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BUSINESS MANAGEMENT SYMPOSIUM

No single recipe for facing challenges of globalization

Outsourcing not necessarily a winning strategy; differentiation and innovation still the key

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There are multiple ways for companies to stay competitive in a globalized world, and even firms in what are often perceived as sunset industries have the potential for success, scholars and business executives said at a recent symposium in Tokyo.

Symposium panelists field questions from the audience at Keidanren Kaikan in Tokyo on Jan. 18. The panelists are (from left) Teruaki Aoki, Robert Madsen, Haruo Kawahara, Hugh Whittaker, Suzanne Berger and Samuels.

The sheer pursuit of cheap labor is not a winning strategy, and companies relying too much on outsourcing could end up losing their innovative capability, the participants said at the Jan. 18 symposium, "Globalization and the future of the national economy."

The event, held at Keidanren Kaikan, was jointly organized by Keizai Koho Center and the Massachusetts Institute of Technology's Japan Program.

In her keynote speech, Suzanne Berger, professor of political science at MIT, explained how a five-year research of 506 companies worldwide by a team of MIT scholars including herself showed that there are a variety of ways to deal with the challenges of globalization.

Berger said globalization meant for companies a radical shift from the business models of the late 1980s, when integration of various functions of a company -- research, development, design and manufacturing -- within its four walls was considered the key strength of the best-performing firms.

Suzanne Berger, political science professor at Massachusetts Institute of Technology, delivers the symposium's Keynote address.

That has been replaced today by a "complete fragmentation of these production systems and redistribution of activity between home societies and host societies," the scholar told the audience.

"Each of the functions -- R&D, product idea, design, procurement of components, manufacturing, logistics, sales and after-sales service -- used to be carried out within single, integrated companies like IBM in the 1960s and '70s, and today we see new independent actors appearing" for each of those functions, she said.

The iPod example

Apple Computer, for example, did the product definition -- and part of the design -- of its popular iPod digital music and video player, but uses Japanese components and outsources its manufacturing to a Taiwanese company that assembles the products mainly in China, she said.

"The genius of the Apple people was to see how to use (components procured elsewhere) to construct a product that would be extraordinarily successful," she said.

"So what we're looking at is a kind of shift from multinational companies that used to control all of the functions to multinational companies today that remain strong in product definition, marketing and distribution" but subcontract detailed design and manufacturing to others, Berger noted.

As companies across industries break apart their basic functions, how do they decide what to keep within their own company and what to outsource -- and what to offshore to subcontractors abroad?

The conclusion of the MIT research, she said, is that there is no single recipe.

"In the personal computers industry, it's true that Dell buys all of its components, puts in very little manufacturing and is very successful. But so are Samsung and Sony" with half of the higher-end Sony Vaio computers produced in Nagano, and Samsung using many of its own made components in its computers," Berger said.

Berger emphasized that the only winning strategy in dealing with globalization is to differentiate -- to create unique capabilities in the company that are difficult to replace.

While a number of companies say they move manufacturing operations abroad because of labor costs, labor often accounts for a small portion of the total production costs, she said.

Constant relocation

And choosing a company's strategy based on a pursuit of cheap labor "moves the company into a situation where it will have to be relocating continuously," she warned. "If your strategy is competition with others chasing after the cheapest labor, there really is no way of winning, because there will always be others who are willing to go the further mile" into more remote areas of the world.

The MIT study suggested that Japanese and American firms react differently to the dilemma of outsourcing -- that the practice may result in creating competitors, according to Berger.

Japanese companies -- perhaps because of their past experience in which outsourcing to Taiwanese and South Korean eventually created powerful competitors for them -- are cautious and maybe too concerned, whereas American firms are so aggressive in outsourcing their own capabilities that they may find it difficult to retain their innovative capabilities, she observed.

The difference is also reflected in the way Japanese and American companies develop their China strategy, she said. American businesses tend to outsource to local firms when they make products in China, while Japanese companies are more likely to build their own plants in China, she added.

Such a gap will have a longer-term consequences, Berger noted. By producing at their own plants in China, companies may learn more about Chinese consumers, whereas an American firm that outsources to Taiwanese subcontractors who then produce in China will have little direct experience of the local market.

"Over time, these differences in strategy would be very penalizing for American companies' ability to learn to understand the China market," she said.

Richard Samuels, director of MIT Center for International Studies and head of the MIT-Japan Program, pointed to the moves by major Japanese corporations to shift some of their manufacturing operations back to Japan in recent years.

"While it is clear that Japanese managers did indeed move with perceived globalizing shifts in market, they did not do so at the same pace, nor entirely in the same direction, nor with the same outcome, as their counterparts in Western Europe and United States," said the MIT professor of political science.

By mid-2004, it became clear that the "hollowing-out" of Japanese industries had ended, with data showing Japanese electronics starting to aggressively invest to boost their manufacturing capability back home, he said.

The move shows that emphasis on autonomous technology, diffusion of technology within the country, and sustaining long-term manufacturing capability remain core values in Japan, Samuels said. "The question is, can these sets of values be sustained in a world of globalization? If so, at what cost?"

Homeward-bound

Kenwood Corp.'s relocation of its portable audio equipment production from its Malaysia plant to Yamagata Prefecture three years ago came under media spotlight as one of the first examples of the "return to made-in-Japan" phenomenon.

"Japanese managers tended to assume that it is cheaper to manufacture their products in other parts of Asia" because of labor cost, said Kenwood CEO and President Haruo Kawahara. But it turned out that it is cheaper to produce in Yamagata than in Malaysia, he said.

Total production cost declined by 10 percent, and the relocation resulted in a 73 percent cut in defective product ratio. The number of workers on a product line was reduced from 22 in Malaysia to seven in Yamagata because the employees at the Yamagata plant, who had longer-term employment relationship, were able to accumulate skills and perform multiple functions, Kawahara said.

Kawahara echoed Berger's alarm over excessive outsourcing. While outsourcing may be initially beneficial to the firm's competitiveness because it involves little indirect costs and no capital investment, "progress stops over time and you lose the cost competitiveness," he said.

Losing human resources

Production costs become rigid and you are unable to flexibly respond to changes in market conditions if you rely on outside manufacturers for supply of key components, Kawahara said. "And more importantly, outsourcing means you lose the human resources. People who have experience and knowhow about production retire, and nobody in the company will know anything about production, and the firm loses its competitiveness."

Teruaki Aoki, adviser to Sony Corp., said that even as China becomes increasingly important in Sony's manufacturing activity, its plants in Japan will continue to play a central role as the "mother" of its worldwide operations.

According to Aoki, the Japanese plants account for half of Sony's global production, while China's share, including those in the mainland by Taiwanese subcontracted firms, has topped 20 percent.

Sony's basic policy is to produce where the market is, and China with its huge market is estimated to account for more than 10 percent of the firms' worldwide sales in 2010, he said.

The Japanese plants meanwhile focus on the launch of new products, manufacturing high-end products, as well as developing manufacturing devices and technology, Aoki said, adding that they also serve as training ground for human resources for Sony's overseas operations.

Hugh Whittaker, professor of business administration at Doshisha University, said his study of Hitachi Ltd.'s restructuring efforts since the mid-1990s indicates that Hitachi and other major Japanese electronics firms will not abandon their traditional emphasis on "monozukuri" -- or manufacturing of goods -- but are willing to adjust it to changing circumstances and more global environment.

He said that the main features of Hitachi's attempt to create a new "monozukuri" system include: innovation in business models, a strategic view of technology, increased emphasis on profitability, selective application of outsourcing, pursuit of group and external synergies, mobilization of resources on a more global scale, speedier information and decision-making processes, and complementary changes to employment relations with its workers.

Robert Madsen, a senior fellow at MIT Center for International Studies, meanwhile discussed the more macroeconomic aspects of globalization and said that while some successful companies will survive even in the so-called sunset industries through management efforts, declining sectors do exist.

Although national economies may continue to prosper as they shift to growing sectors, specific communities that have depended on declining industries suffer, and there are tremendous human costs entailed by changes in corporate behavior prompted by globalization, Madsen told the symposium audience.

"Globalization is a good thing in general . . . but there are profound problems with it and we really have not developed all the mechanisms we need to make the system as well as it should be," he said.