Restructuring in Japan

Unexpected opportunities for foreign companies

Study based on a company survey jointly conducted by the German Chamber of Commerce and Industry in Japan (GCCIJ) and Roland Berger Strategy Consultants

February 2009
Contents

Preface ................................................................................................................. 5

What’s changed in Japan and why? – Restructuring programs of Japanese companies and the business environment ................................................................. 6

Survey findings
How do Japan-based foreign companies successfully restructure? .............13

Conclusions
Foreign companies enjoy more freedom than Japanese companies ..............21

Recommendations
Don’t exaggerate Japan’s peculiarities, but be aware of subtleties .......... 23

Authors .............................................................................................................. 26
Despite the changes that have shaped the Japanese economy in recent years, we still encounter distinctive features of business in Japan. Foreign managers working in the country have long been well aware of certain typical practices, whether they concern the long-term supplier relationships, lifelong employment or the seniority principle. And this experience has led to the Japanese subsidiaries of foreign corporations adapting more or less to the Japanese business environment.

But what happens when big changes have to be made – when more competition, rapid sales slumps or tougher profit targets imposed by the foreign parent company demand a tough restructuring program? The people heading the Japan-based subsidiary then find themselves in a dilemma. On the one hand, they are under pressure to restructure and that probably means cutting jobs and consolidating the supplier portfolio. On the other, they think they have to consider a Japanese business environment in which “you can’t fire anyone” and the long-term relationships with suppliers seem sacrosanct. Japan, too, has been hit hard by the present financial crisis. So restructuring programs of every kind will again be at the top of the agenda, both for Japanese and for foreign managers.

So what’s possible and what is not possible in Japan? How can a foreign company design an effective restructuring program for its Japanese subsidiary? Our study seeks to provide answers to these questions. The term “restructuring” is used here to cover all far-reaching changes, not only those affecting the workforce but also changes in organizational structure, supplier portfolio and business strategy.

The results of our survey are surprising. We found that foreign companies enjoy a far greater degree of freedom in Japan than domestic companies. What’s more, Japan’s peculiarities need not be an obstacle to restructuring, but can sometimes even help. The point is to know how to use the available scope for restructuring and to proceed sensitively but without falling into the trap of excessive self-restraint.

The study was compiled in the second half of 2008 as a joint project by the German Chamber of Commerce and Industry in Japan (GCCIJ) and Roland Berger Strategy Consultants. It is based on an online survey in which questionnaires were sent to the senior management of 385 European companies in Japan. A total of 98 replies were evaluated, representing a response rate of 26%. In addition, a number of the companies responding agreed to in-depth follow-up interviews.

Since the study’s findings are largely based on confidential information, we cannot identify the companies taking part or the individuals interviewed.
Restructuring programs of Japanese companies and the business environment

How have Japanese companies been restructuring since the Bubble Economy burst? The mid-1990s saw a sharp rise in the number of restructuring programs in Japan. Japanese firms began taking a number of actions that are commonplace in Europe, such as divesting assets, cutting jobs and consolidating supplier portfolios. But this did not mean that the differences between the Japanese and the American or European approach to restructuring disappeared. In the following sections we shall look at these differences and the special features of Japan that underlie them. We shall consider them here in four spheres: strategy, organization, employment and suppliers. The choice of instruments was motivated by the need for flexibilization and job cuts without allowing too much conflict to arise over the institution of “lifelong employment”. After all, the tradition of serving a company and having a job for life at any price is so deeply rooted in Japanese working life that economists even speak of “in-house unemployment”.

Strategic alignment

Japanese companies were embedded for decades in an environment of stable shareholders and multilateral cross-shareholding. The links with other companies went well beyond the business ties common in the West. One such close arrangement was seen in the keiretsu type of business groups within which highly intensive financial and trading dependencies existed. Banks often played a key role in such business groups. This was the background that explains, at least in part, the strongly expansive, diversification-oriented strategies pursued by Japanese companies in the 1980s. The banks were largely interested in risk spreading and expanding financial services for their business customers. The shareholders, however, would have been better served by a stronger focus on returns and core business operations designed to achieve greater transparency. Many changes in Japanese firms have since strengthened these trends, but they are still less important than in Europe, let alone in the USA.

After the collapse of the Bubble Economy, the importance of cross-shareholdings and what is known as stable shareholders declined sharply. At the same time, the share of foreign and institutional Japanese investors rose. One manifestation of this trend was the wave of corporate restructuring as numerous Japanese companies or parts of companies were acquired by investment funds. These developments have had a major influence on the restructuring of Japanese industry as a whole.

In terms of strategic restructuring after the Bubble Economy had burst, Japanese companies began to focus more strongly on their core business and treated diversification much more cautiously. And many Japanese manufacturers began relocating their production to low-wage economies in Southeast Asia. The large-scale relocations of production became known in Japan as kuudoka (hollowing out). However, we are now seeing movements in the other direction as high-tech companies in particular bring manufacturing capacity back to Japan.
Organization

The organization of Japanese businesses used to be subject to all sorts of restrictions under company law. But one of the responses of the government to the economic crisis was to begin widening the options for forming companies. In 1998, "pure" holding companies were again permitted. Two years later, amendments to the Commercial Code made it easier to establish spin-offs. These two actions helped to create more transparent structures, revealing which individual business units were succeeding and which were failing. The large Japanese corporations made full use of this new organizational freedom. After spin-offs had been permitted, over six hundred were set up in the first twelve months alone. The figure for 2005 was more than 1,100.

In addition to transparency, another positive impact of the reforms was that subsidiaries were able to break with the high wage levels enjoyed by staff in the parent company. Once the segments had been established as the responsibility of autonomous units under the umbrella of the holding company, it became easier to split them off, sell them to other companies or bring them into joint ventures. These M&A activities, with business operations being exchanged and amalgamated, were part of a consolidation of Japan’s fragmented and highly diversified competitive landscape. These deals were further simplified by a series of amendments to the law on mergers and acquisitions. Thus, stock swaps were permitted between Japanese companies in 1999, and then opened up to foreign companies in 2007 through "triangular mergers". The number of M&A transactions has drastically increased in recent years.

![Figure 1: Development of M&A deals, 1985-2007 (number)](source: Recaf 2008)
Restructuring in Japan

What's changed in Japan and why?

For a very long time, the core workforce of large Japanese corporations enjoyed an implicit guarantee that they would be employed until retirement (shuushin koyou, “lifelong employment”). But this quasi-guarantee of a job for life has rested on three pillars: the labor laws, the consensus on job security, and the labor market. And all three have been undergoing important changes in recent years.

In the field of law, the Labor Standards Act was passed in 2003 and set out new conditions under which dismissals are possible. Indeed, the courts had already begun treating appeals against dismissals less sympathetically from 2000, giving companies wider scope for their human resources management. And other employment regulations had been revised even before that, especially with the amendments of 1996. These included greater powers to assign workers to other workplaces, opening the door to the use of temporary staff and the development of non-core workforces.

Switching between employers has also become more common, as Japanese firms appoint more “mid-career hires”, i.e. candidates with previous professional experience. Moreover, the public got used to the idea that job security cannot be taken for granted when Japanese companies began downsizing their workforces during the recession. On the other hand, surveys by Japan’s Statistics Bureau show that not even 10% of Japanese employees are interested in taking a job elsewhere. Lifelong employment remains extremely important to employees of all age groups. Generally speaking, we can conclude that no paradigm shift has occurred here. There is no sign of an end to the mutual expectations of a job for life.

In terms of perceptions, our survey of European companies in Japan also shows that managers regard employment law and the job-for-life tradition as the key external obstacles to restructuring (see Figure 2). Managers are not aware of the relaxing of regulations in the legal sphere, but they have certainly noticed a winding down of lifelong employment in practice (see Figure 3).

### Figure 2
Obstacles to restructuring [times mentioned]

<table>
<thead>
<tr>
<th>External Factors</th>
<th>Times Mentioned</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dismissal protection under labor law</td>
<td>23</td>
</tr>
<tr>
<td>Traditional supplier relationships</td>
<td>25</td>
</tr>
<tr>
<td>Tradition of life-long employment</td>
<td>21</td>
</tr>
<tr>
<td>Complex distribution system</td>
<td>20</td>
</tr>
<tr>
<td>High severance payments</td>
<td>19</td>
</tr>
<tr>
<td>Rigid restructuring program by the parent company</td>
<td>16</td>
</tr>
<tr>
<td>Complex rules on restructuring under company law</td>
<td>12</td>
</tr>
<tr>
<td>Resistance from business partners</td>
<td>11</td>
</tr>
<tr>
<td>Negative media coverage</td>
<td>9</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Internal Factors</th>
<th>Times Mentioned</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reluctance to change</td>
<td>24</td>
</tr>
<tr>
<td>Lack of crisis awareness</td>
<td>29</td>
</tr>
<tr>
<td>Lack of experience with project work</td>
<td>26</td>
</tr>
<tr>
<td>Union influence</td>
<td>9</td>
</tr>
</tbody>
</table>

Source: Survey of European companies by DIHKU and Roland Berger, 2008

Lifelong employment still very important
Despite the low number of in-house factors mentioned by European managers, there is no doubt that the obstacles to restructuring plans are primarily internal. We are talking here about the lack of willingness to embrace change on the part of employees and their lack of familiarity with structured and tightly scheduled project work.

Even in the recession that followed the collapse of the Bubble Economy, there was no clear trend toward Western restructuring patterns accompanied by large-scale lay-offs. It is true that workforces were downsized, some radically. Yet this happened – and still happens today – by reducing the traditional privileges like lifelong employment to ever smaller groups of core staff. Companies have increased the proportion of non-core workers in their workforce, i.e. female, temporary and part-time workers. They serve as a buffer offering flexibility in times of economic difficulty. In fact, the number of these irregular workers had already begun rising toward the end of the Bubble Economy period. The ensuing collapse accelerated this trend. Over the longer term, their share of the total workforce rose from 15% in 1984 to 34% in 2008.
Japanese companies generally seek to drive down labor costs by the following means:

- Reducing
  - Overtime
  - Bonuses
  - New appointments
- Transfers
  - To other companies
  - Within the company
- “Voluntary” early retirement and redundancy arrangements
- Replacing core staff with non-core workers and then laying off non-core workers in times of crisis

Two of these instruments are very specific to Japan and play a major role: staff transfers to other companies and early retirement schemes.

The transfer of employees to other companies, usually to suppliers or subsidiaries, takes place both on a temporary basis or as a permanent arrangement. Transfers are usually accompanied by a salary cut. In the case of a temporary transfer, the worker has the difference made up by the posting company. If transferred permanently, he receives a one-off settlement. However, studies show that temporary transfers – typically from a large corporation to small and medium-sized companies in which it has shares – are often the first step toward a permanent transfer. In many cases this means that the movement from a secure job in the corporation to lower pay or unemployment is ultimately not avoided but only delayed.
Early retirement deals are only special to Japan in as much as they are often offered along with compensation to staff as young as thirty. In other words, they amount to severance agreements and thus a form of dismissal, because the settlement goes nowhere near to replacing a genuine retirement pension. For many younger employees, the settlement hardly amounts to a year’s salary. Even Japanese managers admit, when probed, that they are really redundancy arrangements. So the term “early retirement” is only a euphemism. But it does allow the public to maintain a belief that Japanese companies did not fire anyone even through the extreme economic difficulties that followed the Bubble Economy years.

Case study: Use of irregular workers at Canon

In 1995, Canon employed 10% of its workforce as irregular workers in its factories. By 2000 the proportion had grown to 50%; and by 2007 to as much as 70%, now a clear majority. By using such high numbers of irregulars, the company has been able to maintain the job-for-life privileges of a small core workforce. However, some of these irregulars do at least have a chance of joining the company’s core staff in the future.

Supplier relationships

In Japan, supplier relationships are frequently long-term arrangements involving customer-specific products and high customer-specific investments. Even cross-shareholdings and staff exchanges are not uncommon and sometimes the way suppliers are managed looks more like in-house coordination than deals with outside companies.

Japanese companies also had to restructure their sourcing practices in the recession. These practices by the big corporations passed down the pyramid of supplier networks like a wave. In the mid to late 1990s, the large automakers undertook a radical shakeup of sourcing. In order to achieve drastic cost cuts (10% to 15%), suppliers were pushed into laying off workers, off-shoring production and paying less to their own suppliers in turn. In all these actions they were advised by their customers, the automakers. The most rigorous restructuring approach was taken by two corporations now under foreign management: Mitsubishi Motors and Nissan. They both dispensed with holdings in their suppliers, transformed long-term partnerships into market-oriented relationships, standardized and modularized many of their inputs, and began demanding big price reductions. What’s more, they significantly reduced the number of suppliers they used.

The fact that the European companies participating in our survey continue to regard traditional supplier relationships as a major obstacle to restructuring suggests that the foreign managers might be underestimating just how far the Japanese business environment has been transformed.
Restructuring in Japan

What's changed in Japan and why?

Case study: Restructuring of supplier management at Nissan
As in all aspects of restructuring, Nissan was a pioneer in the field of supplier management. Under the leadership of Carlos Ghosn, who now enjoys cult status in Japan, the company’s purchasing costs were drastically reduced. This was a key element in the financial success of the "Nissan Revival Plan", with almost the entire operational profit of 290 billion yen in 2000 coming from savings made in purchasing. Together with Renault, Nissan changed many elements of its supplier relationships. In particular, the company cast off most of its holdings in suppliers. From 1999 to 2002 alone, it had dispensed with its controlling interests in seven of the ten largest long-term suppliers – a decision which was bound to cause some harsh conflicts. On top of this, Renault and Nissan combined their purchasing power and began buying many components from the same supplier on more favorable terms. By 2004, their joint purchasing organization, RNPO, was covering 70% of the overall purchasing volume. The number of suppliers to Nissan fell sharply within three years, by 40% among parts makers and by as much as 60% among service partners. Other elements were maintained, such as the practice of switching older Nissan staff to supplier organizations or the Nisshokai supplier association. But, generally speaking, the approach adopted by Nissan offers a good example of restructuring in the purchasing sector. It has shown how much is possible in Japan.

Japan – changes relevant to restructuring

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Previous key drivers</th>
<th>Changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholder/strategy</td>
<td>• Cross-shareholdings • Stable shareholders • Few foreign shareholders • Stakeholders more important than shareholders</td>
<td>• Sharp decline in cross-holding relationships • Higher proportion of foreign shareholders • Stronger shareholder orientation</td>
</tr>
<tr>
<td>Organization</td>
<td>• Management options restricted by laws</td>
<td>• Spin-offs made easier • Pure holding firms permitted • M&amp;A facilitated</td>
</tr>
<tr>
<td>Employment</td>
<td>• Lifelong employment for core workers in large corporations • Restrictive rulings under labor law</td>
<td>• Further shrinkage of the core workforce, large numbers of non-core employees • Employer-friendly rulings</td>
</tr>
<tr>
<td>Suppliers</td>
<td>• Cross-ownership • Long-term supplier relationships • Keiretsu structures</td>
<td>• Reduced cross-ownership • More market-oriented relationships • Looser keiretsu structures</td>
</tr>
</tbody>
</table>
Survey findings

How do Japan–based foreign companies restructure successfully?

Profile of the companies surveyed

The European companies in Japan who responded to our survey come from a range of different industries, the main ones being mechanical engineering, professional services and automotive and automotive supplies.

Approximately half of all the participating companies employ up to 50 people, but nearly a quarter have over 200 employees.

As for the responsibilities of the managers questioned, their activities are mainly focused in the fields of marketing & sales (83%), while quite a few participants are also active in production (26%), research & development (25%) and sourcing (19%). Multiple answers could be given here.

Restructuring actions by foreign managers more accepted

Two thirds of the participants had carried out restructuring actions in the last ten years, a quarter of them reporting large-scale programs. The reason given for restructuring was primarily the general imperative to reduce costs (36%). 18% of managers said M&A was important, 13% spoke of responding to stagnating sales, and another 13% mentioned global programs run by the parent company.

As many as two thirds of participants thought they enjoyed more freedom to restructure than domestic Japanese companies.

The following statement was typical for our respondents: “Employees are more willing to accept non-Japanese actions from foreign managers. This is a great advantage when restructuring.” Only 17% believed they face tighter restrictions than their Japanese competitors. The managers thought there were considerable limitations on their efforts to restructure employment and supplier arrangements, but only a few identified the influence of the media and resistance on the part of business partners as an obstacle. A surprising finding is how successful restructuring programs have been: About a third of companies stated that the objectives of their program had been achieved in full. As many as two thirds thought they had largely met their targets. Just 2% stated that they had largely failed. However, we must not forget that the statements are self-assessments and the picture painted here may well be too rosy.

An important success factor became apparent from many interviews, irrespective of the kind of restructuring being considered: careful monitoring of implementation. All too often the foreign side had taken a lack of open conflict with staff as a sign that the Japanese employees agreed with specific changes, so the managers expected smooth implementation. But in many cases the actions were then shelved or delayed. Staff either used “misunderstandings” as an excuse or simply “sat out” the changes. Until a company realizes what is happening, valuable time is lost. This is illustrated by the following experience reported by a German supplier in the mechanical engineering sector.
Survey findings

Case study: Failure to monitor implementation and spot the staff’s delaying tactics

A German engineering supplier had taken over a Japanese company. Economic difficulties and the problem of integrating the new business demanded a series of changes. These seemed to have been accepted in-house without any objections from employees.

In practice, however, the Japanese staff were undermining implementation, in some instances quite drastically. For instance, it was agreed that particular products would be discontinued and announcements would be issued. The plan was to give customers several years to prepare for these changes, as is common in the industry. Shortly before the withdrawal deadline, the German CEO was meeting with one of the customers affected. He got around to mentioning the product withdrawal, which according to his information had been announced more than two years previously and was due to take effect in two weeks’ time. But the customer had not been informed by Japanese sales, and the meeting ended in disaster. The consequences were a refusal by this customer and others to do any more business with the firm for five years and a damaged reputation in the market.

The German CEO also had a few unwelcome surprises in sourcing negotiations. When meeting a supplier, he referred to the conditions in the English-language supply agreement in front of him. But the supplier insisted on more favorable terms in accordance with the Japanese version of the same agreement. It turned out that the German company’s buyer had changed the agreement in the Japanese translation to the benefit of the supplier.

In both cases, the Japanese staff responsible explained that the situation had been caused by “misunderstandings”. The management of the German company has drawn its own lessons:

• Formulate instructions very precisely and rule out any potential for “misunderstandings”.
• Establish a close-meshed system to monitor implementation and identify foot dragging in good time.
• Go directly to the customer and don’t rely on staff.
• Best of all, convince your own people of the need for change so that they have no reasons for using delaying tactics.

Japanese companies themselves began far-reaching restructuring after the collapse of the Bubble Economy. This involved terminating the long-term relationships they used to have with employees and suppliers. The following sections look at how far the Japanese business environment applies to foreign companies in Japan and what actions the companies in our survey have taken in the respective fields of restructuring.
Strategic alignment

There is an obvious difference between Japanese and foreign companies. Since the owner of a foreign business in Japan is normally the foreign parent company, the Japan-based subsidiaries don’t need to worry about the views of Japanese shareholders. As for Japanese corporations with foreign shareholders, the foreigners have often served in the past as an effective instrument for legitimizing restructuring actions to the Japanese business world – a good example is Renault’s role at Nissan.

In terms of restructuring fields, fewer companies in our survey reported strategic actions. Most had focused on workforce adjustment or organizational changes (see Figure 5). But the lack of strategic restructuring may partly reflect the relatively small size of these companies, since they generally leave strategy decisions to the parent company. Among the strategic actions they did report, the focus was clearly on expansion into new business segments. This objective was cited 26 times. When it came to implementation, however, they clearly faced some major obstacles. Acquisition of companies in Japan was reckoned to be one of the most difficult of all strategic actions (see Figure 6).

---

**Figure 5**
Frequency of implemented restructuring actions [times mentioned]

<table>
<thead>
<tr>
<th>STRATEGY</th>
<th>EMPLOYMENT AND PERSONNEL COSTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expanding into new business segments</td>
<td>Downsizing</td>
</tr>
<tr>
<td>Reallocating distributors</td>
<td>Internal transfers</td>
</tr>
<tr>
<td>Acquiring (parts of) companies</td>
<td>Cutting bonuses</td>
</tr>
<tr>
<td>Changing distributors</td>
<td>Reducing salaries</td>
</tr>
<tr>
<td>Selling whole business segments</td>
<td></td>
</tr>
<tr>
<td>Reducing production capacities</td>
<td></td>
</tr>
<tr>
<td>Winding down whole business segments</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>ORGANIZATION</th>
<th>SUPPLIERS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restructuring organizational units</td>
<td>Reducing purchasing prices</td>
</tr>
<tr>
<td>Reorganizing marketing and sales in-house</td>
<td>Consolidating the supplier portfolio</td>
</tr>
<tr>
<td>Changing the supervision and monitoring system</td>
<td></td>
</tr>
</tbody>
</table>

Source: Survey of European companies by DIHK and Roland Berger, 2008
Restructuring in Japan

Survey findings

When it comes to changing the legal structures of a company, foreign businesses face the same restrictions as domestic ones. However, these rigidities were mentioned by only a few of the companies surveyed. And even these did not perceive the legal options as particularly obstructive (see Figures 2 and 3). Part of the reason may again be that many of the subsidiaries in our survey are pretty small and tend to have a simple legal structure. The organizational action cited most frequently was the restructuring of organizational units. However, most firms did not consider this particularly difficult and reported that their plans had been implemented successfully (see Figure 6).

Case study: Transition from relationship-oriented sales to a more technical approach

Foreign managers are deeply aware of the strong role of personal relationships in customer-supplier dealings. In fact, it has become part of their mindset and is hardly ever questioned. Their Japanese sales people often reinforce this attitude. When moves are taken to adopt a more technical relationship that would be normal in Germany, the counter argument is always that the Japanese customer insists on the status quo of close personal ties in daily business and that this ensures high quality products and services.

Yet the example of a German automotive supplier shows that things can be done differently. The company partly relocated product development back to the parent company. The engineers whose jobs had disappeared were transferred to sales. Although they initially saw this treatment as degrading, the positive feedback from customers showed that this step had been long overdue. It was discovered that the customers were already a step ahead of the German company. In fact, Japanese automakers had begun moving away from relationship-centered business practices long ago – not in all sectors, but in many – with the collapse of the Bubble Economy. And the changes intensified with the entry of European groups like Renault or DaimlerChrysler. For the German automotive supplier, the paradigm shift from “relationship manager” to “proponent of technical benefits” resulted in sustained sales growth.
Foreign companies in Japan often have human resources structures that differ from the setup in Japanese companies. They employ significantly more lateral hires from other industries and make less use of the seniority principle. Due to the relatively small size of the companies surveyed, their scope for in-house training is limited, so they tend to recruit specialists for specific positions. By contrast, Japanese companies adopt a more generalist HR strategy, appointing graduates fresh out of university. In fact, job applicants and staff themselves tend to expect foreign companies to be different. What they appreciate about foreign companies is shorter working hours, longer holidays, better remuneration, faster promotion and performance-based rewards. And women often praise the equal opportunity policies. On the other hand, a job with a foreign company is still considered risky compared to the career security offered by Japanese employers.

Large foreign companies in Japan are subject to a number of restrictions under labor laws when they seek to cut jobs on a large scale, but this is not the only obstacle. Big European subsidiaries in Japan said in our survey that their room for maneuver is further limited by attitudes on the labor market for university graduates and the markets for their products. What they fear here is damage to their reputation, which could be exacerbated by negative press coverage of dismissals.

The scope for adjusting staffing levels are seen as limited by a number of factors. The survey found that the legal obstacles to laying off staff were mentioned most frequently by managers. But lifelong employment expectations were also still ranked as an important restrictive factor (see Figure 2). Together, these two points were seen as the main barrier to workforce adjustment, while Japanese unions appear to play only a minor role compared to those in many European countries. Many of the managers expressed great relief that job-for-life expectations had weakened. Yet they seem to have hardly noticed the dismantling of legal obstacles under Japan’s labor law (see Figure 3).

**Figure 7**

*Detailed view of job cuts – frequency, difficulties and success*

<table>
<thead>
<tr>
<th>Staff cuts made by 44 of the 98 companies surveyed</th>
<th>High</th>
<th>Low</th>
</tr>
</thead>
<tbody>
<tr>
<td>Early retirement scheme*</td>
<td>28</td>
<td></td>
</tr>
<tr>
<td>Lay-offs</td>
<td>39</td>
<td></td>
</tr>
<tr>
<td>Staff transfers to suppliers</td>
<td>7</td>
<td></td>
</tr>
</tbody>
</table>

* Number of times mentioned respectively, multiple answers possible

Source: Survey of European companies by DIHK and Roland Berger, 2008
Restructuring in Japan

Survey findings

Of all the restructuring actions mentioned, staff cuts took second place, and lay-off plans are clearly affected by these barriers. Most of the companies questioned said they had ultimately been successful in reducing their workforce, but almost half noted there had been difficulties with the actions they took. By contrast, the widely used Japanese system of early retirement tends to run more smoothly (see Figure 7). But transferring employees to suppliers or to other associated companies is not a realistic option for the smaller European subsidiaries with very little supplier integration. Summing up, we can conclude from the survey that both the legal situation and the job-for-life tradition still represent significant external limitations, even though foreign companies generally enjoy greater freedom than their Japanese counterparts.

Case study: Japan’s company-as-community tradition can even make staff cuts easier

The Japanese subsidiary of a German automotive supplier, run as a joint venture with a Japanese partner, got into difficulties in the late 1990s. Following the collapse of the Bubble Economy, its customers among the major Japanese automakers began ordering far fewer parts. Sales fell by two thirds. The company was initially able to keep its head above water thanks to the agreed compensation paid by customers for the quantities they no longer wanted. But by 1998, tough restructuring had become unavoidable. The shedding of thirty employees (out of around 180) was achieved smoothly and very quickly. Within three months these people had left the firm without the employer having to give notice and with relatively low settlements. So what had happened?

The new CEO, a Japanese manager seconded from Germany, appealed to the solidarity of those identified for redundancy. To build a new, rejuvenated corporate culture in the Japanese subsidiary and to cut back on personnel costs, he had selected only people older than 50. Appealing for their acceptance, he used the following vivid metaphor: “Our company is a boat caught in a storm, and we have a leak. The way things stand we won't make it back to port. You, as older employees, have life-jackets in the form of the experience you have built up over many years. Your younger colleagues have no such life-jackets and will otherwise drown. So I implore you: Leave the boat, swim to safety, and wait for us at the port. We’ll pick you up there later.”

So thirty people aged over fifty agreed to leave the company. Some looked for work elsewhere, others went freelance. And when the subsidiary had overcome the crisis, its Japanese head kept his promise. Some of these older ex-employees were reemployed, some of the freelancers were awarded contracts by their former employer. We see here that the company-as-community tradition still associated with many companies in Japan has both advantages and disadvantages. On the one hand, profitable parts of a business are expected to cross-subsidize loss-making divisions. On the other, we have seen from the above example that a company can successfully appeal to the older workers’ sense of solidarity with their younger colleagues.
Case study: Influence of labor unions
Most of our respondents state that the unions in Japan have not played a significant role in the implementation of restructuring plans. Yet this may be due to the fact that many German subsidiaries do not have unions. The situation might look very different in cases where a Japanese company has been taken over. In an extreme case, the German management can even find themselves dealing with several unions. This was the experience of a German company that had taken over a Japanese mechanical engineering firm. Not only was there a large but relatively moderate union active among the workforce but also a small communist union causing quite a few headaches for the German CEO. While agreements could be reached fairly quickly with the moderate majority union, the communist minority would try to block any compromise right up to the last minute.

What about lay-offs and severance pay?
All sorts of figures and rumors can be heard with regard to the size of settlements for workers laid off in Japan. What must a company realistically expect to pay? Like almost every other aspect of business in Japan, the answer is: It all depends. The survey identified the following quantitative and qualitative factors:

• **Length of employment with the company:** A few rough figures exist here as guidelines. For instance, a severance settlement after ten years could be set at 0.8 times the employee's basic annual salary (without bonuses), and after thirty years at 3.5 times this salary.

• **Power of employees:** A company operating in the consumer goods industry must maintain a good reputation among its customers, the general public. Here, the potential of the workforce to exert pressure is naturally greater than in the case with a firm that produces capital goods. Public protests by employees can do considerable harm to the reputation of a company selling to the public. A second aspect is the strength of the union. If it is well organized and backed by a broad majority within the company, the union can obviously exert more pressure on management. But even where there was no union prior to restructuring, employees can turn to the Rengo (the Japanese unions' umbrella organization) for support. Some of our interviewees said the Rengo can be very forceful.

• **Management's negotiating skills:** If managers are able to convince their people that the company faces a difficult situation and that staff cuts are unavoidable, they can gain approval and keep demands to realistic levels. Here, too, it is sensible to follow the Japanese method. When a Japanese company announces concrete targets for staff cuts, it also makes a compensation offer to a large group of employees. Management then waits to see who will apply. Informal pressure can then be exerted to determine exactly who from the group accepts the offer. The important point is that the appearance of a voluntary agreement is maintained so that the staff can maintain their sense of dignity. If, by contrast, individual employees are openly selected for redundancy, there is a far greater risk of opposition.

When it comes to discussing the size of severance payments, misunderstandings can arise if a foreign manager fails to realize that the sums suggested partly cover the pension claims of the staff to be laid off. These claims would have had to be met in any case. While such payments are a cash outflow, they don’t constitute an additional expense, assuming that adequate funds have been set aside for this purpose in the past.
Survey findings

Supplier relationships

Many foreign companies in Japan have very limited supplier relationships, especially if they don’t produce goods in Japan themselves. And three fourths of our respondents are in this position. This is not the case, however, for acquisitions of companies that were originally Japanese. Here, the foreign company finds itself deeply enmeshed in the Japanese institution of supplier relationships. This applies to 18% of our survey participants. The scope for restructuring a company’s sourcing arrangements is constrained here by the relationship with suppliers and their expectations but also by the attitudes of the company’s own staff. The survey found that conflicts arise over actions to achieve restructuring and post-merger integration. The tradition of long-term supplier relationships was cited most frequently as an obstacle to restructuring. Managers did not see much relaxation of these arrangements (see Figures 2 and 3). However, 28 companies reported that they had lowered their purchasing prices, while 21 had consolidated their supplier base.

Case study: Avoiding intermediaries in sourcing

Japanese SMEs often handle their sourcing via trading companies that act as intermediaries, especially if the suppliers are offshore. Although this approach makes things easier, it does entail additional costs. And without any overview of the market, the customer is unable to judge how big these costs are. This was the situation facing a medium-sized Japanese food manufacturer that had been acquired by an investment fund. One of the new management’s cost-cutting actions was to stop the use of intermediaries and establish direct contact with the raw material suppliers in China. Even taking into account the additional costs of handling the deals itself, the outcome for the company was a saving of almost 10% of sourcing costs.

Indeed, it is not uncommon for the trading company to act for the customer on the sales side, too. In this way, such traders can build up a strong negotiating position. Japanese staff become wary of their power. They fear that by putting pressure on a trading company on the purchasing side, there will be negative consequences on the sales side. But more and more companies have succeeded in breaking or at least reducing their dependency on intermediaries. This was the experience of a medium-sized engineering supplier that used a large number of different trading companies to source its inputs. Having come under French ownership, the number of intermediaries was reduced from 250 to 190 in three years.
Conclusions

Foreign companies enjoy more freedom than Japanese companies

The study shows that successful restructuring projects in Japan are possible and in many cases easier than thought. Indeed, they are sometimes even easier than in Europe. This is the experience reported by foreign managers who have restructured businesses in Japan.

European companies operating in the Japanese business environment have far more freedom than their domestic counterparts – both as a general principle and in specific fields. This finding is surprising – at least in terms of the clarity of responses. It certainly helps to correct the belief frequently expressed by foreign managers that doing business Japan involves all sorts of "impossibilities".

It must, however, be borne in mind that the businesses surveyed are dependent on their parent company in Europe. The parent company provides the impetus for restructuring and sets a clear framework for implementation, thus limiting the subsidiary's freedom. In effect, restructuring programs undertaken by European subsidiaries in Japan are always a compromise between the requirements of the European and Japanese business worlds.

We found that the companies surveyed here seem to have mastered this challenge. The overwhelming majority have succeeded with their programs despite severe difficulties in implementation.

The key points in brief

- **Japanese companies** have **radically restructured** since the collapse of the Bubble Economy, reducing their workforce and distancing themselves from suppliers.
- To achieve **extensive downsizing of the workforce**, lay-offs have often taken the form of "early retirement" or been carried out indirectly by means of transfers to partner SMEs.
- The proportion of "non-core workers" with temporary contacts and little job security continues to grow, while in many companies the small "core workforce" still enjoys "lifelong employment".
- **Foreign companies**, which are not subject to pressures from Japanese shareholders, have far greater freedom in their restructuring actions. Looking from the outside, people often overrate the limitations managers face in Japan.
- **Rules set under labor law** and the **job-for-life tradition** are still, however, regarded as **major obstacles to restructuring** by foreign companies.
- **Traditional supplier relationships** also hinder actions to restructure sourcing arrangements.
- In general, however, it is **less the external limitations** and more the internal problems that bother companies. The challenge is to **motivate staff to embrace changes** and guide them in project work.
- Despite these difficulties, the **restructuring programs undertaken by foreign companies in Japan**, even to downsize workforces, have **mainly been successful**.
Conclusions

- In fact, managers of foreign companies do not regard restructuring programs in Japan as necessarily any more difficult than in Germany or the rest of Europe. Some 25% of respondents thought restructuring was even easier than in Germany; 30% said it was easier than they had previously imagined.
- Expansion actions, especially moves to break into new business segments, proved more difficult and far less successful.
- Foreign companies can make creative use of typically Japanese behavior patterns to advance their restructuring programs. The special features of Japanese business should be carefully considered in two areas: communication and implementation monitoring.

Figure 8
How companies estimate their success in restructuring

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>36%</td>
<td>Objectives fully achieved</td>
</tr>
<tr>
<td>62%</td>
<td>Majority of objectives achieved</td>
</tr>
<tr>
<td>2%</td>
<td>Objectives not or hardly achieved</td>
</tr>
</tbody>
</table>

Source: Survey of European companies by DIHKJ and Roland Berger, 2008
Don’t exaggerate Japan’s peculiarities, but be aware of subtleties

So it is clear that restructuring in Japan is possible. To ensure success, however, a number of factors must be observed. At first glance, there doesn’t appear to be anything “exotic” about them. After all, communication is key to restructuring in Europe, too. But when it comes to the concrete implementation, Japan’s special business culture can be decisive. The Japanese dimension often lies in the details, but details are crucial to success.

Identifying and use leeway, questioning “Japan’s peculiarities”

The widely reported “gaijin bonus” also goes to foreigners carrying out restructuring programs. Foreign companies are more easily forgiven for taking unpopular actions, also in human resources. What’s more, most foreign employers have little to do with Japan’s market for graduates, so they can worry less than Japanese companies about damage to their reputation. The challenge is to make use of the freedom that exists.

The example of the German automotive supplier that put sales on a more technical footing demonstrates that not everything a company’s own people describe as specific to Japan really is the Japanese way. It may only be specific to the subsidiary itself or to a Japanese company taken over. Managers often encounter a narrow viewpoint from Japanese staff who rarely change to other companies and have little experience of alternative ways of doing things. While staff are telling a foreign manager that something cannot be done a certain way in Japan, his Japanese competitors might have already built very different structures, putting them well ahead in terms of progressive organization or management methods. The situation can often be easily clarified by a quick benchmarking exercise.

Figure 9: Recommendations for different stages of restructuring

Identifying and use leeway, questioning “Japan's peculiarities”

The widely reported “gaijin bonus” also goes to foreigners carrying out restructuring programs. Foreign companies are more easily forgiven for taking unpopular actions, also in human resources. What’s more, most foreign employers have little to do with Japan’s market for graduates, so they can worry less than Japanese companies about damage to their reputation. The challenge is to make use of the freedom that exists.

The example of the German automotive supplier that put sales on a more technical footing demonstrates that not everything a company’s own people describe as specific to Japan really is the Japanese way. It may only be specific to the subsidiary itself or to a Japanese company taken over. Managers often encounter a narrow viewpoint from Japanese staff who rarely change to other companies and have little experience of alternative ways of doing things. While staff are telling a foreign manager that something cannot be done a certain way in Japan, his Japanese competitors might have already built very different structures, putting them well ahead in terms of progressive organization or management methods. The situation can often be easily clarified by a quick benchmarking exercise.
Restructuring in Japan

Adopt Japanese behavior patterns where they help
Japanese patterns of behavior, such as disguising lay-offs as “early retirement”, can help to achieve certain outcomes, like workforce downsizing, without provoking unnecessary opposition in the workforce. The Japanese approach allows both sides to save face.

Demonstrate reliability, especially as a foreign company
Several of the companies surveyed reported that demonstrating reliability from the outset and building trust had brought important benefits. Trust is critical to success, especially because the Japanese side tends to be generally suspicious of foreign companies with their alleged “hire-and-fire mentality”. Making promises it can keep at its location and gaining the trust of its employees will impact positively on the further development of a foreign company. For example, a German manufacturing company reported on its experience in joint venture negotiations: Its rationalization goals had been much easier to assert after announcing a strong commitment to the Japanese site and to the workforce it was to take over. The union even offered some new ideas to make the plan work.

Take account of employees’ company-as-community expectations
For many employees in Japan, their company is still far more than an employer. It is a community based on solidarity between colleagues that will get everyone through difficult times. At one level, this attitude applies to the relationship between the Japanese parent company and its subsidiaries. As long as the parent company is economically strong, it will find it difficult in the Japanese environment to justify cuts despite poor results. Unlike European business groups, Japanese groups commonly operate cross-subsidies between successful and less successful companies. At another level, there are in-house expectations among staff that will also apply to a foreign-owned Japanese subsidiary. For instance, it is commonly felt that managers should reduce their own salaries before seeking to downsize the workforce. Staff also expect to see transfers between functions rather than lay-offs in one section and appointments in another, even where such moves won’t work. In Germany, negotiations over staff who have to be fired are often limited to questions of legal entitlement and compensation schemes. In Japan, much more support is expected, as the participants in our survey confirmed. Many companies, for example, become actively involved in finding new employers for the people they lay off.

Communicate closely, informally and in good time with in-house multipliers
The managers in our survey rated close and direct communication as the most important success factor. Communication is indispensable, not only to convince staff but also to get feedback. Where this cannot be achieved through official channels, informal discussions after work might work, including “nomunication” (from the Japanese nomu: to drink). Moreover, in many companies in Japan there are “gray eminences” who can be key multipliers. These are older employees who do not occupy an important position in the organizational hierarchy and even may appear superfluous at first glance, but they have a high standing in the eyes of their colleagues. Younger employees in particular take instructions from them irrespective of official lines of command. Identifying these “gray eminences” and communicating through them, at least in certain matters, can be very helpful. This has been the experience of managers in a number of successful foreign companies. By contrast, Japanese staff are less impressed by impersonal media like in-house journals or staff news on the intranet.

Recommendations
Another important aspect is the way messages are presented. In Europe the conclusion or the main point usually forms the starting point for a message and the details follow. The Japanese, however, tend to adopt an inductive way of arguing. They start with concrete facts and examples and then derive the main point.

Communication also has a legal dimension. Under Japanese law there are numerous procedural requirements for handling lay-offs. These range from notifying the labor office (if more than 30 workers must go) to observing the appropriate number of rounds when negotiating. Foreign managers are recommended to take expert legal advice here.

**Involve Japanese staff when planning changes, but don’t expect too much in project work**

When asked about internal obstacles to restructuring, three factors were highlighted by our management respondents: a lack of crisis awareness, an associated reluctance to change, and a lack of experience with project work. All three are staffing factors. Let us start with the last factor: Project work means operating outside the familiar hierarchies and long-standing relationships. It means collaborating with colleagues from other departments and divisions. For Japanese staff, these demands generate additional insecurity and additional stress, because in a temporary project organization there are no clear rules governing hierarchical relations. In some cases it is also difficult to get Japanese staff to provide clearly structured facts and make recommendations based on the facts. As for the first two points, these factors are closely related: Only when people develop crisis awareness can they be expected to take ownership of far-reaching changes.

**Ensure careful monitoring of implementation**

An absence of open opposition to changes is certainly not the same as a smooth roll-out. In Japan, special attention must be given to implementation because conflicts can easily be underestimated. Delaying tactics and attempts to "sit out" changes are common patterns of behavior in companies where the workforce is skeptical about the need for restructuring. This was demonstrated in the case of the German supplier in the mechanical engineering industry. The best approach is therefore to convince employees that changes are needed. Since this doesn’t work in all cases and for all staff, it is essential to find out what is really happening by means of carefully monitoring implementation. Especially where changes mean bad news for suppliers or customers, managers are recommended to check whether the Japanese staff have passed on the facts as agreed or whether difficult points have been left out or watered down out of consideration for a business partner.
Dr. Dirk Vaubel  
**Partner, Roland Berger Strategy Consultants**

Dr. Dirk Vaubel has lived in Japan for over thirty years, first working as a corporate attorney, then as Managing Director for Wella Japan. He became a partner at Roland Berger Strategy Consultants in 1991. With his consulting expertise, Dirk Vaubel has helped to establish and expand many foreign companies in Japan, sitting on the board of directors of some of these companies. His main focus has been on market entry in Japan, identifying joint-venture partners and M&A targets, especially in the field of consumer goods and automotive.

Email: dirk_vaubel@jp.rolandberger.com  
URL: www.rolandberger.com

Dr. Carsten Herbes  
**Direktor, Leiter Forschung & Entwicklung, Nawaro BioEnergie AG**

Dr. Carsten Herbes took degrees in Business Administration and Japanese Studies at the universities of Mannheim, Heidelberg and Hitotsubashi (Tokyo). His doctoral thesis dealt with conflicts in post-merger integration between European and Japanese companies. He is currently running R&D at Nawaro BioEnergie AG. Carsten Herbes had previously worked for almost ten years for Roland Berger Strategy Consultants at the Munich and Tokyo offices, where he advised international clients on a range of issues including market entry in Japan, M&A and post-merger integration. He regularly publishes on topics concerning Japanese industry (training, M&A, PMI, German companies in Japan) and lectures at several universities.

Email: carsten_herbes@nawaro.ag  
URL: www.nawaro.ag

Martin Gottschlich  
**Project Manager, Roland Berger Strategy Consultants**

Martin Gottschlich is a Project Manager at the InfoCom Competence Center and has been at Roland Berger for eight years. He has specialized in the development and implementation of strategies and transformation programs in a number of different sectors, including the telecommunications, automotive and high-tech industries. During his two-year period with Roland Berger’s Tokyo office, he supported various Japanese and European key accounts in these industries, designing growth strategies for the Japanese market, restructuring programs and cross-border management assignments. Martin Gottschlich is a trained and qualified lawyer and studied at the universities of Saarbrücken and Keio University (Tokyo).

Email: martin_gottschlich@de.rolandberger.com  
URL: www.rolandberger.com
Marcus Schürmann
Deputy Executive Director of the German Chamber of Commerce and Industry in Japan (DIHKJ)

Marcus Schürmann has worked in Japan since 1989. After representing a German company in the optics industry, he took on a directorship with the Japanese subsidiary of Germany’s largest compressor manufacturer with responsibility for activities in Northeast Asia. Marcus Schürmann joined DIHKJ in 2000. In addition to numerous cross-organizational assignments at the Chamber, he has been advising predominantly medium-sized companies as part of the “DEinternational” service, assisting them with questions of market entry in Japan, change processes and HR management.

Email: mschuermann@dihkj.or.jp
URL: www.japan.ahk.de