Strategic Change
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Practice of strategic change in Japanese companies

- *The unique economic and management systems which have been successful in the past are no longer enough.*
- *Japanese companies need to develop management approaches which are appropriate for a turbulent environment.*
- *The article argues that four things are critical: a move from cost based to market-value based management; meeting global standards of corporate governance; building new models that support corporate values; changing traditional management mind-sets.*
- *The requirements for strategy-based management and transformational strategic change are analysed.*

A. Preface—environment and strategic change

Japanese companies are undergoing serious business environmental changes which they have never experienced before. As Western companies restored their competitiveness, global competition became more severe. Therefore, Japanese companies are unlikely to increase revenues from export businesses. In addition, the domestic market is depressed. Thus, Japanese companies lie at the entrance of the deflation spiral.

Furthermore, financial 'Big Bang', which started in April 1998, required the managerial transformation of Japanese companies. It also included diverse measures of both collecting capital and using it, global standard management based on international accounting standard, and migration of consolidated corporate management.

During the reconstruction after World War II, Japanese companies developed distinctive economic and management systems, called Japanese management systems, in which they prioritized immediate solutions. In the 1980s, the Japanese management systems became advantageous, and the systems contributed to Japanese economic growth. However, after the collapse of the bubble economy in the early 1990s, the Japanese economy went down and was exposed to the mega-competition of the global market economy. The Japanese unique economic and management systems became a negative factor for growth. According to theories of economics and business administration, conventional Japanese systems and mechanisms should be renewed in order to realize efficient economic rationality. Japanese companies are required to build new competitive management systems or mechanisms that meet the principles of economics and management.

> *Japanese unique economic and management systems became a negative factor*

What is required for Japanese companies to realize further growth and development in such a business environment?

It is proved that Japanese companies, with conventional business models, are not able to correspond to environmental changes, although the environment has been largely changing. In other words, circulating and empirical improvement-driven operation does not work in that change.

Impacts of environmental changes and their influence on business require creation of both a new corporate structure and a new business model (Figures 1 and 2). Unless Japanese companies change, they hardly expect further growth and development.

It must be dangerous if managers believe that they can correspond to this environmental change with traditional, circulating and empirical countermeasures, such as cost reduction and business restructuring. Since Japan faces economic/financial changes driven by the Japanese 'Big Bang', and changes from protective management escorted by the Japanese government (so-called convoy method) to

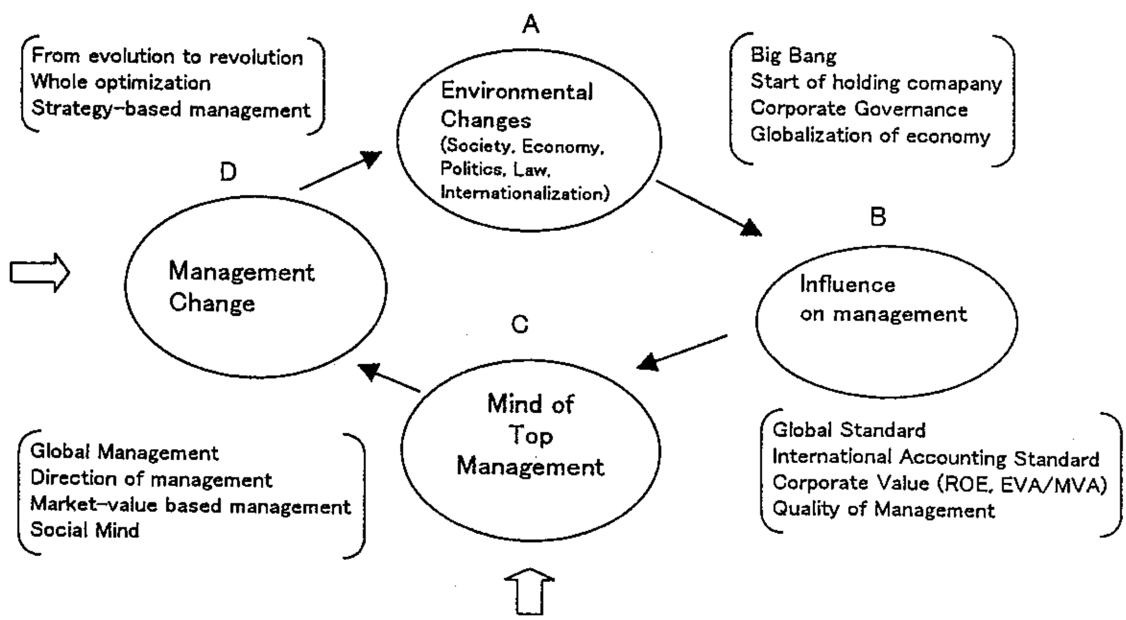

Figure 1. Environment, managerial mind and managerial style.

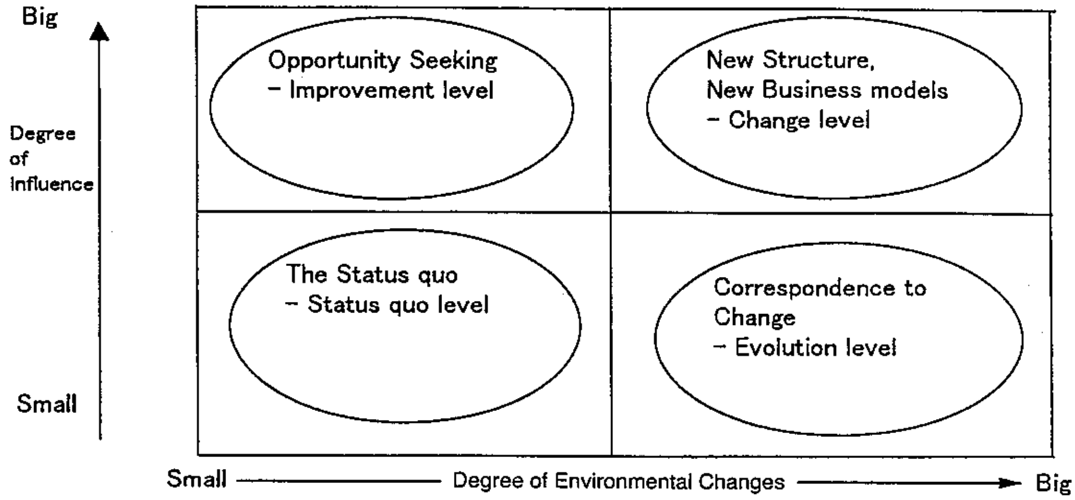

Figure 2. Positions of change.

free competitions or to market economy, Japanese managers are required to learn new management styles that they never had before.

In the borderless economy or in the mega-competition, management change that Japanese managers should perform is not always the same as Western management did in the past. In the author's opinion Japanese management change has two aspects: one is common between Western and Japanese management, and another is uncommon between them. The common management comes from operational global standard. In this field, Japanese companies must create common measurement complying with global standards of management such as implementing international accounting standards or ISO 9000/14000. The uncommon management is due to different mind-sets between Western and Japanese managers. While Western managers historically esteemed total management function, Japanese managers prioritized operational management control to pursue the advantage of either quality or cost performance. For this reason, Japanese managers seldom experienced corporate management based on the capital theory on cash flow and corporate value maximization.

Pursuing continuous growth and development, Japanese companies need new leadership of top management with new managerial mind-sets and views, in order to build a new Japanese management. In the author's opinion, strategy-based management is needed to support new top management's leadership, and holistic management is also needed to create corporate values.

B. Basic approach to change Japanese management

Although the financial Big Bang and the relaxation of regulations required changes in corporate management activities, Japanese companies seem unable to change their conventional management styles. Thus, a serious mission of Japanese managers is to build new management styles.

However, managers should not blindly rush into changes. Managers must accurately grasp the factors necessary to accommodate environmental changes, and they also must not divert from management fundamentals.

In order to build new management styles, Japanese managers must take the following themes into their management styles.

1. From cost based management to market-value based management

Although cost based management is an origin of Japanese management, the basis of new Japanese management should be to maximize corporate values according to the capital theory. To maximize corporate values, managers must perform market-value based management in an attempt to maximize cash flow.

2. To global standard management

Corporate governance is a basis of management describing the purpose of a corporation. Recognizing corporate governance as a part of global standard, managers can start changing traditional Japanese management. Indeed, in creating new management styles, managers must develop and apply common global standards, due to the fact that they need common criteria for corporate activities across national borders.

3. Building new business models in pursuit of corporate values

The essence of new management is to determine corporate values, which is materialized by the practice being governed by the capital theory or led by corporate governance. The meaning of corporate values changed from the base of conventional market share or revenues to that of social responsibilities for stakeholders or to capital responsibilities (returns on equity) for stockholders. Furthermore, corporate values have even become broader like economic value added (EVA) or market value added (MVA) as a measurement to assess corporate wealth, because corporations are the main bodies producing the nation's wealth. It is naturally inferred that the strategy for maximizing corporate values is different from that for achieving traditional goals. Indeed, business models to realize corporate strategy for increasing corporate values are not the same as traditional business models.

4. Realization of strategy-based management

Strategy-based management, as shown in Figure 3, aims to quest for corporate values, and to anchor the quest down in corporate activities. An important practice in this management is to connect strategy creation for corporate value maximization with strategy execution in a practical scene, and with control over the execution. Conventional operation-driven management does not give much help to companies for putting innovation forward. Strategy-based management helps companies in building both a management cycle (plan–do–see) and a corporate growth cycle (strategy–function–culture), creating best strategy having competitive advantage, executing the strategy as the best practice, and generating the best culture under which companies always respond to change.

5. Change of manager's mind-set

Managers of Japanese companies are expected to change their traditional management mind-sets, mentioned in the previous section. It is crucial whether or not managers can determine to change their minds, or whether or not they, with beliefs, decisively lead corporate reformations. Although managers might hesitate to accept new management mind-sets, they would do so if they thought that it was imperative. An important thing is that managers should always learn and gain knowledge in order to change their mind-sets, and sufficiently evaluate knowledge.

C. Realization of corporate change: leadership and management of changes

It is necessary to prepare, at least, four conditions in order to put the change forward. As mentioned in the basic approach to change, the key to successful changes is to firstly build business models associated with environmental changes. Then, the following four conditions should be satisfied (Figure 4).

1. Adaptability to environmental changes

If a company is unable to accommodate environmental changes, it must not begin transformation. Even a company which was indifferent to environmental changes, cannot help but accommodate today's changes, because environmental changes such as the financial Big Bang, the relaxation of

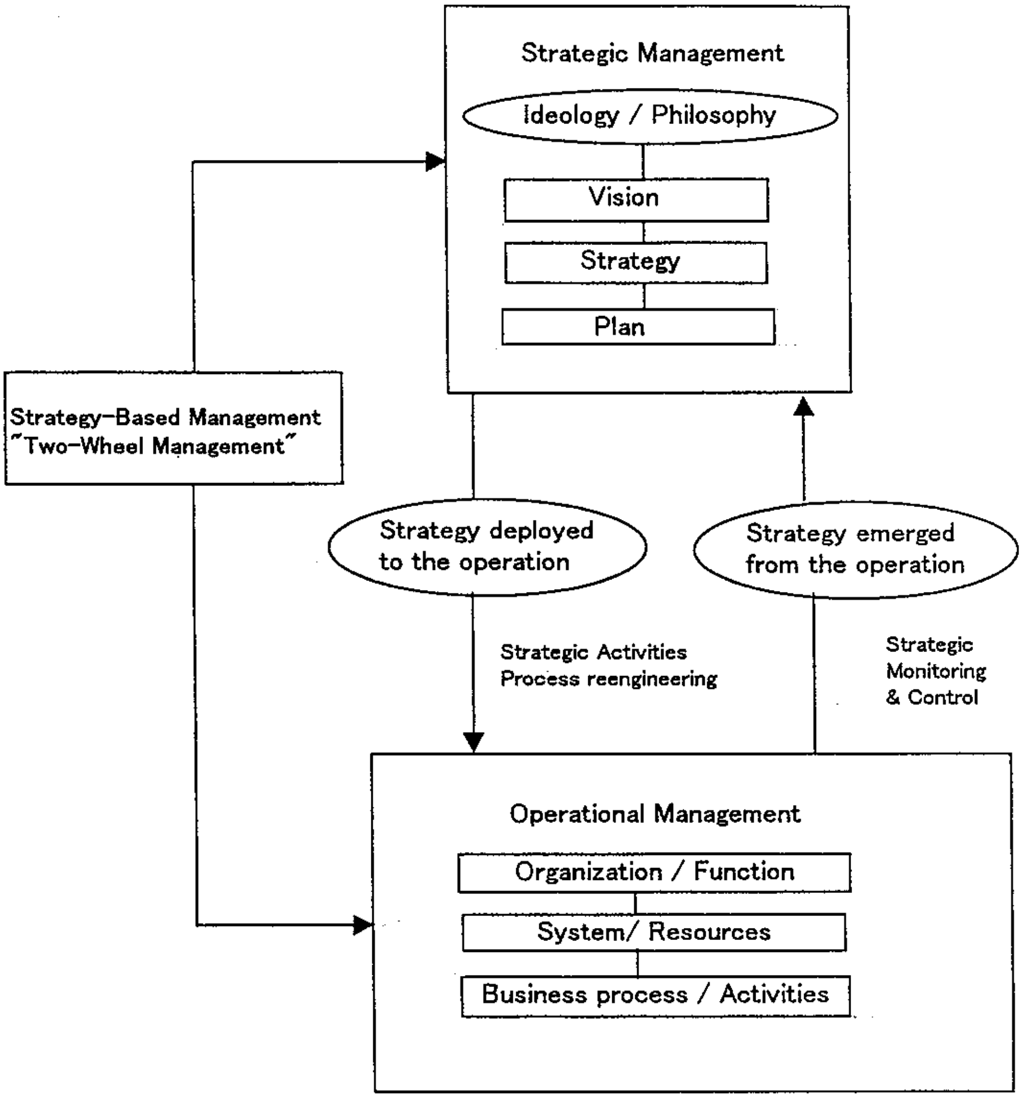

Figure 3. Framework of strategy-based management.

regulations, and compliance with global standards are too critical to be ignored. With adaptability to changes, a company can avoid any perils emerging from such environmental changes, find out opportunities for future growth and development, and eventually achieve success. Thus, gaining ability to accommodate environmental changes is prerequisite for a company to initiate changes.

2. Design and scenario of changes emerging from the whole and the individual

Managers must firstly disclose the entire design of corporate changes. Historical analysis shows that many companies failed in their changes if they performed immediate transformations imitatively, without preparing the entire design of the changes. Such companies, in particular, did not accurately evaluate the possibility, or limits, of methods driving changes, yet they easily used methods. It is important to make the entire design of changes from the viewpoints of optimizing both the whole and the parts of a company, and to construct logical connections between the whole and the parts. The entire design should describe scenario for changes. Managers must make clear the degree of importance among every part of change, prioritize each part, set a managerial target, and draw scenario of entire changes. As painters draw a picture on a canvas, managers

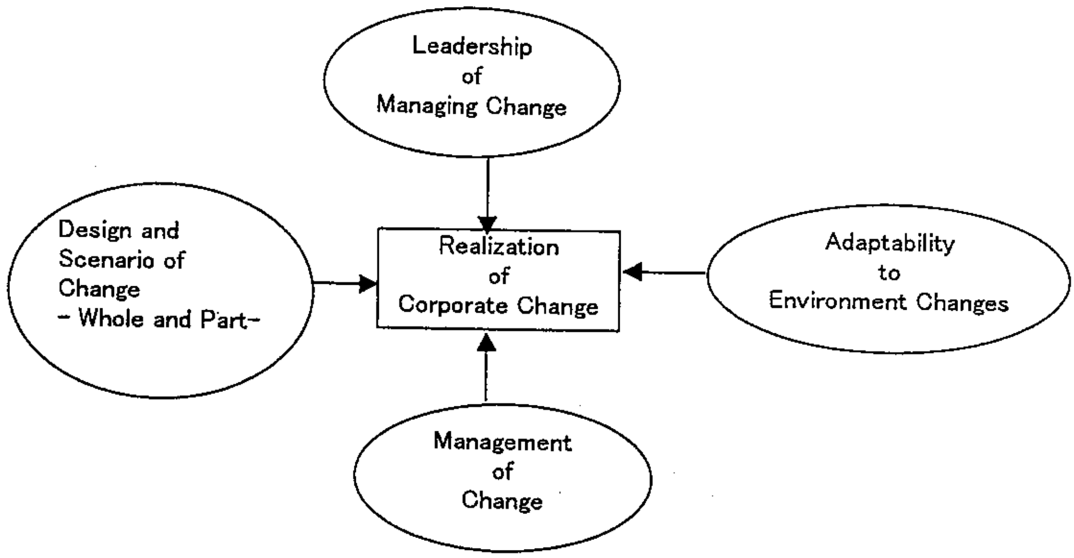

Figure 4. Design of corporate change.

(leaders of change) draw a scenario of change, considering psychological influence on their organizations: anxiety, hopes and motivations. Based on the scenario, concurrent optimization of the whole and the parts emerges, which builds a new corporate identity.

3. Management of changes

It is often argued that the management of changes is not adequately developed. Despite being intent on changes, managers should not expect effective results from reformations unless the management of changes is well prepared. Indeed, there are some cases in which results from transformations turned out to be worse than the status before transformations.

In the past, Japanese companies rushed to use reengineering methodology, which generated positive results in the US. The results were, however, miserable, because reengineering methodology was misused as a mere operational improvement tool. Although Japanese companies tried to get rid of wasteful fat, they lost necessary muscle in the end.

Reengineering methodology was misused

There are five key suggestions to progress changes.

(1) Importance of fundamental management theory

As managers start managing changes, they must recall management theories such as the capital theory, corporate governance, and management cycle.

(2) Formation of holistic management

Changes should not be understood as a gathering of partial transformations. Managers must firstly build a framework of holistic management. Then, they should put partial themes of transformation in the framework. It is essential for managers not to prioritize incremental transformations.

(3) Creation of a learning organization

A temporary transformation may be reversed easily. An organization must create a system in which transformation can never be reversed. Such a system initiates continuous learning, and helps build and maintain a cycle between evolution and revolution. Also, managers must realize feed-forward management and emergent management (strategic monitoring and control system).

(4) Evaluation and consistency of change prescription

There are many methods in changing. It would be unquestionable if managers used the methods after evaluating their efficiency. To successfully progress change, managers must have management tools as prescriptions. It is important to evaluate the possibility and limitation of those management tools, and to make clear the efficiency of the tools in order to raise management quality. Managers should not ceremonially implement the tools, but implement them as an essence of management in search for what management should be.

(5) Creation of a corporate growing cycle

The previous section argues that corporate change is progressed by forming a learning organization. The change is accomplished based on the relation between strategy and organization. As Chandler (1962) argued, 'Organization follows strategy', best strategy creates best practice. Also, best practice generates best culture. This 'corporate growing cycle' (Figure 5) should be established as a cycle of changes.

4. Leadership for managing changes

What should be the nature of leadership in order to change both corporate structure and its business process? The following four elements are considered to be necessary for such leadership.

(1) Accurate understanding, prediction and judgement of environmental changes
(2) Abilities to design vision and strategy for management of changes
(3) Commitment and efforts to promote transformation thoroughly into the organization
(4) Abilities to design and produce new holistic business models

The previous section discusses that an organization must have prompt correspondence to environmental changes as an important condition of successful changes.

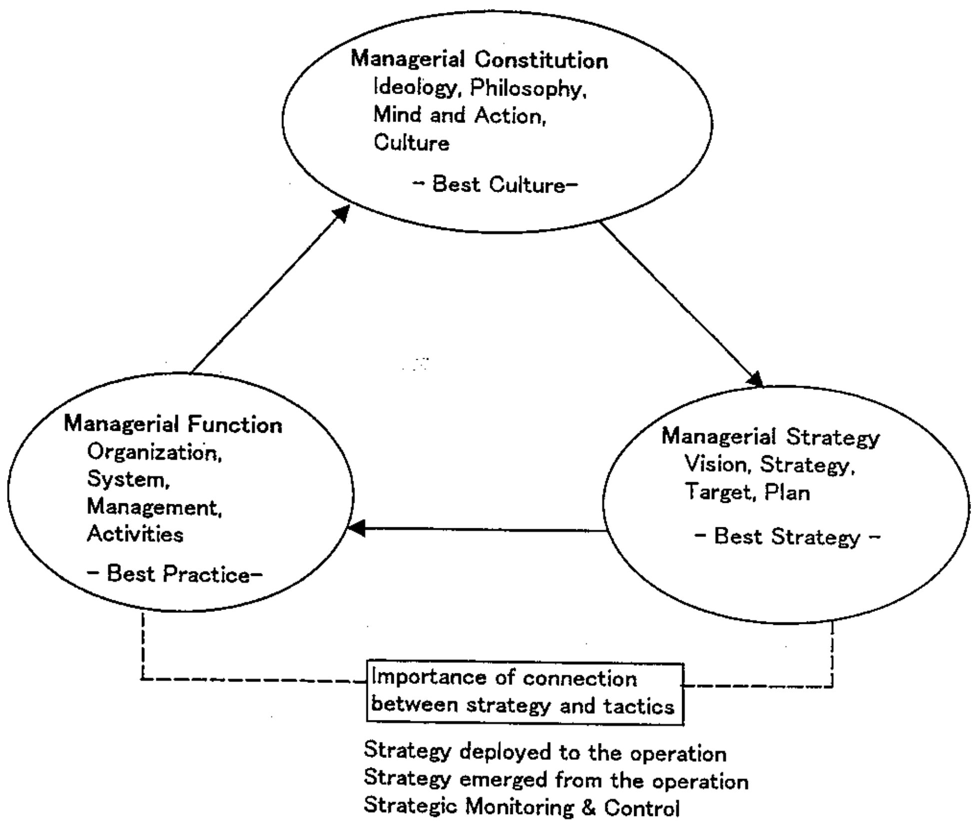

Figure 5. Strategic management for corporate growing cycle.

Meanwhile, the leader of an organization must have a keen sensitivity to environmental changes. Without sound judgement, the leader would not find growth opportunities in the environmental changes. In addition, the leader must design and produce both a whole scenario of the management change and a new business model. The leader must also demonstrate strong commitment and efforts to promote management change in the entire organization; in practice, he/she has to possess accountability and responsibility as a leader.

D. Strategy-based management and strategic change transformation to high corporate values

1. Relation between strategy-based management and corporate value

The previous section discusses 'building new business models based on corporate values', and 'realizing strategy-based management'. This section introduces a framework of practical corporate change management. It is a key of strategic changes that strategy-based management provides a framework (foundation) of holistic management. Strategy-based management, in pursuit of harmonization in optimization between the whole and the parts of an organization, also provides a way of maximizing corporate values based on the capital theory.

Even if many companies consider moving to global consolidated management as they were permitted to start holding companies in Japan, they are unlikely to initiate this migration without establishing a framework of holistic management. Corporate change helps a company to play two important roles. First is raising shareholders' value (ROE) by pursuing the increasing corporate values. Second is creating a nation's wealth by maximizing both EVA and MVA.

On the other hand, corporate change makes it possible to gain swiftness of management and to create valuable corporate strategies by clearly separating management from capital or by differentiating management from businesses. Global consolidated management makes the way of management common as a global standard, and it can accelerate migration to management across national borders.

Corporate change management, as mentioned earlier, would not be the result of the series of activities solving individual and mutually different themes. Only holistic management, esteeming quality of management, would attain the change. That is, an organization would attain strategic change by establishing strategy-based management.

2. Establishment of a highly profitable corporation: creation of new business models in pursuit of profits

In 1997, the average ROE of American companies (S&P 500) was seven times higher than that of Japanese companies, 21% vs. 2.7%. It is clearly inferred that the difference in cash flow between highly profitable American companies and Japanese companies should affect the future business performance in global competition.

> *In 1997, the average ROE of American companies was seven times higher than that of Japanese companies*

Through strategic change, Japanese companies aim to restore competitiveness in this mega-competition, and become highly profitable as American companies are. Therefore, the strategic change of Japanese companies accompanies fundamental transformation of business structure and the creation of new business models as mentioned previously. In order to transform traditional Japanese business models into highly profitable business models which pursue high corporate values, Japanese companies need to pay attention to the following:

(1) Change by pursuing corporate values
Points: theory of capitals, shareholders' benefits, corporate governance, cash flow

(2) Change by value chain
Points: continuous generation of economic value, network and spiral effect, service business based on creating value
(3) Change by harmonization
Points: product/technology/market mix, commodity, changing structure, hardware and software mix
(4) Change by core competence
Points: relative competitiveness, business opportunities for future growth, implicit knowledge and explicit knowledge, de facto standard (platform)
(5) Change by synergy effect
Points: system design for synergy effect and strategic evaluation
(6) Change by whole optimization
Points: holistic strategy, economy of scope and balance between the whole and the part

Japanese companies have partially experienced transformations by applying, 'core competence' and 'synergy effect'. However, they have not experienced reformations by applying, 'corporate value', 'value chain', 'harmonization', nor 'whole optimization'. In constructing highly profitable companies, managers need to recognize the importance of these four viewpoints.

The new business model for growth is composed of the three elements as shown in Figure 6.

Korean and Taiwanese companies may prevail over Japanese companies, if Japanese companies are stuck to the old 'rule of competition' such as cost reduction and improvement of job efficiency. Therefore, the new business model should give a new perspective that a company can maximize 'corporate values' (Element 2) by taking a new 'strategic position' (Element 1) to change the old 'rule of competition' (Element 3).

Figure 7 illustrates the relation between this business model and the business domain. As is shown, pursuing both high corporate values and high profits would mean, in the end, taking new business models in new business domains. Figure 7 also suggests that, in pursuit of increasing corporate values, a company should apply a new business model in the current business domain rather than applying the current business model in a new business domain, because the company can expect higher possibility in the former pattern.

Developing a new business model, with which a company can strategically position itself to change the 'rule of competition',

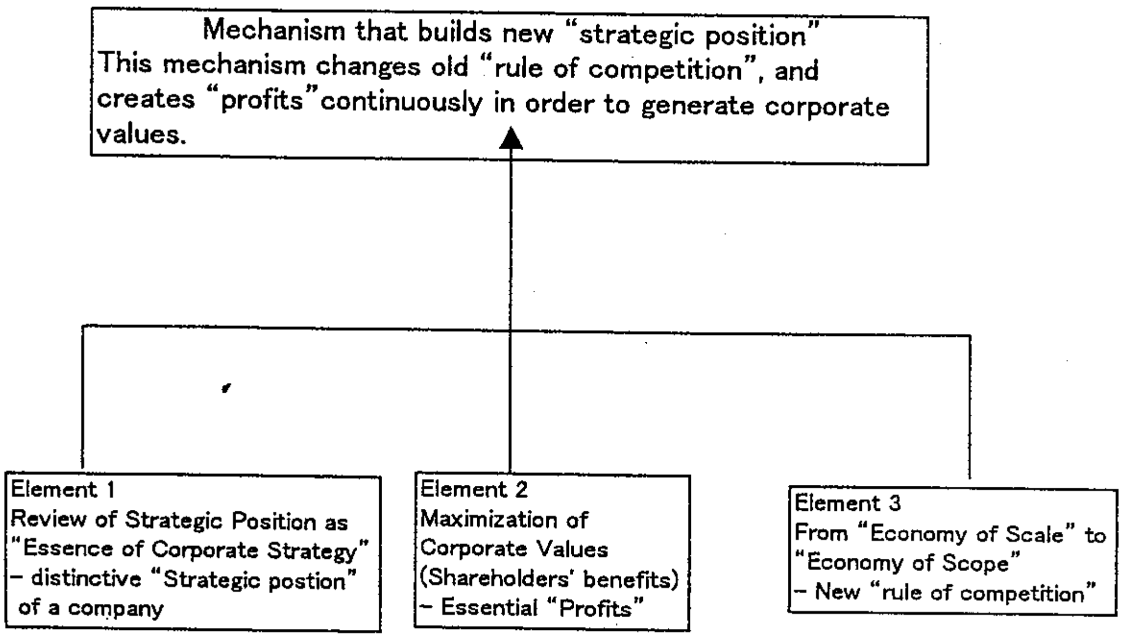

Figure 6. New business model for corporate growth.

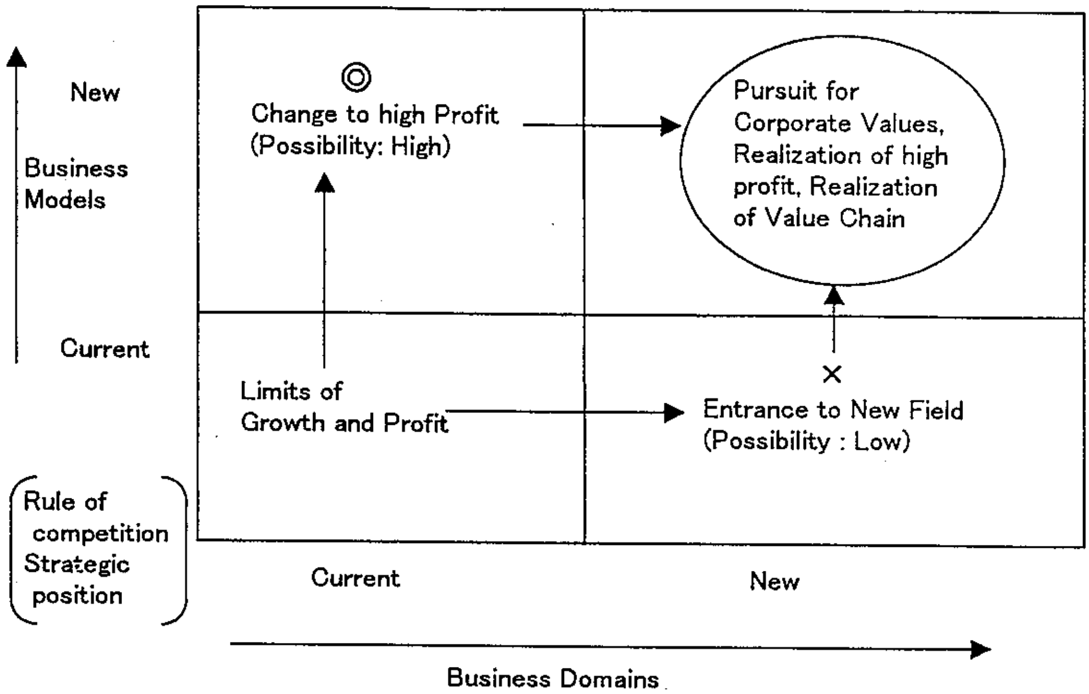

Figure 7. Business domains and business models.

would optimize corporate values if the development was associated with relocation of the business domain.

3. Strategic monitoring and control management

Simons (1995) argues in his book titled, *Levers of Control*, that an organization must have four control levers in order to control organizational dynamics. Two of the four levers are diagnostic control systems and interactive control systems. The diagnostic control systems are feedback systems designed to ensure achievement of predictable, specified goals. The interactive control systems are used to stimulate organizational learning and the emergence of new ideas and strategies.

A style of Japanese companies' strategy formulation is originally an emergent oriented one, and the process of strategy implementation is not clearly defined. On the other hand, a style of American companies' strategy formulation is an analytical and scientific approach oriented one, and the process of implementation is precisely structured.

This difference in strategy formulation and implementation leads to a turning point in choosing the control systems for corporate change management. That is, Japanese companies are likely to guide a bottom-up emerging strategy, while unlike American companies, they are yet to establish an analytical management process in strategy formulation and implementation.

Application of 'strategic monitoring and control' management which unifies Simons' diagnostic control systems and interactive control systems, is mostly noticed among Japanese companies in pursuit of strategic changes (Figure 8). In strategic monitoring and control management, an organization frequently sets 'strategic meetings' where participants, perceiving environmental uncertainties, vividly discuss and debate strategies. This organizational circumstance allows strategies to emerge. Also, the organization diagnoses and analyses the emerged strategies, and in parallel, the organization keeps generating deductive strategies, considering the change of environmental and competitive factors in the analytical strategy making process. This combination of diagnostic and emergent

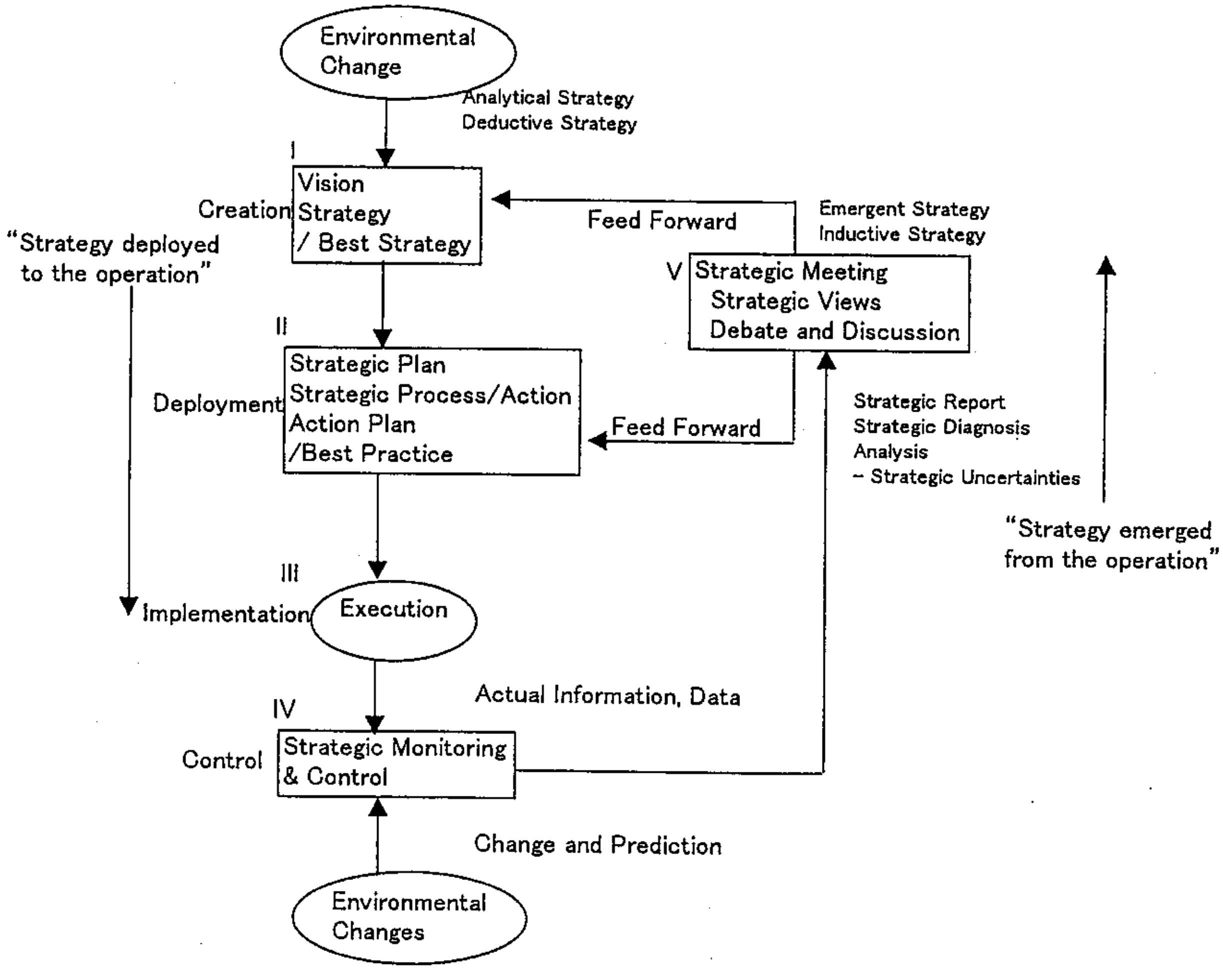

Figure 8. Strategy creation, deployment and implementation by strategic monitoring and control.

control systems is called 'strategic monitoring and control'.

So far, strategy deployment and implementation by Japanese companies has been ambiguous, and strategies have not been implemented smoothly in the field of operations. However, through 'strategic monitoring and control', strategies can be deployed smoothly in the field of operations, irrespective of whether strategies are created in the analytical process or in the emergent system. This means that strategic monitoring and control management is a key to highly successful accomplishment of strategic change.

E. Conclusion

It is difficult for most Japanese companies to proceed with corporate change in a depressed economy. However, Japanese companies are unlikely to survive in the global competition if they merely depend on traditional methods, such as restructuring and cost reduction.

In pursuit of global consolidated management, Japanese companies should perform strategic change in accordance with management principles and theories. In other words, Japanese traditional business models, which used to be advantageous, have become disadvantageous. Japanese companies should return to the fundamentals, and build new business models to maximize corporate values. Having positively built business models of increasing returns, Sony has entered on a new phase of enhancing its profitability.

In order to create new business models, Japanese companies must consider the following three strategic viewpoints; shareholders' benefits management, global management based on global standards, and realization of strategy-based management as a framework of holistic management. Furthermore, establishing 'strategic monitoring and control' is a key to accomplishing strategic change, because it helps combine analytical strategies with emergent strategies, and realize both 'strategies deployed to the corporation' and 'strategies emerged from the operation'.

Japanese companies are likely to restore the competitiveness in the global market if they develop a design and scenario of strategic change, and if leadership of change management, having new managerial viewpoints, appears in the companies.

Biographical note

Kishio Ishida is the president of the leading Japanese strategic management consulting firm, Yahagi Consultants Inc., in Tokyo.

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