which suggests "we may be looking at a new chapter" in foreign investment activities. He stresses however that this does not imply that Japanese companies are suddenly "up for sale," nor that it will be possible to purchase top-flight firms, or that the purchase will be easy. It simply means that many of the barriers which had been supposed to exist may in truth be imaginary.

Key requirements

For foreign firms the key requirement is a presence at its marketing points, and any company dealing in a global product is likely to be increasingly aware, these days, that a base of some sort in Japan is indispensable. The needs of these foreign firms differ from many investment drives of the past in one major way, namely that in Japan it is not manufacturing facilities that are usually required, since Japan is often no longer a cost-effective site in this respect, but rather distribution or "finishing" facilities. The vital strategic advantage for a foreign firm lies in its having a warehousing and distribution capability inside the Japanese market "with direct hands-on control of its pricing and its competitive position at the market point."

The Western investor also needs to develop a willingness to accept Japanese performance standards in relation to his investment. Taking the cosmetics industry as an example, Abegglen points out that Shiseido, the Japanese market leader, finds that an acceptable level of return on sales is around 4.5%. Thus any foreign firm entering this particular market would have to accept that 4.5% is the upper limit in terms of the return that can be expected, and recognize also that profits will always be determined by one's competitors. Failure to adhere to this business rule can be costly.

A common case is where a foreigner comes in with a unique product, priced high and achieving high profits, and effectively holds an "umbrella" over the market, which then allows a Japanese competitor to come in from behind with a less sophisticated yet less expensive product. In time, with the expansion of the market and an incremental improvement of the product, it is then the Japanese competitor who ends up taking the market, while the foreign firm continues to attempt to maintain its unrealistically high profit margin.

For almost all foreign firms the recruitment of staff is likely to present problems. Abegglen says that although reasonably able young Japanese, in the 20s to early 30s age bracket, can often be attracted by the prospect of better opportunities and faster promotion in a foreign firm, there is a major problem in finding good staff at the upper/middle management level. These people "are just not on the job market," and thus a slow process of bringing in foreign staff to fill the gaps initially is inevitable. "Get some help in assessing your Japanese candidates" is another warning offered. One Western expert recently joked that "if a foreign company can make a mistake in Japanese personnel selection it is to be expected it will do so," and Abegglen stresses the importance of setting up an effective recruiting apparatus. Abegglen urges foreign companies to look to Japan for new business opportunities, but is equally keen to remind them that "there are no quick fixes; it will be a long haul and it will rarely be easy." Part of the problem, he says, is "the assumption that there will be some special privileges available."

In summary, Abegglen claims that a foreign company can find success in Japan provided that (1) there is a conviction from the top that Japan is absolutely critical to a world-wide position, (2) there is a sufficient understanding of Japan, such that the company lives within Japanese performance parameters and (3) sufficient resources are made available in the effort to build up the Japanese base. The mind set of Western executives must change, he says, so that attitudes are adjusted to account for the latter part of the 20th century, in which Japan is one of the world's most important centers of commerce. ●