

The Nikkei Weekly, 1 April 2013

To confront today's challenges, Japan's boardrooms must change



Japan Business Seminar

Richard Solomon

Corporate boardrooms across Japan are struggling to cope with 20 years of a moribund economy, deflation, a rapidly aging workforce and increased foreign competition. Management practices that worked well when Japan had fewer competitors and manufactured domestically for export are not working so well now. Nicholas Benes, representative director of the Board Director Training Institute of Japan (BDTI), recently offered some insights on the situation.

BDTI is a nonprofit organization that trains senior management and statutory auditors on effective board practices related to corporate governance. According to Benes, Japanese companies are in danger of failing to create, manage and grow truly global companies. "Few Japanese firms have succeeded to build top-level global companies," Benes said. "In order to become successful global enterprises, Japanese firms increasingly must integrate foreigners into senior management. But because many executives still hold a Japan-centric view of the world and current

management is racially homogeneous, the corporate governance system here is not up to global standards nor well understood by outsiders promoted into it."

Benes cited the experience of Michael Woodford, the first non-Japanese person to be appointed CEO of Olympus Corp. "Woodford is a glaring and unfortunate example of how, as Japanese firms promote more foreign executives into the senior ranks, they will need to introduce transparent governance processes that can be trusted to work properly and fairly. Foreign executives must be enabled to fully participate in governance, not be excluded from it."

But Benes stressed that Japanese companies typically only promote Japanese nationals into top positions. "If you look at the boards of most Japanese companies, they are comprised only of Japanese men. What sort of motivating signal does that send to people down below, even if the company is saying that it wants to hire more qualified foreigners?"

One problem Benes pointed to is Japan's low economic metabolism. "Economic

metabolism is the speed by which the economy reallocates assets to their optimal uses," he said. "We do this far too slowly in Japan. We have a poorly operating mergers-and-acquisitions market that is inefficient. As a result, we have many 'zombie' companies."

Benes attributes Japan's two decades of economic languish to an ineffective "exit effect," in which too few inefficient firms exit the market while too few efficient ones enter and grow. "Productivity is the key to growth," Benes said. "There are only three ways to grow gross domestic product — through population growth, capital expenditure increases or productivity. Japan has a shrinking population. It has too much capital already, much of it spent on low-profit strategies lacking in focus, which reduce the return on capital. Productivity is key, but it has languished. The 'exit effect' is usually a positive contributor to productivity, but in Japan it is negative, dragging down productivity growth.

"So Japan needs a more robust, active, reallocation process — it needs more M&As,

management buyouts, private equity investments, and more active corporate governance to discipline, reactivate and restructure companies."

Boardroom practices are changing, albeit slowly. "While current senior management worked their way up the corporate ladder among their all-Japanese peers, middle management at 'good' Japanese companies usually recognize these problems," Benes noted. "They're smart guys. They were sent off to the Hong Kong or Paris office, they have MBAs, and they have learned that it is a different world out there. They come back to Japan and use what they can.

"It's a generational thing — they can criticize senior management just so much, having to wait for the older guys to pass on before change can happen."

That change might be glacially slow, but Benes remains optimistic that boardrooms will adapt in the face of globalization.

Richard Solomon publishes regular Beacon Reports at www.beaconreports.net