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**Japan' New Competitive Advantage: Enterprises' Innovative Initiatives and Government's Reforms**

**Abstract**

*This article is a continuation of the report "Japan's new competitive advantage. Arguments and proposals for structural reorientation" published in the „Comparative Economic Research for Central & Eastern Europe”, vol. 13, no 1/2/2010, which mainly dealt with the role of the private sector's cooperation with governmental agencies. The discussion presented below is divided into four sections. Section one outlines the history of new ITC firms (mobile communications, computers) after the year 2000 and addresses innovation factors. Section two characterizes Japan's „dual economy” with respect to economic competitiveness and innovation. Section three discusses the major structural reforms (Japan Post, the Housing Loan Corporation and the Japan Highway Corporation) that were undertaken in Japan in the 21<sup>st</sup> c. Section four of the article provides final conclusions.*

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## 1. Introduction

According to the most recent report by UNIDO (the United Nations Industrial Development Organization)<sup>1</sup>, in 2009 China preceded Japan in the MVA ranking (Manufacturing Value Added), being second only to the USA. The statistical data show that China's MVA converted into the US dollars (constant prices of 2000) was 15.6% against Japan's 15.4% and 19% in the USA that continued to be a leader in the ranking. These three global economic powers generate together around a half of the world's industrial output.

Although China rose to the second position, Japan remained the most industrialised country in the world, as the report's per capita values show (almost US\$ 9,000 per capita compared with only US\$ 700 in China). However, as the recent financial crisis has been found to be more damaging to the most developed countries, neither the Japanese government nor Japanese entrepreneurs should "rest on the laurels", especially that they have to take up challenges that I wrote about in the first article published last year (Młodawska 2010).

## 2. New firms, new products, new branches of industry

After a stormy period of decelerating growth in the Asian markets in the 1990s, global investors impatiently awaited new opportunities for raising stock prices. Quite unexpectedly, such opportunities appeared in the Silicon Valley with the new applications of data communications technologies (Bursa 2008). Investors and analysts pinned their hopes on the rising star of information and communications technology (ICT), although many small companies entering into this business could not prove that they had a solid capital base or relevant experience. NASDAQ (National Association of Securities Dealers Automated Quotations), one the major global indexes showing the condition of the economy, grew fivefold between 1998 and 2000. In early March 2000 it was at a still high level of 5000 points, but over two weeks it nosedived to 1100 points, thus initiating a 3 year slump in the global markets (Bursa 2008).

The automated quotation system JASDAQ that provides brokers and dealers with the quotes of securities traded on the OTC market (Over-the-

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<sup>1</sup> UNIDO's International Yearbook of Industrial Statistics 2010, [http://www.unido.org/index.php?id=7881&tx\\_ttnews%5D=455&cttash=09cad462f0](http://www.unido.org/index.php?id=7881&tx_ttnews%5D=455&cttash=09cad462f0) (information of 18 March 2010).

Counter) has a long history in Japan. The securities are usually shares or bonds issued by companies that are too small to meet the requirements of the main stock exchange. The internet company Yahoo! Japan, a revelation at the onset of the 21<sup>st</sup>. c., was traded on the same market. In 1999, the Mothers Stock Market was established in Japan to provide new and promising high-tech firms with venture capital. By the end of 2000, four firms entered into this market (Tanaka, 2000). In the same year 2000, NASDAQ US established NASDAQ Japan offering venture capital to businesses.

Regarding new enterprises that are discussed in this article it has to be admitted that the data communications technologies have invariably been important for the Japanese economy, even in periods of dragging recession. Until 2003, investments in this sector grew faster or declined more slowly than in the other branches (from 1994, the only exception was the year 1998). Particularly the years 1999-2000 were a period when capital outlays allocated to ICT grew very fast compared with other branches, where they clearly declined (Nihon Keizai Newspaper, 2000). One of the fastest developing ICT branches in Japan is mobile telecommunications. A Nippon Telephone and Telegraph's affiliate NTT DoCoMo which was established in 1991 needed nine years to increase its capital to almost 475 billion yens (in 2000), an equivalent of over 50% of its mother company's capital (Tanaka, 2000). NTT DoCoMo' success story continued, as after less than a year the company took over NTT's segment of mobile communications.

Another thriving ICT branch is computers and related products, such as Internet communications. Although the sales of personal computers and the values of Internet services grew at the end of 1999, total personal consumption shrank. New Internet firms were established, for instance Yahoo! Japan. Its initial capital standing at 2 million yens in 1997 went up to 60 million yens in March 2000, when the period of growth fuelled by speculators ended. Another new firm is the Softbank Corporation that initially published computer magazines. Today Softbank incorporates several firms presenting different business profiles: computer hardware and software for consumers, internet services, mobile communications, financial services and others.

In matching economic growth and its drivers we need to note that even in the „lean” years of the 1990s periods of accelerated growth could be observed, for instance the years 1995-1996 and 2000, when the Japanese government pursued expansionary fiscal policy with increased spending funded from public debt. However, the policy's stimulating effects were short-lived, unlike the permanently increased government debt (in 2000 gross public debt amounted to

around 142% and to ca. 199% in 2008)<sup>2</sup>. After several years during which the atmosphere of success was being irrationally inflated in the international ICT markets, global investors burst the speculative bubble on 11 March 2000, when they demanded tangible financial results.

Private investments in Japan had a negative value in 2002, but a year later the expectations of a better economic situation improved and entrepreneurs' investments (with only a limited contribution of the government outlays) became the main driver of growth. The year 2005 was very special for the Land of Cherry Blossoms: the main factor improving the current account balance became returns on investments and not foreign trade receipts (however, the disadvantageous economic situation that occurred in the international markets then has to be taken into account). The value of Japanese exports and private investments decreased following the decline in international trade between 2007 and 2010. The domestic consumption shrank because of employment and wage cuts that could be seen across the economy. The governmental agencies' estimates show that the fiscal impulse in 2009 is likely to accelerate production growth and make it reach positive values, although its level will not exceed 1% of GDP throughout 2010<sup>3</sup>.

The „engines” driving the internal growth of the Japanese economy can be divided into three categories:

1. small subcontracting firms, characterised by traditional profiles and ways of doing business, usually weak and dismissing their workers when recession comes;
2. start-up enterprises with the potential for dynamic growth; this group incorporates the ICT firms;
3. big business, i.e. well-established huge „keiretsu” that in practice very slowly depart from the life-time employment principle.

The powerful Japanese „keiretsu” face the challenge of replacing operations strategy (mainly price-based competition and standardized products) with one emphasising long-term stabilization and high profitability (mostly competition based on new products). The unquestionable „icons” of Japanese economy, Honda, Sony and Toyota, are setting a good example in this area. There are also cases of new thriving firms that were established in the 1990s, such as Nidec (a Kyoto-based computer company), Rohm (semi-conductors, Kyoto), Kyoden (consumer and industrial electronics, Nagano), Shimano

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<sup>2</sup> EconStats, Wall Streets, NY, <http://www.econstats.com/weo/V031.htm>

<sup>3</sup> Key Points of the Japanese Economy. Internal documents of the Economic Section of the Japan Embassy in Poland, 5 July 2009.

(bicycles, Osaka). All these organizations specialize in very precisely defined, narrow ranges of diversified products. Representing a modern model of the Japanese company, they do their business without imitating any other organization (Porter, Takeuchi, Sakakibara 2000).

Most large corporations still use a cross-shareholding system, where around 60% of the shares belong to strategic investors, mostly banks, insurance companies and other firms that are interconnected by long-term business relations. This ownership structure causes that the managers mainly think in terms of their organizations' sizes and sales volumes and not their current profitability, thus keeping busy other organizations being part of the same system.

Japan has one of the lowest numbers of new firms among the developed countries. Therefore, adaptation of activities and changes in their effects is even more important in the case of the restructuring giants than in the new organizations. The innovation-stimulating factors include (Vogel 2006, pp. 157-204):

1. firm's general financial result (its condition);
2. the involvement and strength of foreign investors (as well as managers);
3. the sector of activity;
4. firm's age.

The impacts of the factors were investigated by Vogel, who analysed the stories of four electronic firms (NEC, Softbank, Sony, Hikari Tsushin) and two car manufacturers (Toyota, Nissan) over the last 20-30 years.

An empirical verification of the first factor shows beyond any doubt that the large, well-established organizations experiencing financial problems are more determined to implement innovative changes than their more effective competitors. Nissan's story compared with Toyota's confirms this opinion, likewise NEC contrasted with Sony and Hikari Tsushin with Softbank. In each of the cases, the temporarily underperforming firms were necessarily becoming more dynamic. The second factor – the foreign component – exerted bi-directional impacts: foreign majority owners insisted on shaping the supervisory system after the Anglo-Saxon model (with profits being the criterion of performance) and foreign managers, having weaker bonds with the Japanese culture and being less obligated by the special relations between business partners, implemented innovations more easily than their Japanese counterparts. This hypothesis held true again when the cases of Nissan managed by a French director and Toyota controlled by traditional Japanese management were compared. Although a comparison of the international Sony Corporation with NEC does not show that Sony was more innovative in the period in question,

this conclusion can be drawn from the relatively more advantageous financial situation of first organization.

A comparison of the sector-specific innovation, e.g. cars against electronic products, corroborates the hypothesis about a modular production system (electronic products) being more conducive to innovation than an integrated approach, which is typical of the automotive industry. Accordingly, NEC and Sony implemented more new projects than Toyota did, perhaps even more than Nissan. The last of the three factors is age of the sampled firms. The well-established firms having rich traditions and long history are considerably more conservative and adhere to the rules of corporate culture. The new firms, for instance those in the ICT sector, frequently have to break the rules to become visible in the very competitive market (Softbank, Hikari Tsushin). Not only do they refuse to observe the life-time employment principle and to promote and pay their employees according to their seniority, but they also frequently clash with the authorities, when the latter try make them comply with their decisions.

The section below tells the story of a relatively new ICT organization, which was established in 1981. Founded by Masayoshi Son, a son of Korean immigrants, Softbank initially sold computer software. Having entered the stock exchange in 1994, the firm started aggressively and successfully invest in the venture capital market, targeting mainly the US Internet start-ups and achieving spectacular successes in this field (Yahoo). The SBI Group providing financial services was established five years later. In 2000 Softbank acquired almost a 50% stake in the declining state-owned Nippon Credit Bank, now Aozora Bank (Vogel 2006, pp. 157-204). As a cure for the bank's problems, Son suggested linking electronic banking with investments in the data communications technologies. When the plan turned out to be a failure, he decided to sell most of his shares. Although the Japanese government (Financial Services Agency) pressed him to sell his holdings in the financial institutions to the domestic investors, Son preferred to transfer them to the US investment fund Cerberus.

During the dot-com boom (data for February 2000), the market ranked Softbank third in value terms, even before Toyota and Sony, right after NTT DoCoMo and NTT (Lynskey, Yonekura 2001, pp. 1-15). Because the dot-com bubble burst, Softbank decided to sell its holdings in many projects to repay its debts and to finance new investments (Son did not want to take out more loans and his company was priced too low on the stock exchange to issue bonds).

Son's genius prompted him to start selling broadband Internet access. He took advantage of the government's decision that made NTT put out on lease its idle teletransmission lines and reduce charges for the inter-operator connections. Softbank's determination to beat NTT as a provider of broadband Internet

services entailed extremely capital-intensive investments in infrastructure (approx. 37,000 yens to connect one subscriber<sup>4</sup>) and modems that were accessible free of charge at railway stations. This activity made the Japanese market for Internet services more open; at the same time, Softbank with its more than 2 million subscribers outdistanced NTT as a provider of broadband Internet services. However, the heavy investment outlays that the company made and the lower-priced assets in its portfolio caused that its financial results were negative in both 2003 and 2004. Another painful blow came when NASDAQ Japan closed in August 2000. Despite all these failures, Softbank decided to acquire Japan Telecom, a telecommunications company on the verge of bankruptcy. Doing so, foresightful M. Son could save money on the jointly conducted operations and on marketing its services to Japan Telecom's subscribers.

A turning point in the organization's expansion was the year 2005 when Softbank, getting ready to enter into the segment of mobile communications, limited its activity as the provider of broadband services to the most profitable undertakings. A year later Softbank purchased Vodafone Japan (the largest M&A project in Japan so far). The acquired firm was renamed Softbank Mobile<sup>5</sup>. In 2008 Softbank Mobile went into partnership with Apple to sell its new mobile phone iPhone. Owing to the product's immense popularity, the company's current profits in this segment rose by as much as 80% and now Softbank is the only official vendor of iPhones in Japan. The company continued its internationalization – in 2010 Son invested US\$ 20 million to purchase a 13.7% stake in Ustream Inc., a US provider of broadband streaming services, hoping to increase the stake to over 30% in 2011<sup>6</sup>. Based in California, Ustream operates an interactive platform for live transmissions that viewers receive via the Internet and mobile phones.

Today Softbank is the smallest of the three largest providers of mobile communications services in Japan (after NTT DoCoMo and KDDI). The second important source of its incomes is Internet portals (Yahoo Japan, betting and community portals, trade in listed securities). M. Son has built its prominent position in the Internet and media market not only on his compliance with the rules underpinning Japanese corporate culture (the „zaibatsu” structure, cross-shareholding system), but also on the deliberate opposition to these values (he

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<sup>4</sup> Softbank profit soars; buys stake in Ustream,

<http://www.japantoday.com/category/technology/view/softbank-profit-soars-buys-stake-in-ustream-z-3-lutego-2010>

<sup>5</sup> Whatever Became of Hikari Tsushin? Ebiz news from Japan, „J@pan Inc”, 3 March 2008  
<http://www.japaninc.com/tt459>

<sup>6</sup> Ibidem.

rejects the life time-employment principle, the employees are assessed based on their merits and not seniority, government's instructions are challenged). The Softbank case provides grounds for making an informed guess that its successes should be attributed not to the company's applying, or not, to the traditional Japanese methods, but to its using methods that were effective under the given circumstances.

A large number of "long-lived" enterprises in Japan compared with other countries – around 3,000 organizations have been active for longer than 200 years and 100,000 were established over 100 years ago (Susumu, 2009, pp. 4-5) – demonstrates that Japanese firms are very adaptable to changing market conditions. Among the 100,000 firms, around 45,000 conduct some type of manufacturing activity. Some firms stick to traditional products, such as fabrics, sweets or medicines, but many of them have added modern products to their business profiles. For instance, the ironworks NTK (the Nagase Tomejuro Kojo Corporation)<sup>7</sup> which was established in 1871 to produce cast iron shovels, horseshoes, pots and pans, now delivers ultraprecise metal components necessary to produce semiconductors. The company owner says that the long-term success needs skills and techniques that no textbook or a business plan can teach. The Nissha Printing company established in Kyoto in 1929 has a long history as a producer of high-quality prints. Its first printing base was paper, which was replaced in the 1960s by plastic and film elements of electronic devices. In the 1990s the company extended the range of its products to the active elements of touch screens.

As the period of almost 30 years shows, only the largest of the micro ICT organizations have survived – those having solid financial base and company tradition, e.g. Softbank, Rakuten and Livedoor. Unfortunately, no firm as large as Microsoft has emerged.

Economists believe that many Japanese enterprises legitimately implemented profound restructuring processes. Moreover, the country's domestic consumption has been stimulated in the last decade owing to the introduction of exclusive and expensive products (e.g. digital cameras, plasma and LCD television sets, hybrid cars). Japanese firms return to the country to produce many high-tech products, which is a positive phenomenon in itself. A case in point is the producer of integrated circuits Toshiba that between 2006 and 2007 made a record-high investment of 354 billion yens in new assembly lines in its flagship company based in Yokkaichi (Kojima 2008, p. 308).

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<sup>7</sup> The examples were found in the following articles: N.Susumu, *Roots in the Past, Ready for the Future* (pp.4-6) and T.Koki, *Cell Phones Would Hardly Work without Japan's Input* (pp. 6-9); both in: "Nippon.Discovering Japan ...," op. cit.



In 2006 Toray signed a 16-year contract with Boeing for the delivery of carbon fibres used for producing the B787 airliners. The contract will expire in the year 2021 and its worth is estimated to exceed 700 billion yens (Kojima 2008, p. 308).

Therefore, the hopes for a more dynamic growth of the Japanese economy should be pinned on the innovative attitudes among the small and large firms, on the development of products that are too complicated and modern to be made outside Japan, but also on the government's reformative actions.

### **3. „Dual economy” and the call for structural reform**

Year in year out the Japanese government pursued policy that created two Japans: one exporting very competitive products and the other made of deficit sectors producing for the domestic market. The reasons for the low efficiency of many branches should be sought in the huge number of regulations that inflate their costs and in competition restricted by the unutilised potential of economies of scale. A pertinent illustration is protection given to small shops against the competition from large supermarkets that are bound by many rules, one of them being the requirement to complete over 200 forms when the organization applies for a permit allowing it to deal in meat, tofu or consumer electronics products, or deliver laundry services. The building industry in Japan, notorious for unfair tender procedures involving public-sector contracts, corruptive contacts between businessmen, politicians and bureaucrats from the ministry of building, and for blocking foreign competition, is equally dispersed.

The argument for keeping the status quo arises from the assumption that „the competitive Japan” will earn for the entire economy, while the „non-competitive one” will provide economic stability, jobs, self-sufficiency, as well as an informal pension system for the domestic business. As a result, the Japanese building industry employs around 10% of the country's total workforce, being particularly important in the regions where other jobs are lacking. This situation frequently leads to overdeveloped local infrastructure. For instance, small towns have concert halls that are usually empty or rivers a provided with concrete beds (Japan is a world leader as a concrete manufacturer). The creators of this dual “system” did not predict it negative impacts, though; the underperforming branches of the domestic industry increase the costs of exports' components, as well as contributing to high costs of living, i.e. high levels of domestic prices. The indirect impacts are that new and crucial exporting branches are almost completely absent.

Japan is well known for its uncompetitive workforce showing limited productivity in almost all types of services, for instance telecommunications, air transport, private banking, catering services, wholesale and retail trade. Japanese department stores and banks still keep human workforce, while the developed western countries usually replace it with automated systems and self-service solutions. For the sake of illustration, the Japanese government allowed consumers to purchase fuels on a self-service basis as late as 1997. All these circumstances make Japan different from the other developed economies where services are important drivers of growth and an item of international trade. Besides, the Japanese still offer services that cannot be found in other parts of the world.

Porter, Sakakibara and Takeuchi (2000) investigated the relationships between the share of goods in the volume of export and traditional theory of competition. Among the four factors they distinguished as the determinants of national competitive advantage (Porter 2001, pp. 206-227), i.e. the availability and quality of labour force, capital, the size of the internal market and the degree of rivalry between domestic producers, the last factor was recognised as the most important<sup>8</sup>. The strength of competition was unquestionably the most important explanatory variable: the branches where the domestic producers fiercely competed were the most successful in the global markets. Quite a different situation could be observed in industries covered by the government's protectionist policy that provided trade and manufacturing with a safety net.

Interestingly, in all branches that could not demonstrate global successes market competition was in fact limited by the government. For instance, the government officials imposed production quota on the chemical industry and determined the degree to which its production capacity could be utilised. Regarding transactions involving securities, specific regulations and a system of fixed commissions granted a privileged position to four organizations (now three, after Yamaichi Securities went bankrupt). Sufficient resources of productive inputs ensure comparative rather than competitive advantage, the latter being apparently determined by firms' clear-cut business strategies.

Those industry branches that were not successful enough to establish their presence in the global markets usually had poorer access to the primary productive resources (Porter's first and second factors). The relevant examples are production of chocolate when the prices of imported sugar and cocoa are high, air transport unsupported by well-developed experimental infrastructure,

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<sup>8</sup> M. Porter, M. Sakakibara, H. Takeuchi, *op. cit.*, chapter IV. The survey spanned a period of 18 years (1973-1990) and covered large firms which data were available.

chemical industry suffering from a shortage of specialist engineers and an underdeveloped network of university laboratories.

Regarding the third of the factors determining high competitiveness, Japan's a large and absorptive domestic contributed to mass, standardized and weakly diversified production. When consumers have to choose between similar products, then price become the conclusive criterion, which certainly does not help producers improve their profitability. Imitation, constant improvements to obsolete products, manufacture of full ranges of products cannot form a basis enabling a country to achieve modern competitive advantage. The only way is rivalry, originality and the identification of product niches. Until the 1980s, Japanese corporations were among the most competitive organizations in the world in many high-tech sectors, but within a decade serious changes took place and threats appeared. Their western competitors successfully adapted Japanese management practices and even improved them (Charkiewicz 2008, pp. 94-113). At the same time, Asian producers came with similar products, but their costs of the products they copied were much lower than in Japan.

Summing up, "Japan's dual economy" is still live today. Firstly, only very few industries have been successful on the international scale (mostly those producing consumer electronics and cars); as a matter of fact, that strong concentration of export activity is more frequently found among small economies and Japan is not one of them. Secondly, since 1960s the Japanese firms have usually earned lower rates of return on the invested capital compared with firms in other developed countries. Thirdly, although the electronics and automotive industries have always been the sources of Japan's exports and competitiveness, there is also a whole, vast sector of the economy where efficiency is low. It consists of two types of organizations: one type is involved in international trade, but without much success (chemistry, agriculture, medicines, computer software, services), and the other meets domestic demand (wholesale and retail trade, transport and logistics, building, power industry, production of foodstuffs, healthcare).

The government's approach to the frequently deficit sectors and branches has always been definite and protectionist. Customs barriers and other measures were applied to restrict imports under the banner of so-called educational protectionism (Bossak 2006, pp. 199-200). Unfortunately, many of the protected areas show low efficiency still today. Domestic production has invariably been an important resource of jobs, thus replacing to a large extent the underdeveloped social security system.

However, this long-term policy pursued by the government contributed to the aforementioned high levels of domestic prices and caused problems with making exports competitive in the long term. The last several decades show that

in the competitive branches government's interventions were not significant, but in the deficit branches numerous anti-recession price-fixing and production-limiting cartels as well as other administrative measures restricting competition were a rule (Bossak 2006, pp. 111-112).

#### **4. Government initiatives: strategies for socio-economic development, privatization and commercialization**

Besides the above actions that the Japanese firms launch to raise their productivity and improve innovation, the government's strategic activity is also essential for providing Japan with a new competitive edge. The Ministry of International Trade and Industry (MITI) and the Ministry of Economy, Trade and Industry (METI) that succeeded it have implemented four long-term national development programs in the post-war period:

1. in the 1960s and 1970s an 'engines of growth' strategy (picking the winners) was pursued, emphasising the development of the heavy industry, the automotive industry, the ship-building industry and the electrical machinery industry, etc.;
2. the 1980s was a decade of technopoles and technology parks that were set up to initiate future technological boom in the field of electronics;
3. in the 1990s networks linking and promoting innovative micro and macro organizations were promoted;
4. since 2001 METI has been implementing the concept of regional clusters.

Under the most recent strategy the country has been divided into 19 clusters grouping 5000 small and medium-sized enterprises, 200 universities and many cooperating organizations in 9 Japanese regions. The program is carried out by horizontally-integrated, collaborating biopharmaceutical firms, ICT firms and modern manufacturing enterprises and managed by bureaucrats representing METI's central and regional levels.

The METI's present plans are the most ambitions of all concepts that have been applied for the last 30 years. They span a long period of 23 years, reaching the year 2024. They are almost exclusively founded on M. Porter's theoretical achievements and its well-known rhombus and socio-economic clusters' model that describes the conditions under which local firms can attain competitive advantage. However, Porter's proposal used as the single theoretical underpinning does not automatically guarantee that METI will fulfil its objectives, i.e. better productivity and innovation in the economy and improved indicator of firm turnover.

METI concentrates its efforts on building infrastructure and formal institutions, instead of forming social capital and region-specific capacities for bottom-up entrepreneurial initiatives, which would be a more appropriate target for the Program. Rather than giving top-down instructions and controlling, the Ministry should support local initiatives and encourage entrepreneurs who, demonstrating their commitment and knowledge of the local environment, make real progress happen. K. Ibata-Arens wrote (Ibata-Arens 2005, p. 103) that the delivery of successive conferences attended by foreign scientists and METI bureaucrats and seeking specialists skilfully writing grant applications is less important than reaching the existing entrepreneurs and groups that take efforts to attain their objectives. Local communities allow creating an informal atmosphere of trust and interdependence that facilitates innovation in the long term. Entrepreneurial individuals can mobilise latent internal and external resources around which coalitions able to implement effectively the concepts of socio-economic development can be built.

If the METI officials can find local coordinators and exploiters of resources with proven track record of professional success, then the whole project is likely to succeed. Then, after several years, METI will be able to run its programme as a real partner to local entrepreneurs seeking to improve the competitive advantage. It will become an institution providing consultants to support the implementation of particular local programmes, as well as business angels funding innovative projects in the regions.

It is also important for the METI officials to be able to recognize and award local entrepreneurs' contributions to regional projects instead of taking the projects over and tagging them as national undertakings developed at the Ministry. A good example to follow is the Silicon Valley where the entire cluster developed from a systematically organized process initiated by local universities and then joined by local firms, without any involvement from the government administration, at least at its early stages.

Another initiative of the Japanese government that is aimed to boost innovation and productivity of the Japanese economy is based on privatization and restructuring. Let me present now the most important projects in this area: the privatization of Japan Post (JP), the case of the highway companies (the Japan Public Highway Corporation) and the changes in the operation of the Japan Housing Loan Corporation, a governmental institution providing borrowers with funds for their own houses.

Successive governments, particularly that headed by the great reformer Prime Minister J. Koizumi (2001-2005), attempted to limit the involvement of the state by reducing amounts allocated to public works and deregulating economic processes, but also by privatizing a range of the state-owned

enterprises. In 2005, Koizumi put forward a plan to privatize Japan Post being in fact the largest world bank in asset terms. The saving system based on the network of post offices is immensely popular in Japan, particularly in small town. The plan failed and as an act of political retaliation Koizumi removed from the then ruling Liberal Democratic Party of Japan several tens of deputies who contributed to this failure (Vogel 2006, pp. 157-204).

Considering the essential role that postal services play all over the world, they are generally provided by the government-owned corporations. However, the public sector is usually less effective than the private sector. Because of that, many countries decided to privatize their postal services. J. Koizumi was one of the few Japanese politicians for whom the privatization of Japan Post was a duty, almost a passion. However, the organization could not be privatized without taking account of some specifically Japanese factors (Takenaka 2008, pp. 128-129):

1. JP's financial assets representing citizens' savings (bank deposits) and the amounts related to life insurance policies (insurance funds) were estimated to exceed 300 billion yens (approx. 3 billion US dollars), an equivalent of the assets held by three large private banks.
2. Citizens' private resources were used to fund local investments through the governmental Fiscal Investment and Loan Program (FILP), which was in fact a second state budget that frequently came in handy when political goals had to be attained. The postmasters were invariably important elements of the election apparatus of successive ruling parties.
3. The postal trade unions, recognized as one of the strongest organizations of this type, exert an extremely strong influence on the ruling parties' politicians, because of which resistance against privatization was and still is substantial.

Koizumi's reformation plans were almost exclusively based on the cooperation with a professor at the Keio University, Heizo Takenaka. Koizumi made him a minister for economy and fiscal policy and a minister for financial services in charge of solving the banks' bad-debt problem, and finally a minister for postal service privatization. Takenaka's political career was quite unique in Japan, because he left his university directly to become a prominent government official, without even being a Member of Parliament. He performed his duties throughout the Prime Minister Koizumi's term, that is for 5 years and 5 months. In devising the reform, H. Takenaka defined three key principles that were to determine the privatization of Japan Post (Takenaka 2008, pp. 140-142).

The first principle stated that because of the three main types of services delivered by Japan Post, i.e. parcels and letters, banking services and life insurance, the giant should be divided into three independent companies. Until

that time, all business of Japan Post, including its banking and insurance segments, was financially assisted by the state (government guarantees and other financial privileges) and the additional incomes were used to subsidize the first segment. In other words, not only did the obviously market segments (banking and insurance services) receive support, but also the system of internal subsidies discouraged any bottom-up initiatives that could make traditional postal services more efficient. Although both these aspects were economically wrong, the expectation was that the organizations related to Japan Post would insist on keeping its status quo and mode of operation.

The second principle assumed that the new enterprises that would emerge after the breakup would have to compete in the market, like all other business organizations. This actually meant that the government would withdraw its guarantees for the banking and insurance business. Even more serious consequences were expected to arise with the creation of a new supervisory body; a plan was devised to transfer the two segments under the jurisdiction of the Financial Service Agency (i.e. the Ministry of Finance) instead of the Ministry of Internal Affairs and Communications (formerly the Ministry of Posts and Telecommunications). This decision stirred protests among the „postal family members” and sparked a fight between the Ministries for territory (power). Moreover, privatization implied that the officers would inevitably lose their privileged status of civil servants.

The third principle proposed appointing a special minister in charge of privatization of Japan Post, who would be directly subordinated to the Prime Minister and not to the Minister of Internal Affairs and Communications. This solution was intended to ensure that new laws were created autonomously and that a new institution monitoring the three new enterprises was established.

H. Takenaka's major adversaries, the Minister of Internal Affairs and Communications, Taro Aso (the future Prime Minister) and the president of Japan Post, Ikuta, agreed after many debates to divide the organization into four independent companies and to establish Japan Post Holdings Co., Ltd. keeping majority stakes in the three companies: (1) parcels and letters, (2) banking services, (3) life insurance. A 10-year transitional period was set *for the companies* to achieve full integration with the market system (Economist, 2010). The privatization law passed on 14 October 2007 legalized cross-shareholding in order to give some protection to the companies providing banking and life insurance services against the risk of hostile takeover. At the same time, the government committed itself to gradually selling all its shares in the two companies. Because of the public character of the postal service company, slightly different laws were implemented. The government retained its stake (*1/3 stake in the company holding the controlling interest in 2017*, i.e. the last year

of privatization). Because the central subsidies grew smaller following the reduced number of post offices, local governments demanded that the central government increased the shares of tax revenues transferred to the lower tiers when annual budgets were being drawn up.

To reform Japan Postal effectively, more appointments were needed – on 31 October 2007 H. Takenaka was made both a minister for internal affairs and communications and a minister in charge of JP privatisation; at the same time, he ceased to be a minister for the economy and fiscal policy. The reform was slowly losing its momentum. On 30 March 2010, the government headed by Prime Minister Yukio Hatoyama allowed the postal company to raise the upper limit on the deposits from 10 to 20 million yens, i.e. to double it (Economist, 2010), and the life insurance company was permitted to increase the maximum liability amount under a policy from 13 to 25 million yen. The decisions (implying governmental guarantees) met with protests from private banks complaining that the new solutions breached the market competition rules. On 24 March 2010, the government passed a budget of 92 trillion yens for the financial year starting in April; half of that amount is planned to be raised from the government bond issues.

As well as being involved in the privatization of Japan Post, Prime Minister Koizumi also showed special commitment to reforming the special public companies that the government supported financially through the FILP, granting them 6 trillion yens in subsidies and 24 billion yens in preferential loans annually. The money came from the population's postal savings. *FILP promoted investments in the so-called emerging industry branches and subsidised the development of economically weaker regions from its establishment in 1952*. Koizumi tried to prove that the system was obsolete, burdened the state budget and deformed financial markets. His reform was targeted at 77 special public companies and 3,000 affiliated firms.

He became particularly interested in 4 highway construction companies and the Housing Loan Corporation (HLC) that in the post-war period provided cheap loans to help people build their own houses. Koizumi initially planned to disband the HCL, but then agreed to its privatization. Ultimately, the corporation was transformed into the Japan Housing Finance Agency (JHFA) whose president was appointed for the first time from among the private sector managers (*in* April 2007)<sup>9</sup>. JHFA withdrew from the primary loan market to deal in a product called „Flat 35” in the secondary loan market. Within the new

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<sup>9</sup> Message from the President : Japan Housing Finance Agency,  
<http://www.jhf.go.jp/english/message.html>



business, JHFA provides private banks with most funds that are needed to finance the „Flat 35” loans. The banks pay a fixed interest rate, but grant loans to the interested clients according to the market rules (Yamori Kondo, 2008, p. 63). The system has a built-in securitisation mechanism, under which JHFA arranges guarantees for mortgage loans related to „Flat 35”. This is actually a program of governmental guarantees for commercial banks that lend money to clients wishing to have their own houses. The system makes the Agency relatively independent of the government, as its revenues come from the fees paid for setting up a mortgage guarantee fund (Mortgage-Backed Securities) and not from loans or government subsidies.

Moreover, Koizumi initially insisted on privatizing all 9 public financial institutions (including the famous Japan Development Bank), but the special role the institutions play in the system made him accept smaller modifications. This special role consists in that they usually grant loans during economic deceleration, when the private banks either limit or give up lending at all.

A particularly fierce battle against the central administration Koizumi had to fight to reform the highway companies. In 2002 Koizumi took out 300 billion yens earmarked for the construction of highways from the budget, threatened that he would freeze completely all amounts allocated for this purpose and selected four highway companies for privatization. As initially planned, the largest of the four, Japan Highway Corporation, was to be divided into 3 regional enterprises to prevent the profitable highways from subsidizing those operating at a deficit (cross-subsidizing)<sup>10</sup>. The parliamentary statute passed in 2004 provided that the government would keep 1/3 of the new companies' shares and would have a right to make decisions in the key areas of the companies (approval of business plans, issues of shares, selection of the top managers). As the owner of the controlling interest, the government still commands the highways and the privatized companies only operate them under lease contracts. The government hold out its promise to repay the Japan Highway Corporation's debts, but refused to scale down the plans for highway network expansion. Privatization helped stabilize the financial condition of the Japanese highway construction sector.

A separate initiative put forward by the Prime Minister Koizumi's government aimed to establish special economic zones exempted from certain government regulations and serving as a means of fulfilling the selected socio-economic goals. The Program started in 2002 and two years later there were as

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<sup>10</sup> F. Mizutani, Privatization of the Japan Highway Public Corporation: Policy Assessment, Paper for the 46th Congress for the European Regional Science Association, <http://www-sre.wu-wien.ac.at/ersa/ersaconfs/ersa06/papers/226.pdf>

many as 328 zones divided into ten categories, mostly in agriculture, education and local community activities. Because of opinion differences between economists and politicians the project was discontinued (Vogel 2006, p. 111).

## 5. Conclusions

It is out of the question that at the present stage of its development Japan needs resolute initiatives to improve labour productivity, boost innovation and increase the number of new firms (firm turnover). It has to be noted, though, that the opportunities that the macroeconomic, fiscal and financial policies may offer do not give much room for manoeuvre any longer. Japan's public debt is one of the largest among the developed countries and public works have turned out to be very costly, ineffective and corruptive. Besides, monetary policy offers limited options of stimulating the economy now, because interest rates are negative.

Therefore, positive changes can be produced by coordinated efforts of the innovative firms and government's strategic reforms. This conclusion is additionally enhanced by the fact that, as history shows, in the period of recession that comes with every economic cycle new small firms employing to 10 persons are always found to be the most numerous. The government's policy concerning high-tech start-ups that aims to increase their numbers should primarily support the formation of the large firms that can survive changes in economic cycles and international competition.

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REFORMATORSKA RZĄDU**

*Artykuł ten stanowi kontynuację tekstu opublikowanego w „Comparative Economic Research for Central & Eastern Europe”, Tom 13, nr 1/2/2010, p.t. Nowa przewaga konkurencyjna Japonii. Argumenty i propozycje na rzecz przeorientowania struktur. Została w nim wyeksponowana rola sektora prywatnego we współpracy z agendami rządu. Artykuł składa się z czterech części. W części pierwszej przedstawiono historię nowych firm w branży teleinformatycznej (telefonia komórkowa, komputery) po 2000 roku, a także wskazano na determinanty innowacyjności. W części drugiej scharakteryzowano „podwójną ekonomię” Japonii w kontekście konkurencyjności i innowacyjności gospodarki. W części trzeciej omówiono najważniejsze reformy strukturalne w Japonii w XXI wieku: Poczty, Housing Loan Corporation oraz Japan Highway Corporation. W części czwartej artykułu zaprezentowano wnioski końcowe.*