

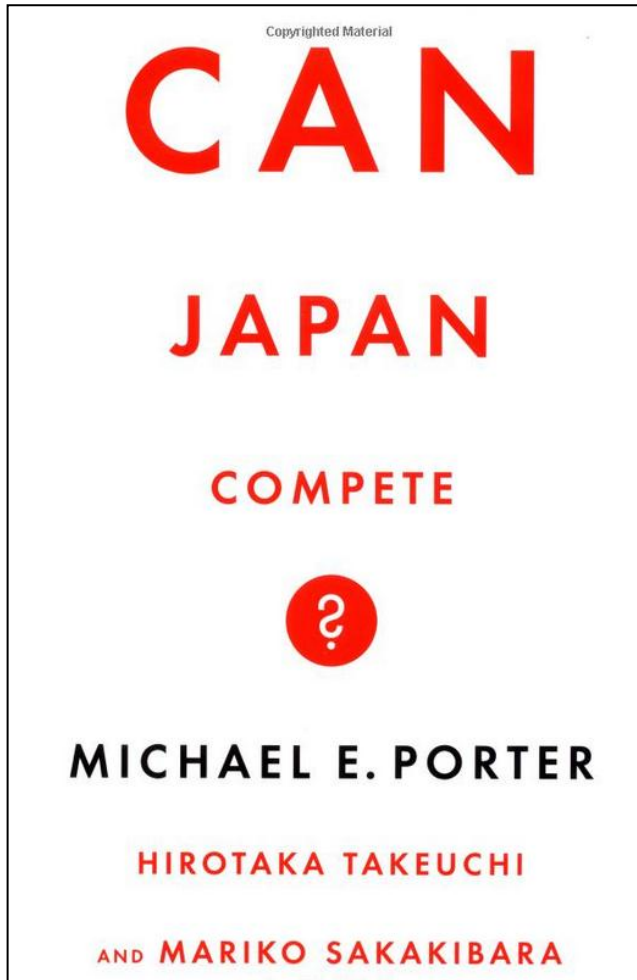
Can Japan Compete? Revisited

Professor Michael E. Porter
Harvard Business School

*Porter Prize Conference
Tokyo, Japan
December 5th, 2013*

This presentation draws on ideas from Professor Porter's articles and books, in particular, [The Competitive Advantage of Nations](#) (The Free Press, 1990), "Building the Microeconomic Foundations of Competitiveness," in [The Global Competitiveness Report](#) (World Economic Forum), "Clusters and the New Competitive Agenda for Companies and Governments" in [On Competition](#) (Harvard Business School Press, 2008), "[Creating Shared Value](#)" (Harvard Business Review, Jan 2011), the [Social Progress Index Report](#) (Social Progress Imperative) and ongoing related research. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means - electronic, mechanical, photocopying, recording, or otherwise - without the permission of Michael E. Porter. For further materials, see the website of the Institute for Strategy and Competitiveness (www.isc.hbs.edu), FSG (www.fsg.org) and the Social Progress Imperative (www.socialprogressimperative.org).

Can Japan Compete?



- What is the state of Japanese competitiveness in 2013? How has Japan progressed since 2000?
- What is Japan's strategic agenda for 2014 and beyond?
- Is Abenomics sufficient?

Can Japan Compete?

1. Japan's Economic Performance
2. Competitiveness and Economic Growth: The New Learning
3. The Strategic Agenda for Japan in 2014

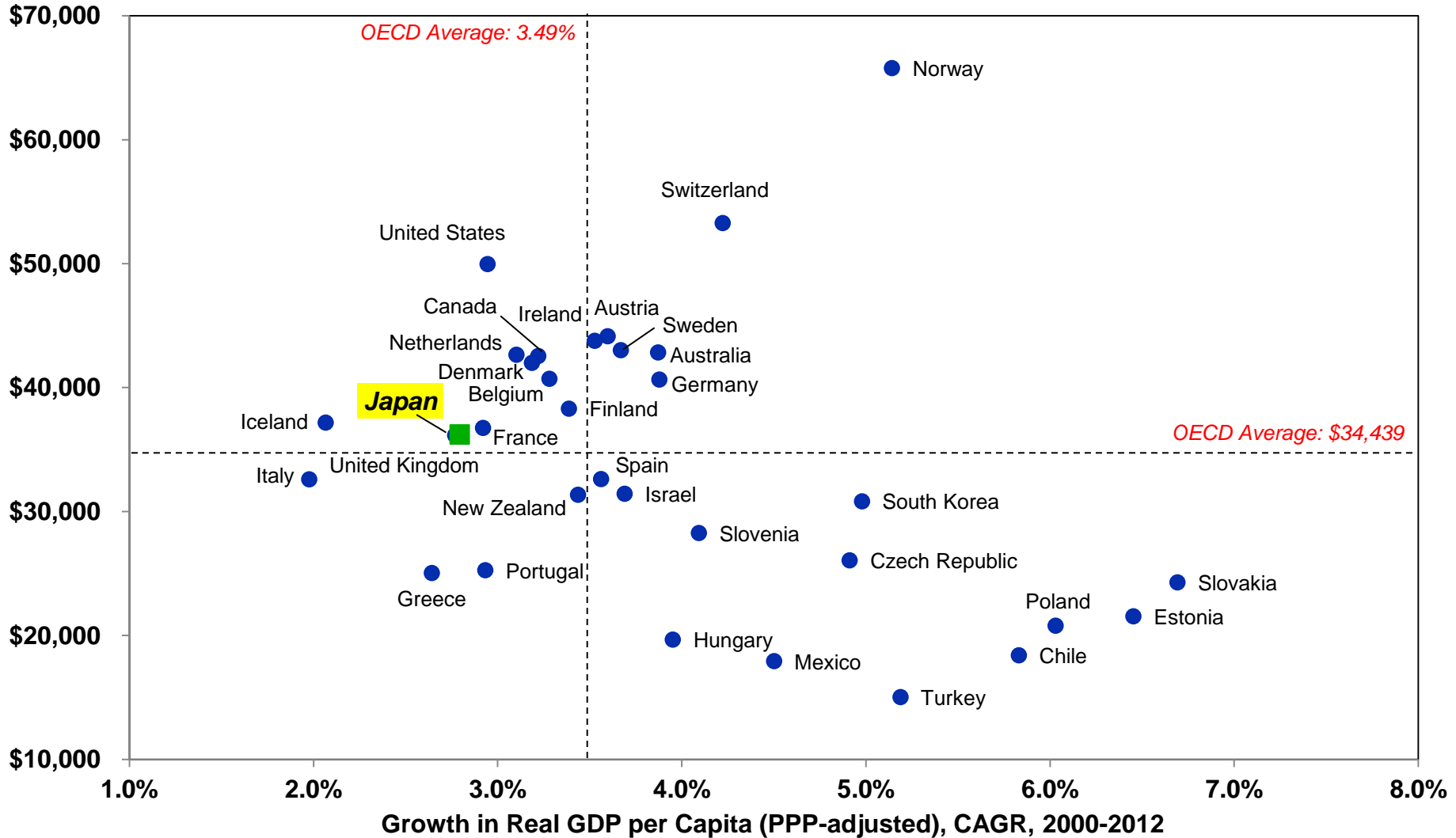
Japan's Economic Performance

- Overall economic performance has been **disappointing**, reflecting a poor macroeconomic environment and continuing microeconomic weaknesses

Prosperity Performance

OECD Countries

PPP-Adjusted GDP per Capita, 2012 (\$USD)



Note: Luxembourg Excluded

Source: EIU (2013), authors calculations

20131205—Porter Prize Japan Competitiveness Presentation—FINAL

Japan's Economic Performance

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- While growth in **productivity of existing workers** remains in line with many advanced OECD peers, Japan has suffered from **declining workforce participation**

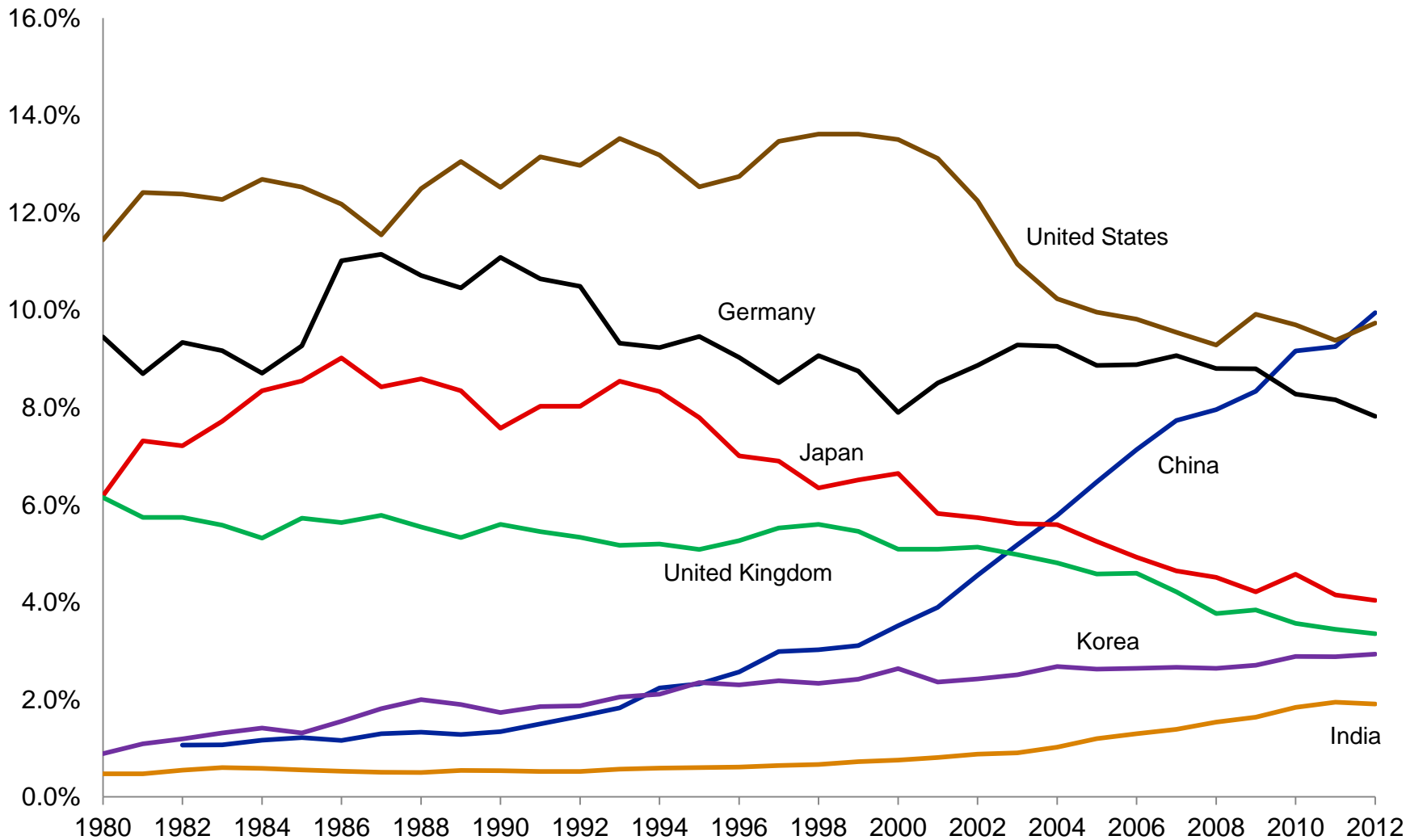
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Share of World Exports

Selected Countries, 1980 - 2012

Share of World Exports of Goods and Services



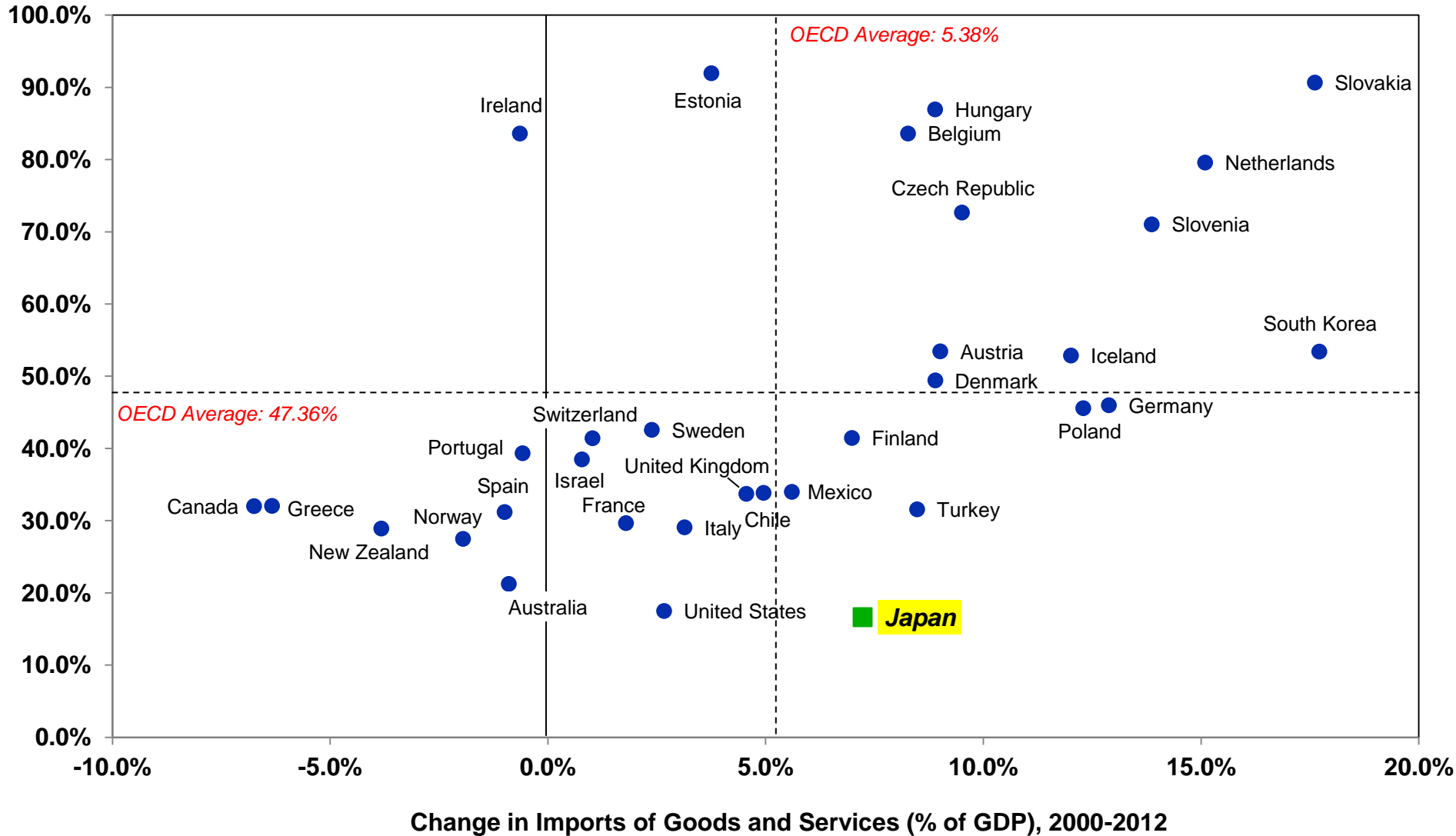
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- Imports into the Japanese economy have grown, reflecting **gradual opening**

Import Performance

OECD Countries

Imports of Goods and Services (% of GDP), 2012



Note: Luxembourg omitted

Source: EIU (2013), authors calculations

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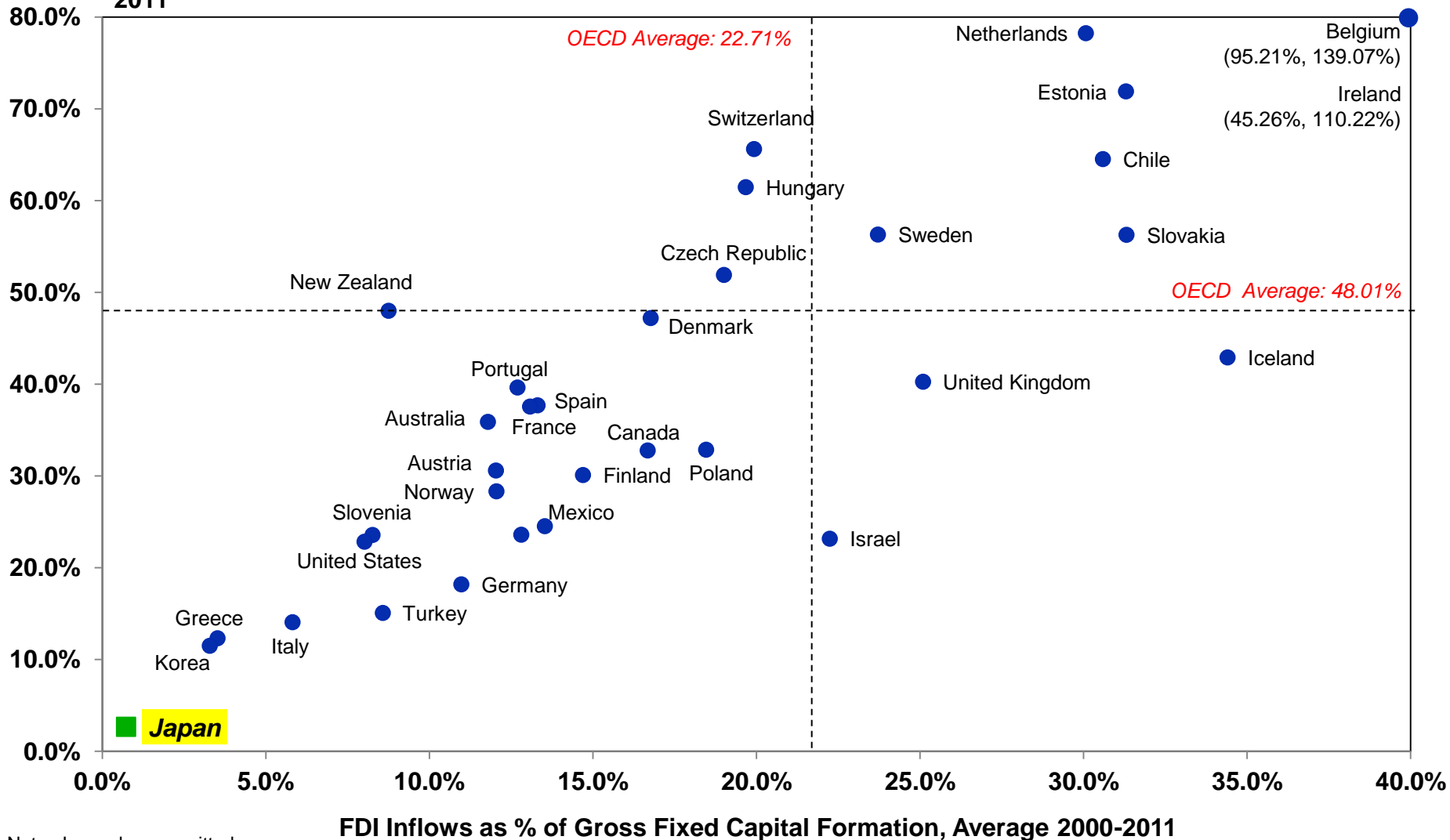
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Inbound Foreign Investment Performance

Stocks and Flows, OECD Countries

Inward FDI Stocks as %
of GDP, Average 2000-
2011



Note: Luxembourg omitted

Source: UNCTAD, World Investment Report (2012)

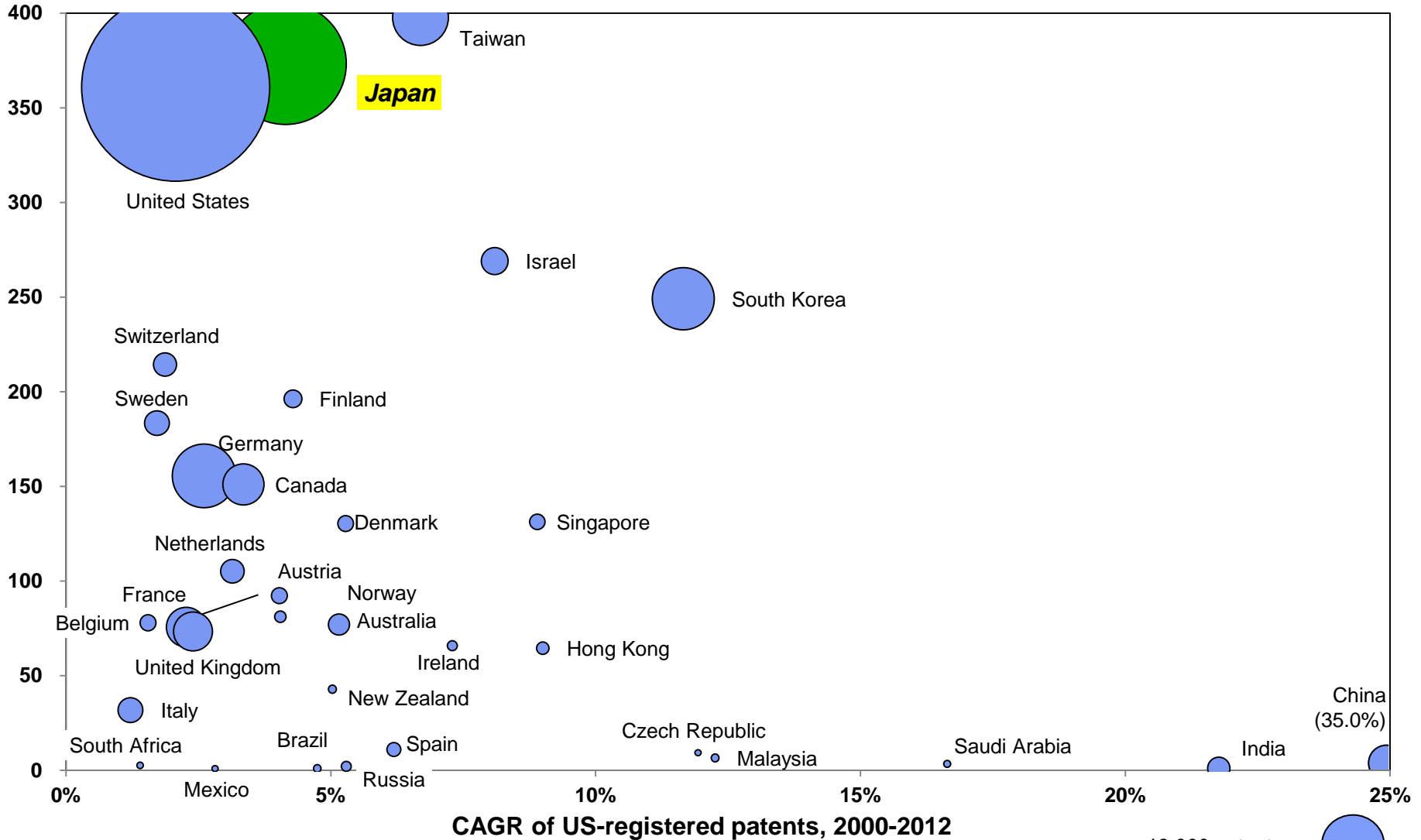
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- Japan continues to be among the **top innovators** in the world, but some other countries are **more rapidly increasing** R&D spending

Innovative Output Selected Countries

Average U.S. patents per 1 million population, 2010-2012



Source: USPTO (2010), Groningen Growth and Development Centre, Total Economy Database (2010)
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Competitiveness and Economic Growth

A nation or region is competitive to the extent that firms operating there are able to **compete successfully** in the regional and global economy while maintaining or improving **wages and living standards** for the average citizen

- Competitiveness depends on the **long-run productivity** of a location as a place to do business
 - The productivity of existing firms and workers
 - The ability to achieve high participation of citizens in the workforce
- Competitiveness is **not**:
 - Low wages
 - A weak currency
 - Jobs per se

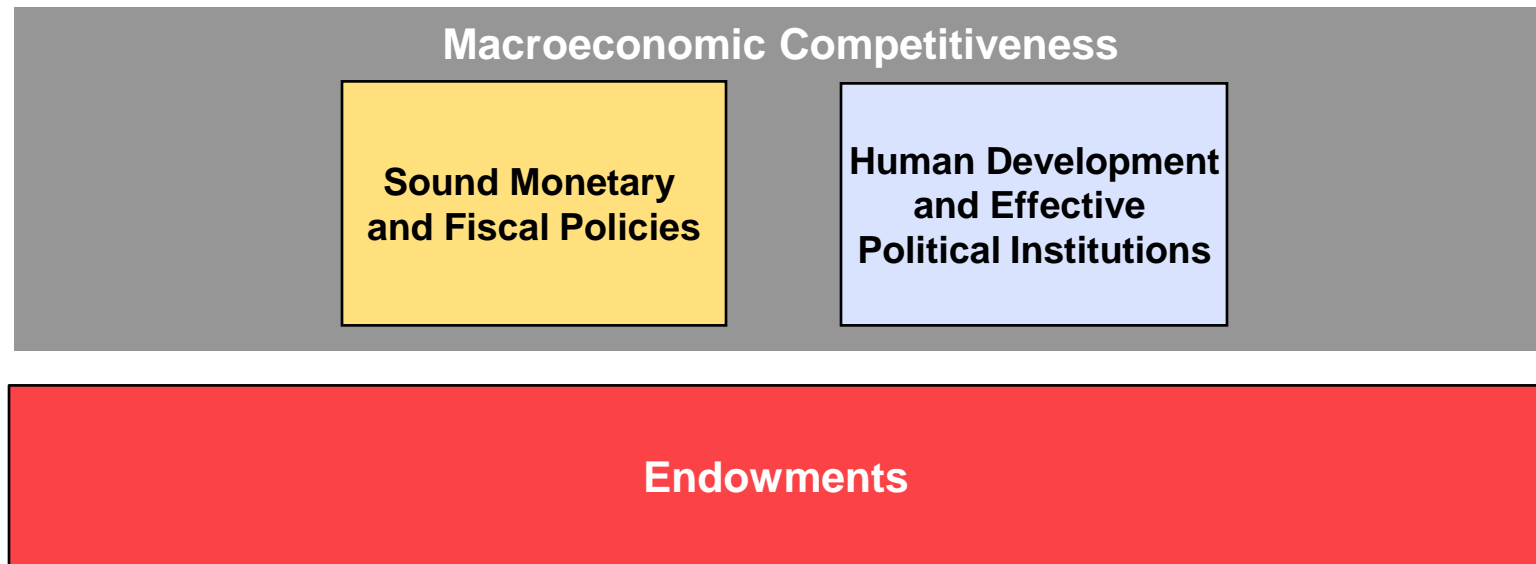
What Determines Competitiveness?



Endowments

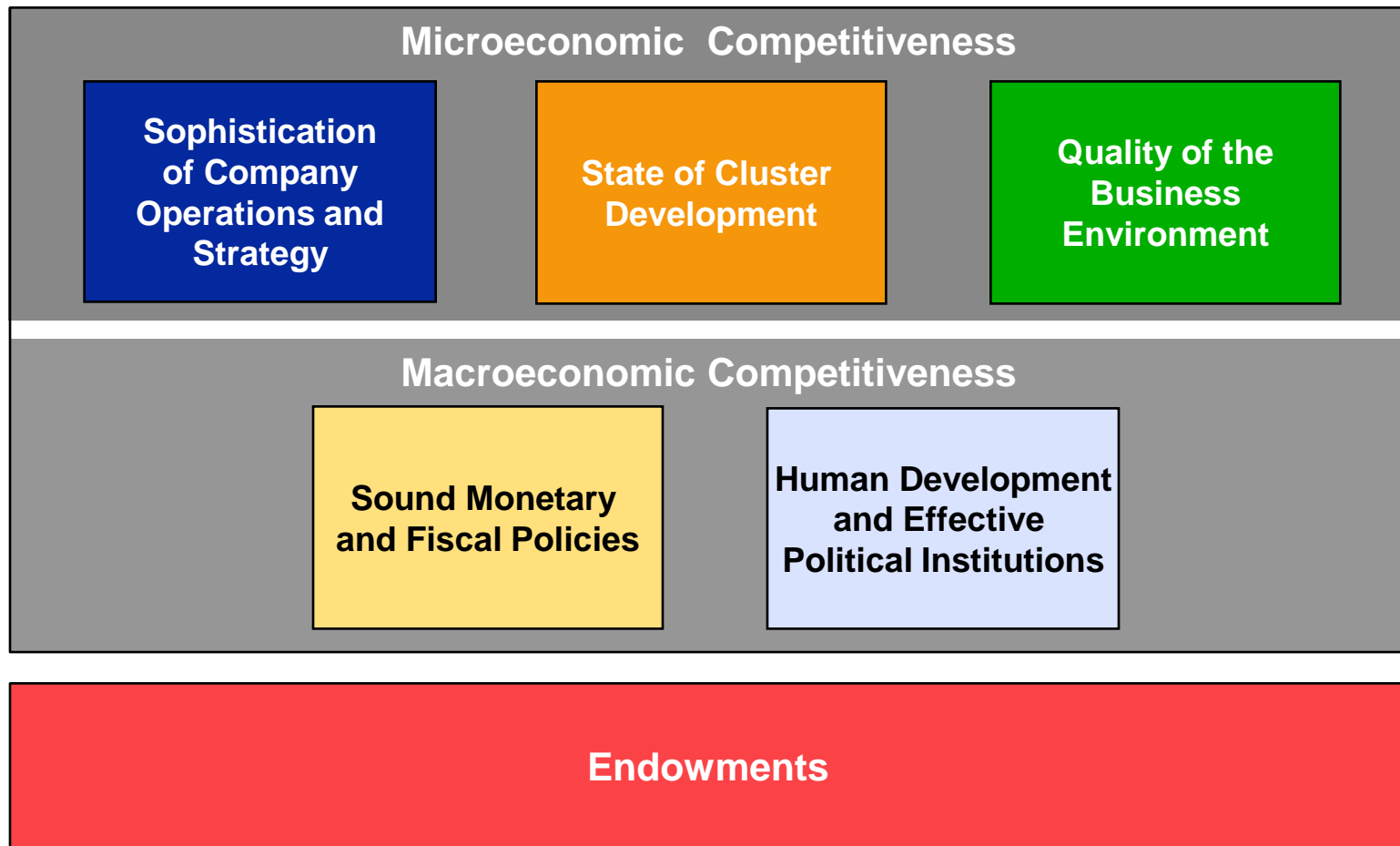
- Endowments, including **natural resources**, **geographical location**, **population**, and **land area**, create a **foundation** for prosperity, but true prosperity arises from **productivity in the use of endowments**

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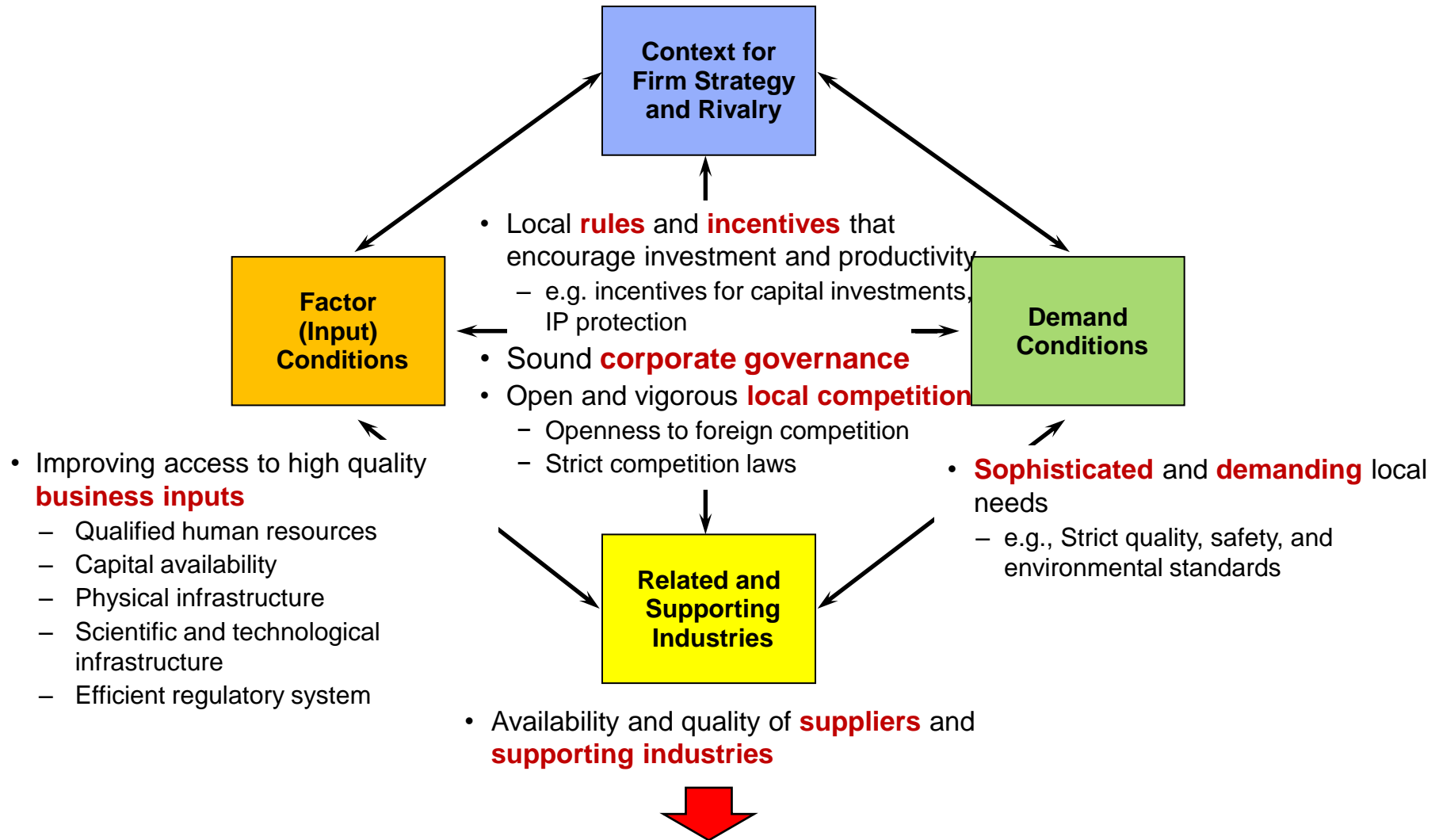
- Macroeconomic competitiveness sets the **economy-wide** context for productivity to emerge, but is **not sufficient** to ensure productivity
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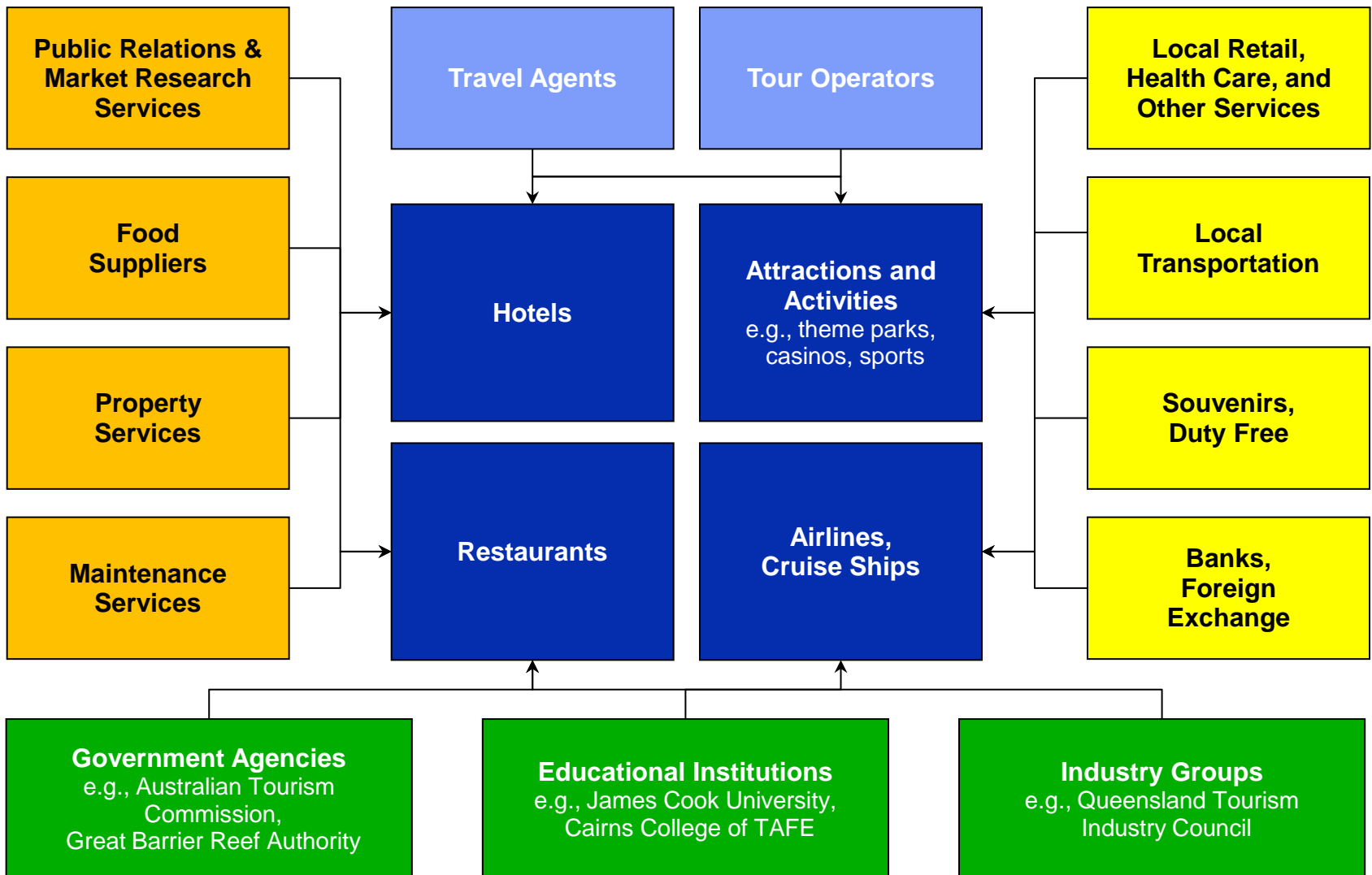
- Productivity ultimately depends on improving the **microeconomic capability** of the economy and the **sophistication of local competition** revealed at the level of firms, clusters, and regions
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Improving the Quality of the Business Environment

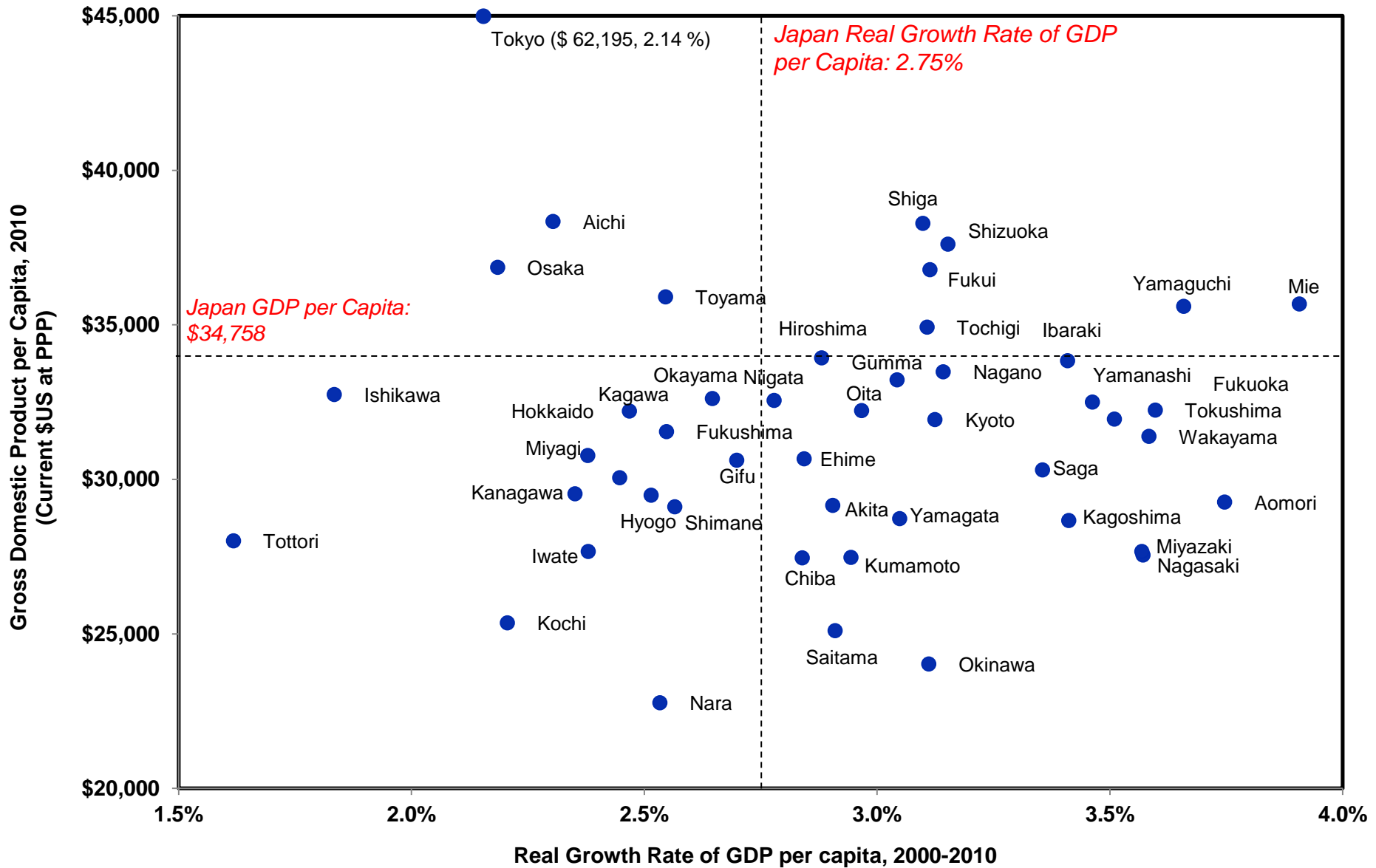


- **Many things matter** for competitiveness
- Successful economic development is a process of **successive upgrading**, in which the business environment improves to enable increasingly sophisticated ways of competing

Developing Clusters: Tourism in Cairns, Australia



Prosperity of Japanese Prefectures



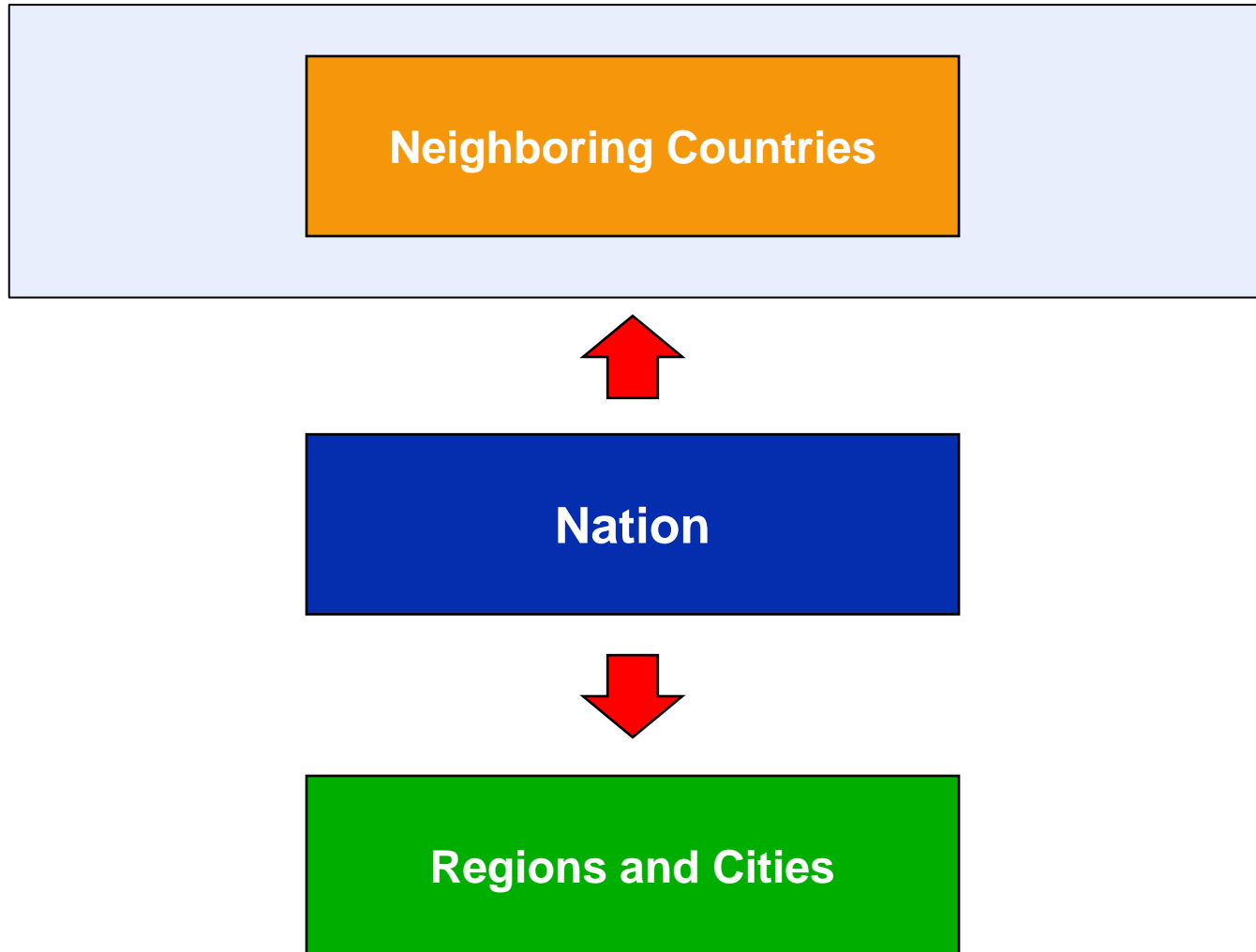
The Role of Regions in Economic Development

- Many essential levers of competitiveness reside at the **regional level**
- Regions **specialize** in different sets of clusters



- Regions are a **critical unit** in competitiveness
- Each region needs its own distinctive **strategy and action agenda**
 - Business environment improvement
 - Cluster upgrading
 - Improving institutional effectiveness

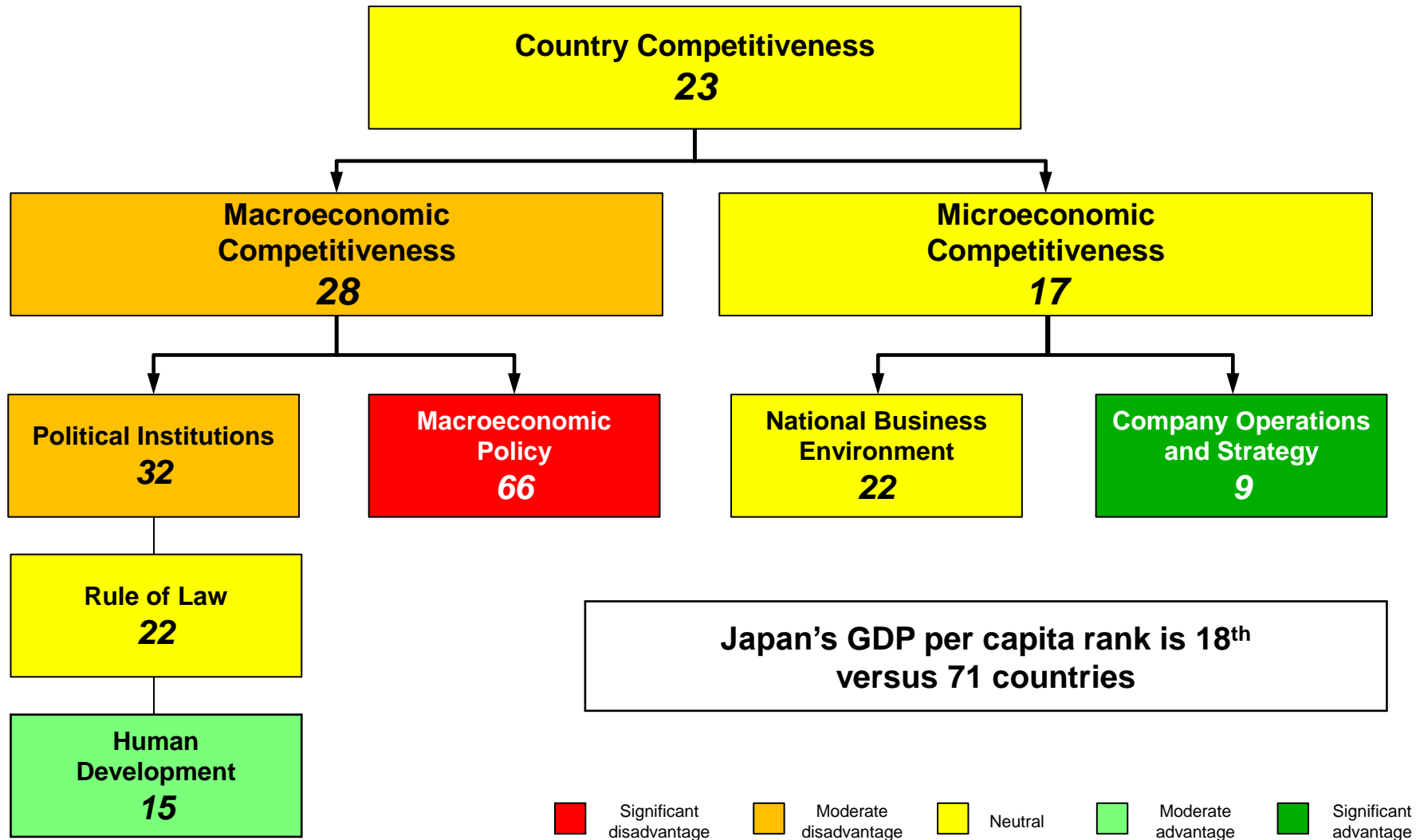
Geographic Influences on Competitiveness



- Economic coordination and integration with neighboring countries is a **major force of productivity and competitiveness**

Japan's Competitiveness Profile, 2001

ISC Competitiveness Model



Note: Rank versus 71 countries; *Color coding based on comparison relative to income;

Source: Institute for Strategy and Competitiveness, Harvard University (2012), based in part on survey data from the World Economic Forum; analysis prepared based on research findings by Scott Stern, Mercedes Delgado, and Christian Ketels.

Can Japan Compete?

The Corporate Agenda in 2001

1. Shift the goal from growth to profitability
2. Create distinctive, long term strategies
3. Expand the focus of operational effectiveness to IT
4. Understand the role of industry structure
5. Reduce unrelated diversification
6. Update the Japanese organizational and governance model
7. Develop a stronger role for the private sector in economic development

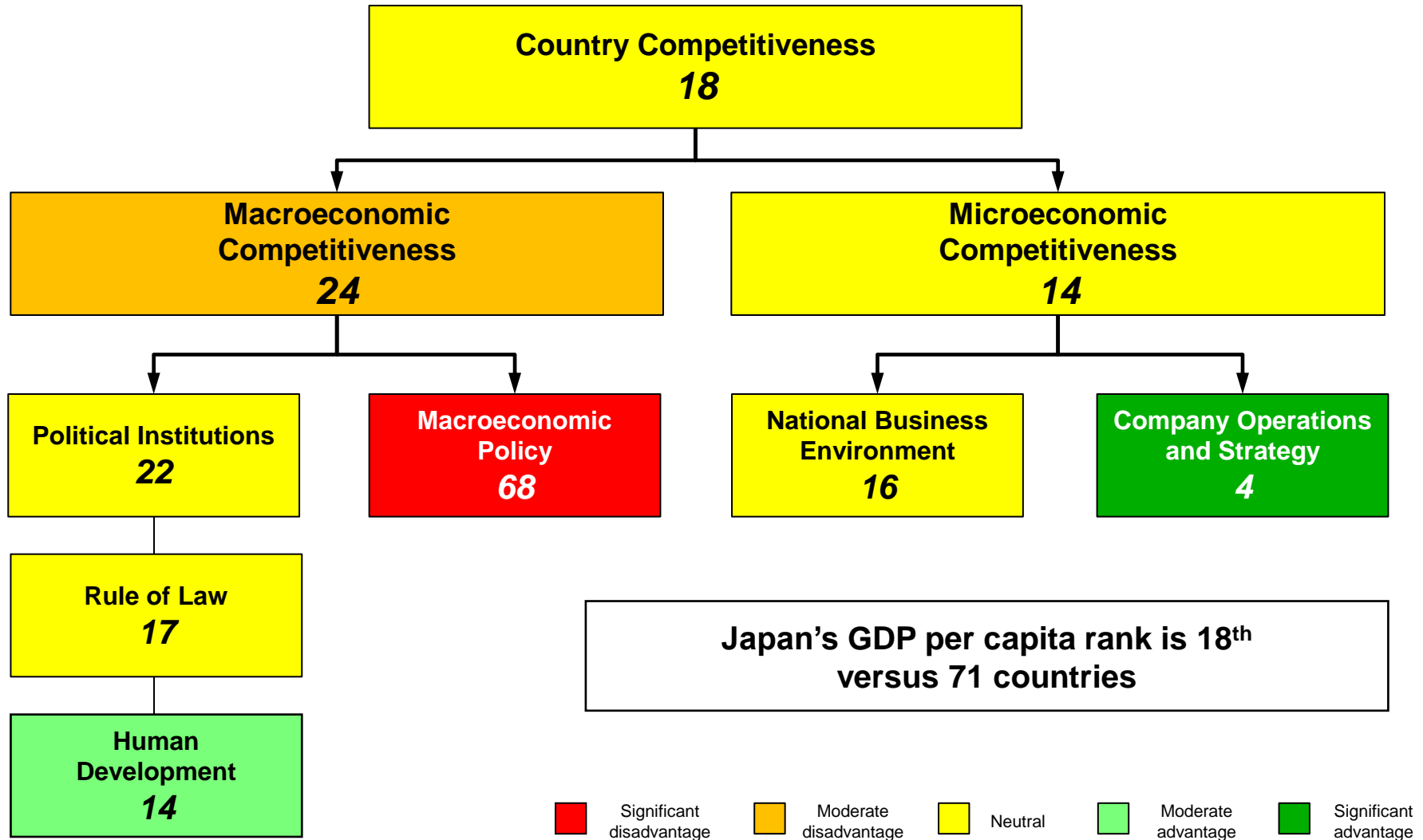
Can Japan Compete?

Government Agenda in 2001

1. Open up domestic competition and reduce government intervention
2. Open trade and foreign investment
3. Modernize archaic and inefficient domestic sectors
4. Build a world class university system
5. Create new models of innovation and entrepreneurship
6. Encourage decentralization, regional specialization, and cluster development
7. Create stronger corporate accountability

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Company Progress since 2001

1. Shift the goal from growth to profitability
 - More businesses are being divested due to inadequate profitability, but Japanese ROIC remains low
2. Create distinctive, long term strategies
 - The Porter Prize has recognized 41 companies with distinctive strategies since 2001
 - Many companies have become more focused
3. Expand the focus of operational effectiveness to IT
 - The utilization of IT has increased substantially, improving productivity
4. Understand the role of industry structure
 - Industry attractiveness has become a larger factor in corporate choices
5. Reduce unrelated diversification
 - Many corporate portfolios have been pruned
6. Update the Japanese organizational and governance model
 - The number of executive board members has been reduced
 - The number of companies with outside board members have substantially increased
 - Cross shareholding has fallen
7. Develop a stronger role for the private sector in economic development
 - Business leaders are becoming more involved in national and regional economic development
 - Shared value has become a major new thrust in Japanese corporations

Government Progress Since 2001

1. Open up domestic competition and reduce government intervention
 - Stricter anti-trust laws and enforcement has brought Japan closer to world standards
 - Government still prone to intervention and government solutions (e.g. electronics)
 - Targeting persists in “growth industries”
2. Open trade and foreign investment
 - FTAs signed with many nations, with the TPP being discussed
 - FDI restrictions have been partially reduced, but barriers remain
3. Modernize archaic and inefficient domestic sectors
 - Rules governing construction improved
 - Protection for small scale retailing reduced
 - Agriculture largely unchanged
4. Build a world class university system
 - Some steps have been taken to raise university standards and accountability
 - Archaic rules still disadvantage students studying outside Japan
5. Create new models of innovation and entrepreneurship
 - Rules for starting businesses have improved, though still not world class
 - IP protection strengthened
 - Access to public listing by newer companies has improved
6. Encourage decentralization, regional specialization, and cluster development
 - Cluster initiatives have proliferated, but progress remains uneven
 - Only modest delegation of central government powers has occurred
7. Create stronger corporate accountability
 - At least one independent board member is recommended for TSE-listed companies
 - Few companies still have effective corporate governance

Trajectory of the Japanese Business Environment

	Rank in 2012	Change in Rank
Overall Business Environment	16	+7
Supporting and Related Industries and Clusters	4	0
Logistical Infrastructure	12	-4
Demand Conditions	16	+3
Capital Market Infrastructure	20	+7
Communications Infrastructure	21	0
Factor Conditions	21	+1
Context for Strategy and Rivalry	22	+7
Innovation Infrastructure	23	-2
Regulatory Infrastructure	38	-2

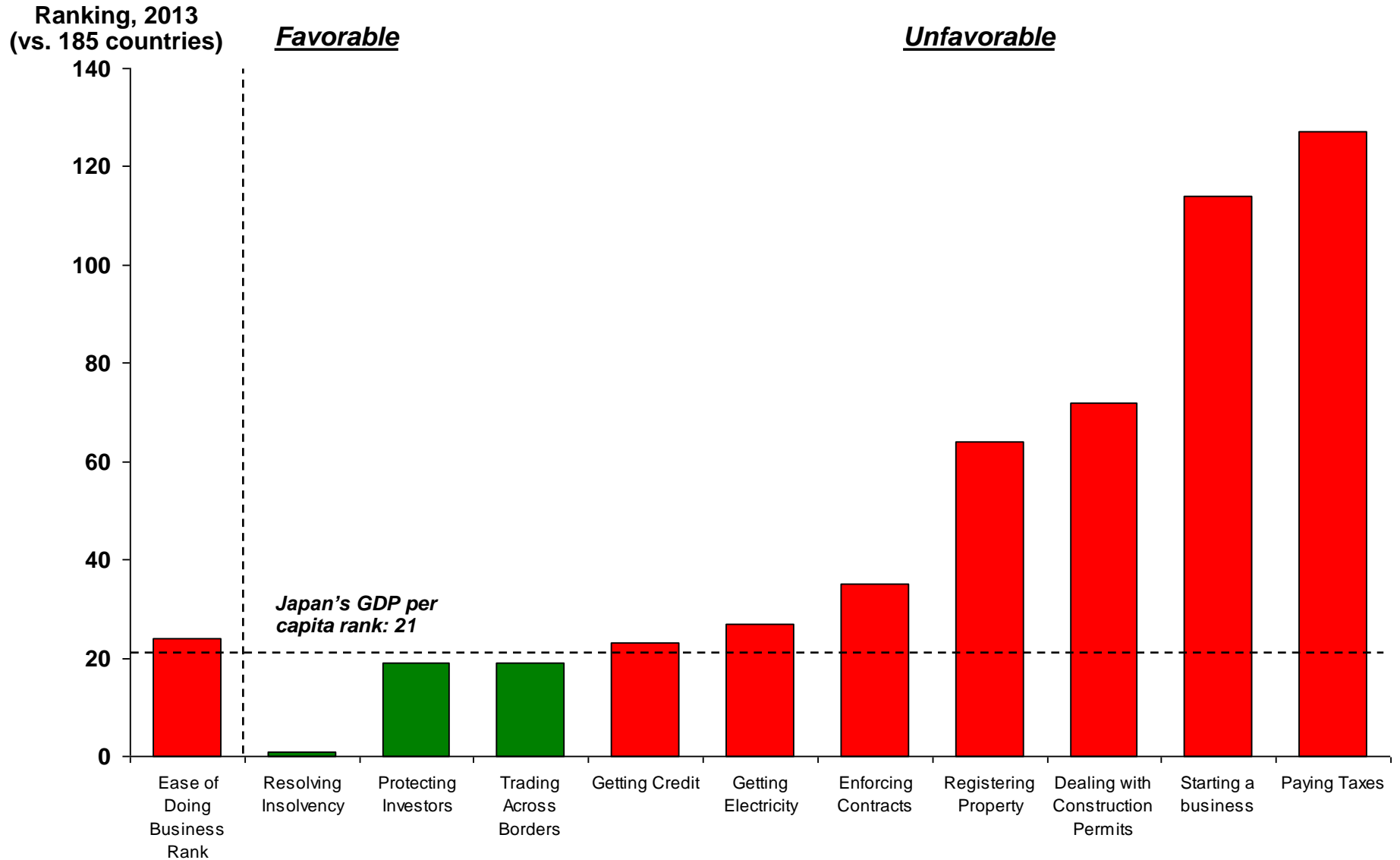
Rank versus a consistent sample of 71 countries

Note: Rank versus 71 countries

Source: Institute for Strategy and Competitiveness, Harvard University (2012), based in part on survey data from the World Economic Forum; analysis prepared based on research findings by Scott Stern, Mercedes Delgado, and Christian Ketels.

Microeconomic Competitiveness Indicators

Ease of Doing Business Rankings – Japan



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Japan's Strategy under Prime Minister Abe

The "Three Arrows" of Abenomics

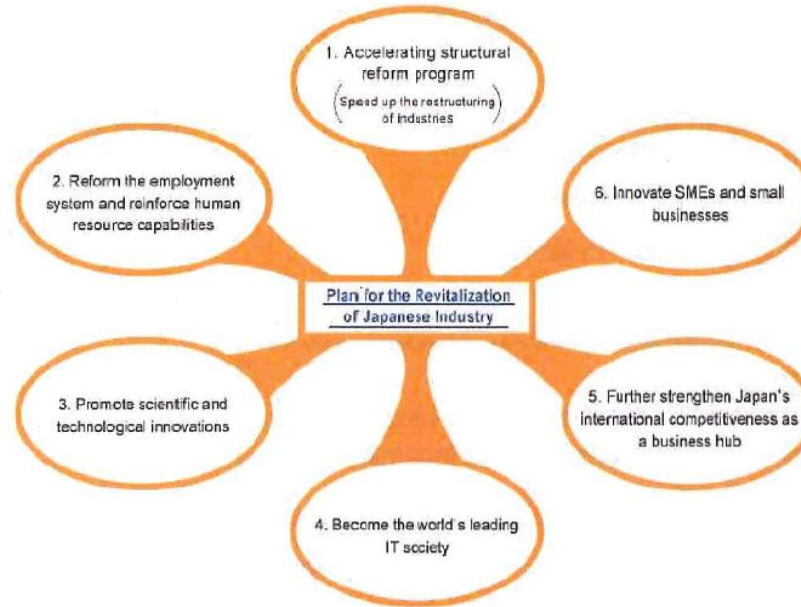
Monetary Expansion

**Temporary Fiscal
Expansion, then
Consolidation**

Structural Reforms

Japan's Strategy under Prime Minister Abe

The "Third Arrow": Structural Reforms



The “Three Arrows” of Abenomics: Progress to Date



Monetary Expansion

- Fully implemented
- Promising Results



Temporary Fiscal Expansion, then Consolidation

- Expansion implemented
- Consolidation beginning
- Success unclear



Structural Reforms

- An extensive list of suggested actions, few steps taken so far

The Japanese Corporate Agenda for 2014

1. Accelerate the shift to **strategic thinking**
2. Accelerate **globalization**, making greater use of M&A
3. Encourage fast track **leadership development** and **mid career recruiting** to complement internal promotion
 - **Mobility of talent** will dramatically improve Japanese company performance
4. Simplify and streamline **decision making** while continuing to improve accountability and governance
5. Evolve **executive compensation practices** to incentivize risk taking
6. **Embrace shared value** as the guiding principle for Japanese business

The National Agenda in 2014

1. **Continue opening** domestic and international competition
 - Eliminate remaining barriers to FDI and imports
 - Reduce government subsidies and intervention in companies
2. Lower the **unnecessary high costs of doing business** in Japan
 - Regulation and bureaucracy is Japan's greatest weakness
3. **Deregulate the key Japanese sectors** to unlock growth, productivity and innovation
 - Agriculture
 - Health Care
4. **Continue decentralizing resources and responsibility** to Japanese prefectures and metropolitan regions
 - Let regions compete to develop clusters, attract investment and upgrade their business environment
5. **Restructure** Japan's fiscal structure
 - Lower the corporate tax rate while eliminating tax breaks
 - Reduce capital gains taxation
 - Moderate taxes on earned income
 - Increase consumption based and non-renewable energy use taxes

The National Agenda in 2014

6. Set a pragmatic **long term energy strategy**
 - The cost of energy is a major competitiveness issue
 - Transitional solutions and carbon taxes will be needed to bridge the present and the future
 - Energy efficiency must become a national priority
7. **Connect Japan** to the rest of the world
 - Raise language skills
 - Support international education
 - Welcome skilled immigration
 - Embrace the internationalization of knowledge
 - Encourage deeper globalization by Japanese companies
 - Move from politics to building economic partnership with other Asian countries
8. **Tap the talent and potential** of Japanese citizens and **enrich the nation's human resources**
 - Embrace and enable womens' participation in the workforce
 - Open up labor mobility
 - Welcome skilled expatriates from abroad
 - Encourage and support Japanese students studying abroad
 - Raise the standards in Japanese universities and business schools
9. **Deepen economic integration** of Japan in the Asian region