Why diversity matters

Japan's economy has been in dramatic decline, says INSEAD professor Stewart Black. What's causing its malaise and can we expect a rebound?

After the ashes of World War II, Japanese firms dramatically rebuilt and transformed themselves, first at home and then on the world stage through exports. By the 1990s when they were buying up icons like Rockefeller Center and Pebble Beach Golf Resort, they seemed headed to dominate the world.

"They were number one", says INSEAD Professor **Stewart Black**. "In terms of revenue, they occupied the top three spots on the Fortune Global 500. In terms of market share, Japan was number one with about a 36 per cent share. The US was number two at about 30 per cent."

But today Japanese firms are not faring so well. Japan's share of the Fortune Global 500 has dropped to around 12 per cent and, says Black, that's a "dramatic fall off."

The Japanese economy has been stagnating for around two decades, but Black attributes the decline in the fortunes of its multinationals to their failure to adapt and globalise.

"They took their systems that worked in Japan and had worked extraordinarily well. I mean, when you think about it, back around 1940 … Japan was only the number seventh economy in the world. They then rose to number two."

"Japan reached that pinnacle primarily through domestic success and exports, which are important, but that will only take you so far before you have to literally expand overseas, and set up factories and so on. And that's where they stumbled, because they sent only Japanese expats by and large."

"Now they're number three, and I'll predict they'll fall some more, because what led to great domestic and export success standardisation doesn't really help you when you expand into foreign and different markets. And that's where they've stumbled and continue to stumble."

"The Japanese have two things working against them; one is their inability to adjust and adapt to markets outside of Japan; and the second thing is the home market is shrinking and a good part of that is just demographics." Japan's population is estimated to have peaked around 2004, Black says, and is expected to continue to decline to about 90 million in 2050.

"So it's a dramatic decrease in population; it's pretty hard to have a growing economy when you have a shrinking population and they're not making up virtually any of that deficit with immigration or anything else. So the prospects for Japan's domestic economy don't look good."

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Japanese firms did expand overseas, setting up plants in the US and Europe, but according to Black's analysis, they failed to diversify their management structures and become truly global.

"When you look at the top executives in Japan, about 99 per cent of them are Japanese. When you look at European companies, about 78 per cent are home country nationals, and when you look at US companies, about 82 per cent. So every multinational still tends to be dominated by nationals from wherever that global corporate headquarters is located. But in comparison, Japanese multinationals have virtually no foreigners as senior executives. So there is no opportunity for different viewpoints, experience and so on to be introduced into their major decisions, especially around global strategy, and that hurts them."

"They have not been good at identifying and developing local leaders. So in most Japanese subsidiaries, not only is the managing director a Japanese expatriate but virtually all of his direct reports are, which is astounding when you think about how long they've been operating in some of these countries."

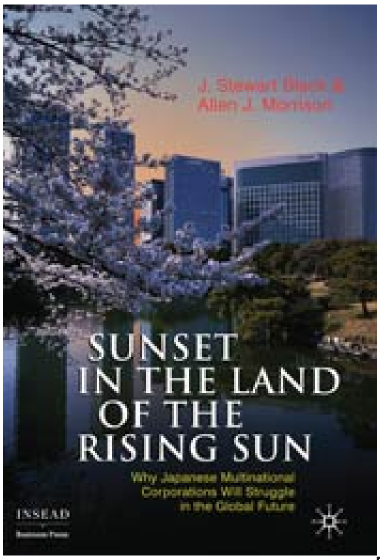
Citing Singapore, Black says a number of Japanese multinationals have been operating in the island republic for 20 to 30 years. "Yet their managing directors, as well as their direct reports, are still all Japanese."

"It's pretty hard to make the case that there aren't qualified Singaporeans to take up those positions. And when you look at European and US firms in Singapore, then a much larger proportion of their local managers are local Singaporeans."

Even if Japanese firms were to decide to localise, "it would take another 20 years for those locals to rise to local positions, then regional positions and global positions," Black says, adding: "I am not so sure that Japanese companies have another 30 years to wait."

"They may be well advised to go out and really look for senior executive talent – non-Japanese senior executive talent – and pull it in and thus far they haven't done it. The only two noteworthy cases are Nissan (Carlos Ghosn is Nissan's CEO) and Sony (Sir Howard Stringer is Sony's chairman and CEO) and in both cases it really got forced on them because of the company's financial crisis."

"You can't get new ideas without new and different people -- people who grew up in the same educational system, culture, language and so on, have similar thoughts. And you can't get new ideas unless you have people who grew up outside of that system. It's not that the Japanese system is bad and the German system is good, it's just that a system is just that – a system."



There are several lessons, Black says, from the Japanese experience. But the key lesson – not only for Japanese firms, but also for multinationals from emerging markets – is for corporations to ensure they have diversity in their leadership. "What helped you grow domestically and grow as an exporter are not those things that help you grow as you expand overseas and then integrate as a global corporation. Because what helps you expand at home and exports is really standardisation and it's what keeps your costs low. As your costs are low it allows you to use price to gain access to overseas markets. But standardisation doesn't really help you grow internationally, because people don't want exactly the same things all over the world and you have to adjust your products."

"Plus what helped you grow at home, in terms of how you managed your people, is not what's going to help you overseas, because people in other countries don't function the same way. They don't have the same management techniques, they don't respond to the same motivators, so you have to change your management style as well."

"Those are two big things that multinationals from the emerging markets have to keep in mind. The third one is they have to be very conscious about ensuring they identify and develop leaders who are outside their home country. And we've done a lot research and this is one of the things they're slow on."

"If we look at some of the largest multinationals from emerging markets in Brazil, in India, in China, in Russia, their senior leadership is still dominated by what I would call home country nationals and they have very few foreigners in their senior ranks."

"So that's probably the most important thing for them to watch out for and to work hard to ensure that they don’t let that home country national bias continue much longer.”

J. Stewart Black is Affiliate Professor of Organisational Behaviour at INSEAD. He has co-authored a new book with INSEAD Affiliate Professor of Management, Allen J. Morrison, called *Sunset in the land of the Rising Sun: Why Japanese Multinational Corporations Will Struggle in the Global Future*.

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