

Chazen International Study Tour Report

Will Toyota Be a Driver for Change in Japanese Industry?

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Introduction

Seventy-four years ago Kiichiro Toyoda, then the head of Japan's Tokyo Toyoda Motor Sales, changed the name of his new automobile firm to Toyota, believing the new name would bring good luck to the fledgling carmaker.

The reason for the change: Writing "Toyoda" in Japanese requires 10 brush strokes, whereas writing "Toyota" requires eight strokes. While "8" is considered a lucky number in Japan because it forms the shape of a mountain, a symbol of strength, the number "10" is not so fortunate — in Chinese characters it forms the shape of a crossroads, suggesting an uncertain path.

Seven decades later, in 2010, Toyota is facing a moment of great uncertainty. A massive worldwide safety recall over acceleration and brake problems involving more than eight million vehicles, including the cutting-edge Prius sedan, has severely tarnished the carmaker's carefully crafted reputation, built over 70 years of hard work and a relentless pursuit of manufacturing excellence.

For these reasons, a trip to Toyota City was perhaps the most anticipated company visit of Columbia Business School's 2010 Chazen Japan Study Tour. In March this year 40 students, one faculty member and a Chazen Institute representative spent seven days in Kyoto, Hakone and Tokyo. The tour, organized by the Japan Business Association, included site visits to Nomura Holdings, Sony, the Mori Building, Gekkeikan's sake-brewing facility and, of course, Toyota.

The trip was made all the more fascinating by the crisis unfolding at this highly respected company, and the carmaker's clumsy and hesitant response to the crisis had only made matters worse, especially as it played out in the media. Just days before our journey began, Toyota's Chief Executive Officer Akio Toyoda made a public apology before U.S. Congress for his company's errors.

A Japanese CEO apologizing before Congress is a highly unusual event. It clearly shows the reputational risk (defined as the damage to an organization through loss of its good name) perceived in the vehicle recall. There is also a fear that Toyota's troubles are damaging the reputations of other Japanese businesses, according to some analysts, and they are raising questions about the viability of Japan's economy and its major corporations.

Challenges lie ahead for Japan's major corporations, and there are lessons they can take from the unprecedented crisis engulfing Toyota. Yet it is also important to note that some Japanese

businesses are embracing change and innovation. Japanese businesses are therefore well positioned for the future — as long as they can learn from the lessons of the Toyota debacle.

Toyota's Troubles

Located one hour from Nagoya in central Japan, Toyota City is a town planner's tribute to the manufacturing might of Toyota, Japan's flagship car manufacturer.

Muscular robotic arms weld together car bodies with devastating speed and accuracy in Toyota's squeaky-clean car production plants, while bands of workers busily inspect new parts, fit in place doors, engines and wheels, and eventually roll fully assembled Corollas, Camrys and Priuses onto the environmentally friendly streets of this car-focused city.

The production line runs with the accuracy of a quartz timepiece, but when problems do occur a worker pushes a button that sounds an alarm and lights a yellow light. Managers quickly consult to determine whether the problem can be fixed without stopping the production line. Red alarms are more serious and they sound a different siren, but they're extremely uncommon these days.

Absolute mastery of the manufacturing process is at the heart of Toyota's enormous success. Over the last 30 years, with a laserlike focus on improving productivity and efficiency, encapsulated by Japan's "kaizen" management philosophy, the revered automaker built a bulletproof reputation for quality that was unmatched in the automotive industry, capturing the car-buying public's adoration with dependable, innovative and reasonably priced vehicles.

But Toyota is much more than simply a Japanese carmaker. It's also the most powerful icon of Japan's rise to manufacturing excellence over the half-century following World War II. It was a potent symbol of Japan's self-confidence on the world stage in the 1980s, and with the perceived safety, reliability and technological superiority of its vehicles providing a key competitive advantage, Toyota has grown in stature over the last three decades, recently claiming the title of the world's number-one automaker — a position General Motors had held since 1931.

Toyota's troubles and their broader implications for Japanese companies was the topic of a lively debate when Columbia Business School's Alumni Club of Japan hosted study tour participants at Josui Kaikan building in the center of Tokyo shortly after the group's visit to Toyota City.

In a discussion moderated by Japan expert and Michigan's Ross School of Business Professor Schon Beechler (also a former Columbia Business School professor), alumni and current students talked about the competitive outlook for Japanese businesses and what the future may hold for Asia's most developed economy.

Kicking off the conversation, Professor Beechler critiqued the recent Newsweek article "Toyota and the End of Japan"¹ as being too pessimistic. Rather than facing a precipitous decline, she said, Japan is instead at "an exciting inflection point."

For other panelists — Japanese nationals educated at American business schools — Toyota's clumsy handling of the recall crisis is a symptom of wider lack of accountability and arrogance that pervades business in the country. It could damage the country's exports, they argued, and is symptomatic of a nation withdrawing from the world instead of engaging with it.

A case in point: While Sony and Nissan both have non-Japanese CEOs, signifying their "global outlook," Toyota remains a "homespun" company. Its Japanese president, Akio Toyoda, is the grandson of company founder Kiichiro Toyoda. A company like Toyota needs a leader with a more global mindset, the panelists said.

"We don't seem to have a clear way to select leaders in our country," said Seiichiro (Tony) Hatori, CEO and president of SSP Co., Ltd., adding that Western corporations tend to have a more democratic and open process for choosing their company chieftains based on a proven track record in business and solid professional qualifications. "Mr. Toyoda was born into his role, but a company like Toyota has to go beyond its national boundaries to find a leader," he said. "Other big Japanese multinationals need to do that too or they will repeat the same mistakes as Toyota."

For Mr. Hatori, Toyota's global recall provides big lessons for the way Japanese businesses should be run. The nation's major multinationals need global leaders and more non-Japanese nationals on their boards of external governors, and they need to include more women on their boards of directors, he said.

Japan has focused on growing its gross domestic product for far too long, leading to an insular state of mind, Mr. Hatori explained. Instead, the country should focus on "globalizing" its businesses. A management team more used to the way a major Western company handles a crisis

¹ Stewart, Devin T. "Toyota and the End of Japan." *Newsweek* 5 Mar. 2010.

of its own making would have likely handled the Toyota recall with greater skill, he said. What's needed is good management know-how.

A stunning economic boom over the 30-year period from 1960 to 1990 — which saw average growth rates of 10 percent in the 1960s, 5 percent in the 1970s and 4 percent in the 1980s — has been dubbed Japan's economic “miracle.” But the nation's economy stalled in the 1990s, a period called the “Lost Decade,” when the Bank of Japan failed to cut interest rates swiftly enough in reaction to the bursting of an asset price bubble in the late 1980s. As a result, over the last 20 years Japan's economy has essentially struggled to grow.

Adding to Japan's difficulties is the fact that companies such as Sony and Toyota, which enjoyed dominance in the 1980s, are now facing stiff competition from rival Asian companies like Korea's Samsung and Hyundai. Panelists said Japanese companies now need to imbue their corporate cultures with a “sense of urgency.” Nearby India and China are growing quickly and represent a significant threat. Indeed, this year Japan is set to be overtaken by China as the world's second-largest economy.

“There's a fear in Japan that we hit our peak in 1990 and that we have been on our way downhill ever since,” said Chikatomo Hodo, country managing director and geographic unit lead for Accenture in Japan. “I am worried about Japan's competitiveness and I hope this prediction doesn't come true.”

There are certainly some worrying signs that suggest Japan's best years are behind it. Electronics was once one of Japan's core industries, but Japan is now ceding dominance in that industry to major new rivals. The market capitalization of Samsung today exceeds \$200 billion, dwarfing those of Sony and Panasonic, which stand at \$38 billion and \$31 billion, respectively. While new electronics companies focused on building their presence on emerging, growing markets, Japanese manufacturers largely ignored them, Mr. Hodo said. Instead, they concentrated their efforts on the declining Japanese and Western markets.

Still, while its top industries may be struggling, Japan has a lot to offer the world. The automotive and electronics sectors can recover, he said, and Japan has expertise in healthcare, robotics and tourism that can make it very competitive in the modern global economy.

What's more, the future of Japan lies in closer integration and cooperation with its neighbors, such as Korea and China, in an EU-style Asian community, said Mr. Hodo. The viability of such an idea will depend largely on the ability of Japanese businesses and the Japanese government to

learn from the Toyota experience and embrace a more “open” stance toward the rest of the world.

“There’s a pressure on this country to open up, but there’s also a deep pride in the Japanese culture,” the University of Michigan’s Schon Beechler noted. “This is the issue that will determine the future of business in Japan; it will determine whether the nation succeeds or fails.”

Signs of Change

Public opinion in Japan may not yet be ready to accept the kind of broad attitude change the panel advocated.

The Japanese public initially greeted the Toyota fiasco with a mixture of shame and suspicion. Toyota executives at first blamed the U.S.-manufactured parts for the problems in its cars, and some observers have even suggested that the U.S. government may have orchestrated the car faults as part of a plan to undermine Japan’s export industry.

However, there are signs that Japanese attitudes are shifting. A February editorial in the Japanese newspaper *Asahi Shimbun*² called Toyota’s response to the recall crisis “too slow” and “obtuse.”

“The entire world is watching whether Toyota is humbled, learns the lessons from these problems and starts producing safe vehicles again,” the newspaper said in an unusual move for an established Japanese media outlet more likely to praise the nation’s most admired business.

Changes are afoot in industry too. The Nomura Group, one of the companies focused on moving away from its traditional ways of doing business, changing business models and altering its compensation practices.

We visited Nomura at a time when Japan’s top investment house, is in the process of turning itself into a global player in the investment banking businesses. An earlier attempt to build on proprietary trading and mortgage securities ended disastrously for Nomura when world markets swooned in 1998 after Russia’s debt default, according to a Reuters report on the bank’s plans.³

“Nomura took a \$1 billion-plus hit and closed down a U.S. operation that was known for its big bets — and big bonuses,” the Reuters report said. Now Nomura is back and plans to focus on customer trading, building a global organization.

² Editorial. “Prius’ brake problem.” *Asahi Shimbun* 6 Feb. 6 2010

³ Reerink, Jack and Emi Emoto. “Nomura U.S. hiring spree key to global ambition.” Reuters 3 Mar. 2010.

Priority number one is the U.S. market, according to Takumi Shibata, Nomura's chief operating officer and the person overseeing the expansion overseas. Interestingly, Nomura plans to shake up its compensation system, moving to a more American-style system by offering staffers stock ownership and bonuses tied to performance and away from the traditional Japanese method of retaining employees by life-long employment.

The change in employment practices is noteworthy. The Japanese attitude to work at all levels is based on a deep feeling of collective responsibility. This fierce commitment fosters an "insider-outsider" mindset that is common to many Japanese businesses — the idea that the company you work for is your "tribe." Anyone who works for the same company as you is an "insider," while everyone else is an "outsider."

Traditionally, Japanese workers have a fierce loyalty to their employer and an unwillingness to criticize the company, explained Professor Hugh Patrick, director of the Center on Japanese Economy and Business at Columbia Business School. In this regard, Toyota is likely the most "Japanese-like" firm around.

"It's the most uptight company ever," he said. "It's very hierarchical and precision oriented, and it also has a high degree of secrecy, so this recall must be a big cultural shock for them."

However, lifetime employment is clearly no longer a guarantee for Japanese workers. In fact, in the current economic malaise engulfing Japan, new university graduates are struggling to find jobs, especially ones they hope to hold on to for life.

Around 20 percent of students graduating from university this spring have no job offers, up 6 percentage points from last year and the highest tally since records began in 2000 in the midst of Japan's banking crisis, according to a report in *The Economist*⁴. Almost half of big and medium-sized firms do not plan to hire any "regular" employees at all this year, the report said, pushing more graduates toward less protected part-time positions.

Elsewhere in Japan we saw businesses changing established business practices.

Toyota, for example — the company that gave the world the Prius, the deity of the environmentally conscious driver — is engaged in some noteworthy green initiatives.

As we toured the welding and assembly areas of the Tsutsumi manufacturing plant in Toyota City, the carmaker's green credentials were very evident.

⁴ "A new ice age: the perils of a frigid labor market." *The Economist* 18 Mar. 2010.

The Prius production plant has grass growing on the roof and uses 50,000 square meters of photovoltaic solar panels (the size of more than 60 tennis courts) to generate power. Photocatalytic paint on the exterior of the assembly plant breaks down airborne nitrogen oxides and sulfur oxides — essentially, cleaning the air around it by producing oxygen in sunlight. It has the same effect as planting 2,000 trees. Toyota also planted 50,000 trees at and around the factory in 2008.

These measures have cut the plant's overall CO₂ emissions by more than 50 percent since 1990, representing a reduction in annual emissions of more than 150,000 tons. That's roughly the volume of CO₂ absorbed each year by a 5,040-hectare tropical rainforest, according to Toyota, while the output of the solar panels is 2000 kW — an energy savings that is comparable to not consuming 2,500 drums of oil each year.

Given that the Toyota City's plants produce the gas-electric hybrid Prius sedan, these energy savings seem very appropriate. The solar panels create about half of the electricity that the plant needs to function, while the other half comes from gas co-generation, effectively making the plant itself a hybrid.

Outside the facility, Toyota is focused on alleviating the impact of its manufacturing activities. It works to preserve the habitats of indigenous creatures, cutting landfill waste by 82 percent and reducing water discharge into local rivers by 50 percent since the program's inception. Toyota also makes abundant use of natural light in the factory, and employees earn rewards by voluntarily planning or hosting environment-related events.

The energy savings and environmental measures are significant. Toyota's green push shows that, although the automaker has been known for churning out dependable, value-for-money cars that get few pulses racing, its green initiatives are nothing short of thrilling.

Conclusion

In conclusion, it's fair to say that Toyota could use more than just a dose of the sort of good luck Kiichiro Toyoda hoped for seven decades ago when he changed the name of his car company.

Yet the car company has shown its resilience over the years and a commitment to constantly improve its business practices. If it can learn to adapt its management practices after the recall debacle it stands a good chance of emerging from the crisis as a far stronger, more globalized company.

What's more, Toyota can become a role model for Japanese businesses looking to change.

With Japanese society focused on harmony and shunning open conflict, consumer activism is underdeveloped and product liability lawsuits against corporations are not common. As they have expanded overseas, Japanese multinationals have therefore avoided developing crisis management teams because they historically have had little need for them.

Now Toyota has a chance to shape a new way of doing business that pays greater attention to consumers' concerns. Cultural factors play a role here. While modesty and diligence are valued in Japan, they can be interpreted as indecision and aloofness in other nations. Developing a greater sensitivity to cultural differences may enable Toyota to better manage future crises.

From speaking with business leaders and experts during our trip, it is also clear that Japanese firms need to move away from traditional business practices, such as guaranteeing lifetime employment, in order to deal properly with globalization. This will make their companies more attractive to investors, and it will go some way toward reviving the nation's sluggish economy. Keeping policies like lifetime employment alive and well in Japan have a cost — they render the economy inflexible, observers argue. And considering that Japan has been mired in a recession and deflation for much of the past 20 years, if businesses fail to change they can expect more of the same in the future.