NRI

lakyara vol.251

Special Edition

Globalizing management at Japanese companies

- Interview with Joseph Badaracco by Shingo Konomoto -

7.November.2016

Nomura Research Institute, Ltd.

Executive Summary

The rapid globalization of Japanese companies' operations in recent years has underscored the need to develop executives capable of succeeding in this new global era. Exactly what qualities are required of today's executives? We invited Prof. Badaracco, who teaches at the Harvard Business School and has written books about leadership theory, to help us answer that question.

Joseph L Badaracco, Jr.

Professor, Harvard Business School

Following undergraduate degrees at St. Louis University and Oxford University, Mr. Badaracco earned his MBA and DBA from Harvard Business School. He began teaching there in 1981 and became a professor in 1993. He has also been teaching a course on business strategy for senior executives at the Nomura School of Advanced Management since 1983. His specialties include business strategy, competitive strategy, and corporate ethics, and his many published works include *Managing in the Gray: Five Timeless Questions for Resolving Your Toughest Problems at Work* (Harvard Business Review Press, 2016).

Shingo Konomoto

President and CEO, Nomura Research Institute, Ltd.

Joined Nomura Research Institute in 1985. After serving as chief representative of NRI's Taipei Representative Office and general manager of its Taipei Branch, he was appointed division manager of Consulting Division II in 2003 and became corporate vice president in 2004. In 2010 he became senior corporate managing director of the Consulting Division, and in 2015 he was appointed member of the board and senior executive managing director of the Supervising Consulting and IT Solution Business divisions before becoming president and CEO in 2016. His recent published works include *China in 2020* (Toyo Keizai Shinposha, March 2016).

What is a "management professional"?

Konomoto: Prof. Badaracco has been teaching for many years at Harvard Business School and also teaches a course on business strategy for senior executives at the Nomura School of Advanced Management.

Badaracco: I have been teaching there since 1983.

Konomoto: Since I didn't join the company until 1985, you've been at Nomura longer than I have. I was only appointed president in April, and I still have a great deal to learn about management. Today I am very pleased to have the opportunity to speak with you.

With the exception of the two years prior to becoming president of NRI, I have spent my entire 31 years with NRI engaged in consulting-related activities. While confident in my skills in the areas of consulting and consulting management, I have limited experience in corporate management.

One thing I felt during my years as a consultant was that many Japanese companies do not take a sufficiently systematic approach to developing executives. There were many "business professionals," but there seemed to be relatively few companies that were purposefully trying to develop "management professionals." Of course there is room for argument as to whether such a thing even exists.

Badaracco: I don't think there are "management professionals" in the sense of the word we reserve for lawyers and physicians. In those fields a professional is someone who has acquired a body of knowledge that can be tested by examination.

Instead, I think corporate executives today are better described as semi- or quasi-professionals. As the world and its organizations become more complex, managing a company requires an understanding of a wide range of disciplines, including accounting, finance, production, and marketing.

In the US, many companies begin the executive development process by hiring MBAs or graduates of university business programs with similarly broad-based knowledge. For the first two to three years they work in a variety of divisions to get experience. Then they are given management positions in small divisions.

This practice may reflect differences in organizational structure between Japan and the US. Japanese organizations are organized functionally, while US organizations tend to be organized by geographical region or product. And inasmuch as US firms use a divisional organization system, executives are typically given the opportunity to manage divisions.

Also, many of the most capable people at US companies do not like to remain experts in a single function, since that tends to make it more difficult for them to reach senior executive positions.

Konomoto: In Japan as well, division managers, unlike professionals in specific functions, are required to manage a wide range of functions, including development, production, marketing, and sales. People who have come up from these areas have a feel for them and are able to manage those divisions capably. Managing an entire company, on the other hand, demands a very different set of skills from senior executives.

Badaracco: Today I think senior executives need to understand all the industries their companies are active in and have a solid knowledge of rival firms and technological trends. Additionally, executives must be able to lead people and solve problems. I think they learn by making many mistakes on the job.

Importance of building a strong management team

Konomoto: Something else I have noticed is that Japanese companies tend to lack management teams capable of providing support for the president. There tends to be one real executive—the company president—with everyone else simply representing the interests of their own divisions. Consequently, there are times when discussion among the executive team does not lead to a company-wide consensus.

The management skills of the president are of course important, but we should not overlook the importance of a supportive executive team that can discuss management issues from the same perspective as the president.

NRI recently studied the relationship between business value at listed companies in Japan and the tenure of the president. We found that business value tended to increase with the president's tenure, but then tended to decrease under the next president in proportion to how long the previous president's tenure held the position. Business value fell even further under the president after that. So the data suggest that while companies tend to do well when their presidents stay on for a long time, value tends to be destroyed under the next president, with the situation growing even worse under the one after that.

Badaracco: That is an extremely interesting approach to the issue. I suspect a similar analysis of US companies might produce slightly different results. Three factors lead me to believe this.

First is the amount of turnover among CEOs. In the US, it is quite common for CEOs to be fired or to leave for other companies of their own volition. I believe the average tenure is only about five years. Second, boards tend to demand well-defined plans for bringing up a successor. In other words, the presence of a single strong CEO is itself a major cause for concern for the board of directors. Third, the incentives for CEOs are completely different. CEOs in the US receive extremely large compensation packages that are tied to performance, so they have a strong incentive to put together the best possible team of people with broad perspectives and sound judgment.

Konomoto: In other words, there is external pressure on presidents to develop a successor and build a strong executive team.

You mentioned that the average tenure of a CEO in the US is about five years. In our analysis of Japanese firms, we found that the companies that grew their business value most consistently were those where CEOs had an average tenure of five or six years.

Why is it desirable to change leaders every five or six years? When someone becomes a company president in Japan, directors who are of the same age as the president are simultaneously promoted to become managing or senior managing directors.

And since there is generally a retirement age for board members, a long tenure for the president leads to situations where other board members of the same generation must step down and be replaced by fresh faces, which results in a group of new board members serving under an experienced president. And if the president stays on but the executive team is replaced, the gap in experience between the president and the team will only widen.

That can create an atmosphere in which it is difficult for the voices of ordinary employees to reach the president's ear or for the executive team to oppose the president's policies. A large gap in experience between the president and the board can also complicate communication between the two, which leads to problems in bringing up a successor.

Badaracco: In the US, too, there are companies that have a charismatic leader surrounded by a group of weak cronies.

There are, of course, great executives like Steve Jobs, but I think people who hold him up as a model are usually misunderstanding two key things.

First, he was a once-in-a-million individual in terms of his talents. Second, he was lucky. The same is true of Bill Gates.

Perhaps because of the existence of such charismatic leaders, there is a tendency in the US to overestimate the importance of leaders and to underestimate the role of the managers who provide support for senior executives.

Labor market's role in developing senior executives

Badaracco: Our discussion so far suggests that much of the difference between Japanese and American executives can be traced to differences in the governance system.

I am of the view that, until quite recently, Japanese boards of directors were boards in name only. They consisted almost entirely of company executives, which made it difficult for them to put pressure on senior executives.

Konomoto: As a result of ongoing governance reforms in Japan, we are finally starting to see gradual increases in the number of outside directors. Last year's Corporate

Governance Code also set out guidelines regarding the number of external directors.

Badaracco: Even in the US, where the practice of using outside directors is firmly established, it was not always the case that they were truly independent. I think market pressure has been more effective in ensuring proper governance.

There is pressure from the labor market as well as from the stock market. Firms that want to retain capable employees must be able to provide them with a desirable future career path.

My impression is that there is relatively little pressure from the labor market in Japan.

Konomoto: Compared with the US, I think Japan suffers from a pronounced lack of mobility among senior executives.

This is something that is rooted in Japan's HR organizations, in my view. Salaries in Japan typically consist of two components: a largely seniority-based component that is determined by years of service and a job-based component that depends on the type of work and employee performance. At most Japanese companies, the seniority-based component is larger.

There might be more mobility among senior executives if the reverse were true, since it would make it possible for companies to seek outside people for senior executive positions by deciding what skills were necessary and how much would be offered.

A growing number of the more global Japanese companies have adopted compensation systems that are seniority-centric in Japan but job-centric in other countries. And some companies are even integrating their HR systems and adopting job-centric compensation systems in Japan. If this were to become more common, I think we would see more senior executives with wide-ranging executive experience.

Problems faced by Japan's global companies

Badaracco: Allow me to ask one question. Do you think Japanese companies face any serious problems at present?

Japan has a low unemployment rate and a large number of globally competitive companies, particularly in manufacturing. And HR and board reforms are being implemented, albeit gradually.

Konomoto: I think the situation differs depending on the industry. If we look at manufacturing, for example, Japan has difficulty competing with countries like South Korea, Taiwan, and China in sectors where scale is all-important. There is no way Japan can compete in products with annual production volumes in the hundreds of millions or even billions. Annual production of automobiles typically maxes out at 10 million units, so that is one area where Japan can still be competitive. It is even more competitive in areas characterized by smaller volume and higher technological value added. I think Japanese firms will be able to remain competitive in products requiring the coordinated involvement of a number of manufacturers in different fields and the combination of different technologies, probably more in the B to B space than in the B to C space.

Badaracco: I completely agree.

Meanwhile, from a standpoint of global competitiveness, I think there is the question of whether Japanese companies can become global enterprises in the true sense of the word.

Konomoto: Japanese and German companies are said to share a similar temperament, but a comparison shows that while many German firms have been able to globalize both their operations and their management, Japanese companies have only succeeded in globalizing their operations. Over the past 10-plus years, therefore, the management styles at Japanese and German firms have diverged greatly.

Badaracco: Some Japanese firms have been criticized for having global production and sales organizations but deferring all important decisions to Japanese executives who are based in Japan. Japanese executives' reluctance to delegate authority may be something that needs to be addressed.

Konomoto: I think one other problem is that Japanese firms tend to have more complex operational models than their overseas counterparts. It will probably be difficult to establish global management organizations unless these models are simplified. Their complexity means they can only be fully utilized by Japanese staff, and that is why it is ultimately Japanese executives who make the decisions. If Japanese companies want to globalize their management organizations, they need to develop simpler operational models that can be utilized by people of various nationalities.

Badaracco: So the phenomenon of "Galapagosization"—used to refer to the isolation of certain cultural characteristics and technologies to Japan—can be observed not only in products but also in the area of management?

Konomoto: I think so. Based on the assumption that Galapagosization (complexity) of operations leads to Galapagosization of management (so that only Japanese can become managers), some firms are trying to establish a system in which the Japanese headquarters will remain on its own "island" while overseas operations will adopt a global-standard business model.

This "one company, two systems" approach is based on the belief that Japanese management structures will not function overseas, while at the same time relatively simple overseas management structures are not suited to the Japanese, who are accustomed to complex, finely detailed operational structures. For example, some Japanese companies are moving the headquarters of divisions with a high percentage of foreign operations overseas and managing them with multinational teams. They then send Japanese executives to those operations to learn global management protocols.

Badaracco: It must be difficult to maintain such a "double standard."

You used the terms "complex" and "finely detailed" to describe Japanese operational models. I think those terms are also excellent descriptions of Japanese culture itself. And I mean that as a compliment. Americans and Germans tend to be more practical.

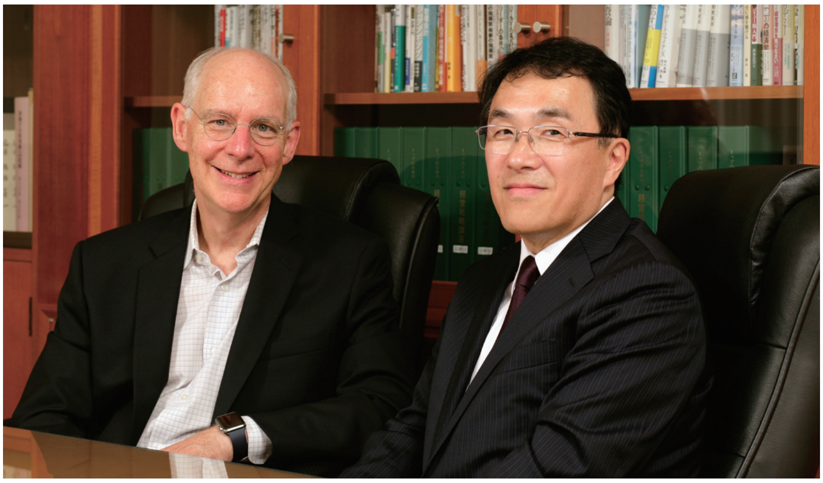
Konomoto: Have you ever been to a traditional Japanese inn, or ryokan? The differences between Japanese and western culture are analogous to the differences between these inns and western-style hotels. At a ryokan, there is a hostess who attends to your every need during your stay. Hotels can also provide a high level of service, but the goal is always to provide service efficiently to all guests, unlike the entirely personalized service one receives at a Japanese inn.

Japan's global enterprises tend to have very low margins—I suspect most have single-digit operating margins. Why is this the case when these firms are globally active and have extremely high-quality products? I think a key reason is the complexity of their operational models. When competing globally, a company needs to establish a system for providing efficient hotel-like service, not ryokan-like service. Unless operations and management can be simplified based on rational principles, I think it will be difficult for any Japanese firms to become truly globalized.

Badaracco: Japan also faces the problem of an aging population, and it may be that the whole country needs to adopt a more simple and sustainable way of life.

Konomoto: Japanese firms may need to create simpler internal organizational and operational structures in order to boost productivity in Japan, which faces a declining birth rate and an aging population, and also to facilitate globalization.

I have greatly enjoyed our talk today. You reminded us that the subject of executive development actually covers a wide range of issues, including the relationship between the CEO and the supporting executive team, the development of a successor, the broadening of the potential base from which executive candidates can be selected, and the establishment of global management organizations. Thank you for your time.



about NRI

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