



Japan ascending

Four steps to reignite growth and vitality in the Japanese economy

Executive Report

Strategy

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Reigniting Japan's economic engine

From a preeminent global powerhouse in the 1980s and early 90s, the Japanese economy has been characterized by stasis and periodic decline for the past two decades. Japanese business today struggles to capture the inspired creativity that characterizes its most successful global competitors. Facing organizational and cultural constraints, many Japanese executives are unsure how to exploit the technological and economic forces that are redefining business models worldwide. However, all is not lost. This report outlines key strategies to help Japanese organizations recapture past achievements and once again assume a leadership role in global business ecosystems.

Japan at the crossroads

From global leadership in the 1980s and early 90s, the Japanese economy has now experienced two decades of relative stagnation. Japan's share of global gross domestic product (GDP) has shrunk by half, from 9 percent in 1991 to 4.3 percent in 2015.¹ Japan's GDP is expected to grow more slowly over the next five years compared to other advanced economies such as the United States, the United Kingdom and Germany.² As a consequence, Japan's GDP per capita is expected to decline relative to other major economies.³

To better understand the implications of Japan's economic challenges and what can be done to redress them, the IBM Institute for Business Value in collaboration with Oxford Economics conducted a survey of 1,151 Japanese executives across 17 industries. Executives surveyed included Japanese business leaders, government officials and leaders of major academic institutions. The survey sought insight into Japan's current economic challenges, major roadblocks to growth and strategies to improve productivity.

Of the executives surveyed, 67 percent believe Japan is experiencing major economic stagnation. Specifically, 53 percent point to challenges created by a shrinking domestic market. Forty-nine percent indicate that the status of women in the workplace generates economic constraints, with 49 percent also highlighting challenges created by regional political and economic instability. Forty-eight express concerns about aging physical infrastructure, and 48 percent cite poor corporate governance.⁴



80 percent of Japanese executives say their organizations are actively pursuing disruptive innovation.

But...



Only 22 percent of Japanese executives indicate willingness to field new ideas from outside their own organizations.

And...



Only 39 percent of Japanese executives allow employees to collaborate with external partners.

Many Japanese corporations have struggled to remain competitive with leading global peers. As a consequence, the number of Global Fortune 500 businesses headquartered in Japan fell from 107 in 2000 to 54 in 2015, a decline of almost 50 percent.⁵

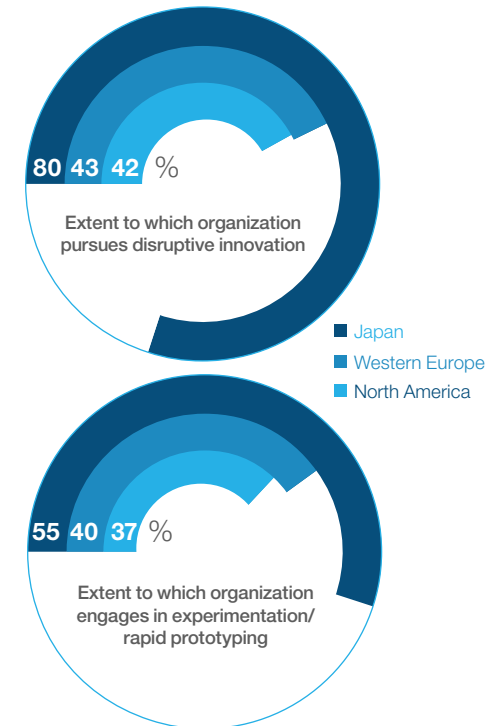
When citing challenges faced by their own organizations, Japanese executives highlight the challenging economic environment and shrinking markets, as well as three additional factors. Fifty-seven percent identify difficulties in obtaining the right talent. Fifty-six percent point to a rigid regulatory environment, while 40 percent of Japanese executives are concerned that disruption will increase due to innovative new competitors.⁶

Aware of what may become existential challenges, an overwhelming proportion of Japanese executives identify the need to become more innovative as essential to the future of their businesses. According to our 2016 Japan survey, 70 percent of Japanese executives place a high level of strategic focus on innovation.⁷ Similarly, the 2016 IBM C-suite Study revealed that as many as 80 percent of Japanese executives surveyed indicate their organizations are in active pursuit of disruptive innovation, including 55 percent whose organizations are aggressively pursuing rapid experimentation and prototyping. This commitment to innovation ranks dramatically higher in Japan than in North America or Europe (see Figure 1).⁸

Despite this focus on innovation among Japan's business elite, the Japanese economy as a whole continues to struggle. Japan's labor productivity relative to major trading partners such as the United States continues to decline.⁹ Japan's leading businesses struggle to keep up with game-changing innovations elsewhere in the world. Reflecting this, Japan's ranking in global innovation indices remains lackluster.¹⁰ All this begs the question why. Why, given a clear, almost uniform recognition of the innovation imperative, do Japanese businesses find it so difficult to reclaim the mantle of global innovation leaders?

Figure 1

Japanese executives place a premium on disruptive innovation

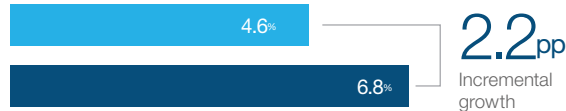


Source: IBM Institute for Business Value Global C-suite Survey, 2016.

Figure 2*Pessimism reigns supreme*

Growth estimates of organizations based on no transformation (as-is) and dramatic growth-boosting transformation

Average growth expectation based on as-is situation



Average growth expectation based on dramatic organizational transformation

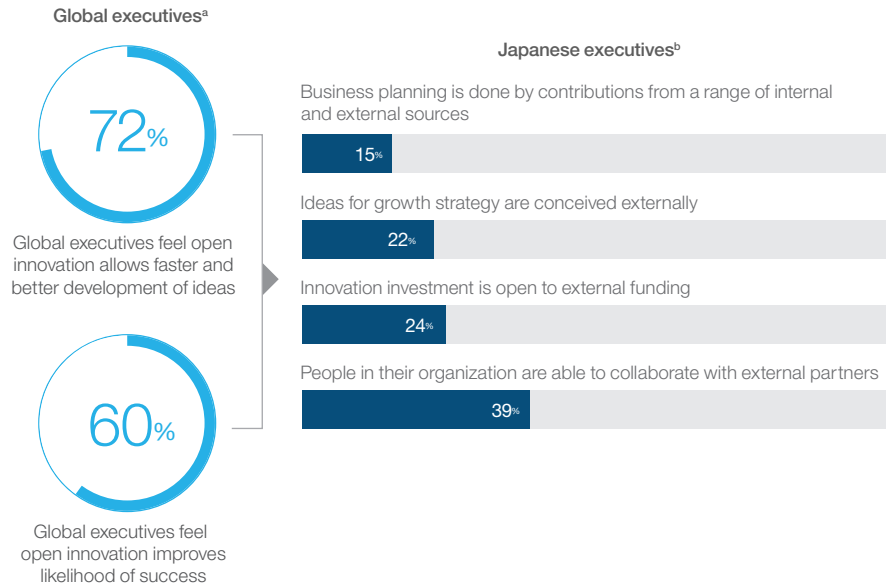
Source: IBM Institute for Business Value Future of Japan Survey, 2016.

Right idea, wrong direction

Sixty-two percent of Japanese executives we surveyed recognize the need to transform their business strategy to accelerate growth. But years of economic malaise seem to have removed much of Japan's ambitions. Even assuming dramatic organizational transformation, growth ambitions are mediocre (see Figure 2). Only one in seven Japanese executives believes annual growth of more than 5 percentage points over normal expectations is possible, even under the most optimistic business assumptions. Just over half believe the maximum possible growth would be less than 2 percentage points, and only one in twelve executives believes that business growth greater than 10 percentage points is possible.¹¹

While a significant majority of Japanese executives are committed to pursuing innovation, only 8 percent indicate that their organizations significantly outperform their peers in conducting innovation.¹² In addition, while many successful organizations worldwide have opened up innovation processes to customers, partners and other stakeholders, Japanese organizations appear stuck in insular, closed innovation paradigms.

According to a recent IBM Institute for Business Value global innovation survey, 72 percent of executives believe that open innovation allows faster and better development of ideas.¹³ In contrast, only 22 percent of the Japanese executives we surveyed are willing to field new ideas from outside their own organizations.¹⁴ Similarly, 60 percent of executives from the innovation survey report that open innovation improves the likelihood of innovation success, while only 39 percent of the Japanese executives we surveyed even allow employees to collaborate with external partners (see Figure 3).¹⁵

Figure 3*An innovation dichotomy*

Sources: a) IBM Institute for Business Value Innovation Survey, 2014. b) IBM Institute for Business Value Future of Japan Survey, 2016.

“To accelerate growth, strategic reorientation and organizational restructuring are essential.”

Chief Operating Officer

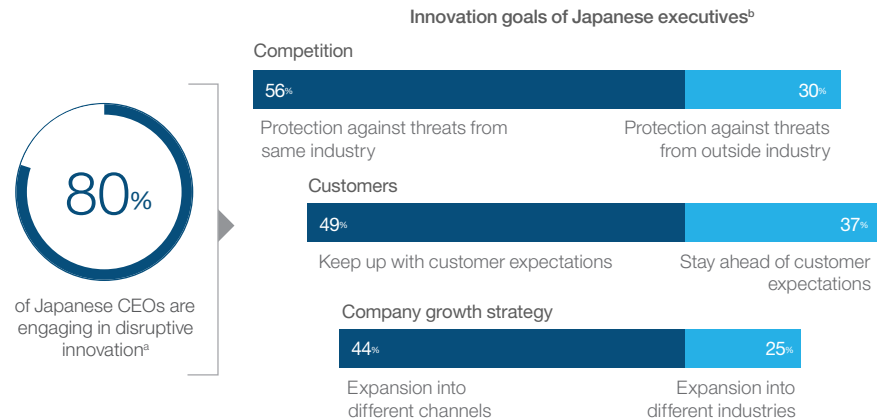
Major Japanese bank

And while an overwhelming majority of Japanese executives say their organizations pursue disruptive innovation, their actual innovation goals are much more reflective of business-as-usual incrementalism than fundamental business redefinition. Only 30 percent of Japanese executives believe they need to protect themselves from threats outside their industry. And only 25 percent are actively seeking to expand into different industries (see Figure 4).¹⁶

Similarly, Japanese executives underestimate the likely impact that new disruptive technologies will have on their industries and organizations. Seventy-eight percent of global CEOs rate technological factors as the single most important external force impacting their businesses, and 67 percent indicate that technological disruption is making them reassess strategic direction.¹⁷ Most Japanese executives, however, seem unconcerned about disruptive

Figure 4

Business as usual

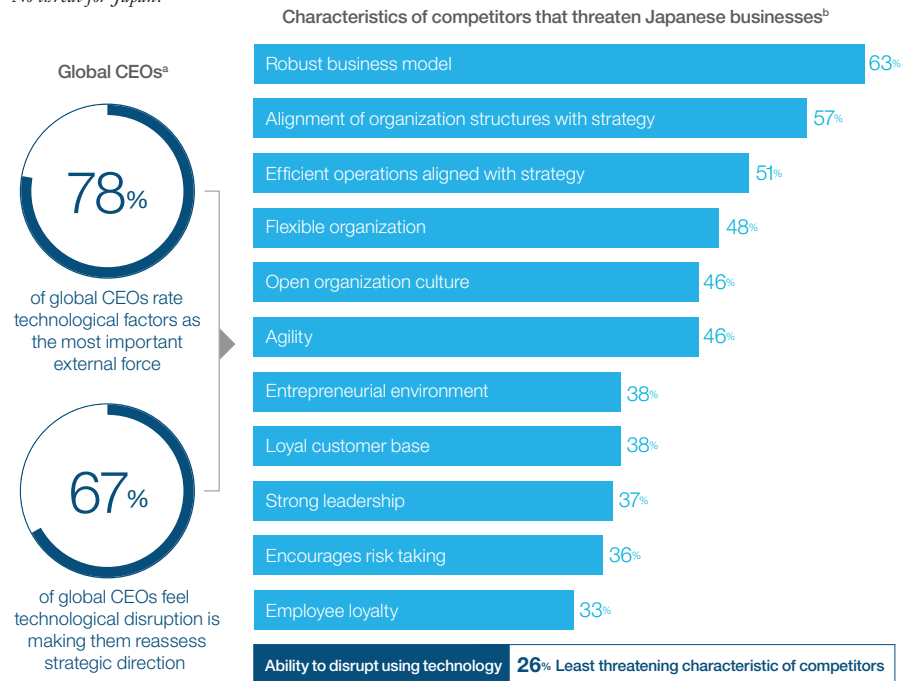


Sources: a) IBM Institute for Business Value Global C-suite Survey, 2016. b) IBM Institute for Business Value Future of Japan Survey, 2016.

technological waves. When asked to identify the characteristics of competitors threatening Japanese businesses, only 26 percent of Japanese executives identified the ability to disrupt using technology as a concern, ranking it lowest among 12 possible capabilities (see Figure 5).¹⁸

Figure 5

No threat for Japan?



Sources: a) IBM Institute for Business Value Global C-suite Survey, 2016. b) IBM Institute for Business Value Future of Japan Survey, 2016.

“I do not feel any such competition could be a threat to us.”

Senior Vice President

Major Japanese telecommunications business

While recognizing the importance of innovation, experimentation and disruption for the success of their organizations and the economy in general, many Japanese business leaders find themselves stuck in a present-day mindset. Organizational focus remains largely on traditional products or services that serve conventional customer segments, rather than on rapidly changing customer aspirations and the increasing importance of consumer experiences.

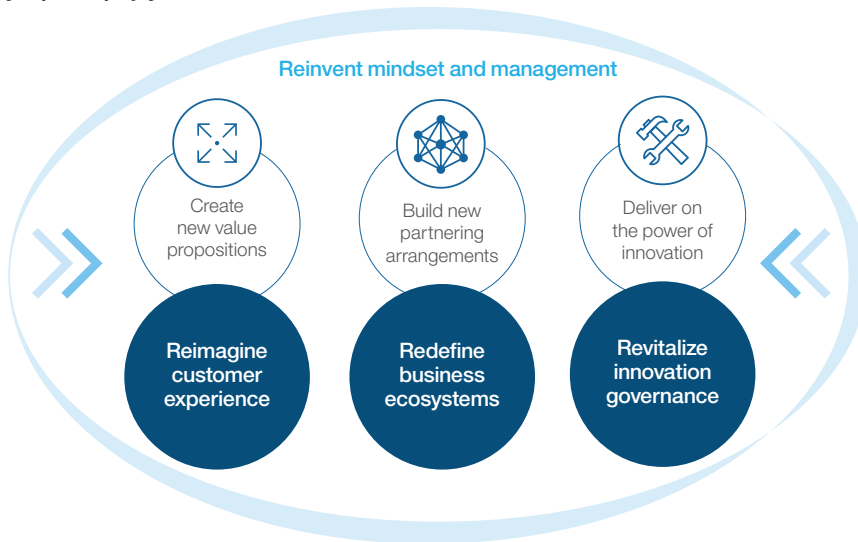
Japanese business leaders largely ignore new forms of competition emanating from startups or emergent cross-industry players, even as traditional industries such as banking experience the implications of massive technology-fueled disruptions. And Japanese businesses remain less focused on the need for speed as traditional development cycles unbundle across industries, with customers demanding continuous experimentation in which they themselves become central participants.

If not us, who? If not now, when?

Japanese organizations have an opportunity to regain global preeminence. But to do so, they need to untie themselves from historic and current practices. Specifically, Japanese businesses need to embrace entirely new customer value propositions, build new partnering arrangements and more effectively harness the power of innovation (see Figure 6).¹⁹

Figure 6

A path forward for Japan



Source: IBM Institute for Business Value.

Key actions to reimagine customer experience

Use envisioning techniques to produce definitive blueprints

Employ envisioning sessions such as design thinking to produce a definitive reinvention blueprint. Facilitate activities to more deeply understand customers, brainstorm new ideas, and visualize unique and unexpected scenarios.

Create pilots and build a foundation of capabilities

Use prototyping and agile development to rapidly create prototypes and test them with customers. Build a foundation of capabilities both internally and externally to quickly scale up successful innovations, or wind down unsuccessful ones.

Build a program of many innovations and launches

Adopt a continuous iterative strategy of building new or extending existing capabilities. Aggressively pursue experimentation, and recognize that being late to market is no longer a viable option. Launches need to be regular, and customers need to be engaged in defining and refining new products and services through time.



Reimagining customer experience

To create new compelling value propositions, Japanese executives should first find new ways to reimagine customer experience. Recent IBM Institute for Business Value research reveals that 54 percent of global executives believe that customers' buying behavior is becoming experience based, and 81 percent of global CEOs plan to use new technologies to build new and stronger customer relationships.²⁰ Reimagining customer experience by means of new focus, expertise and ways of working will help Japanese organizations rise to the vanguard of experience-oriented innovation.

Global leaders aim to be indispensable to customers by becoming central orchestrators and gatekeepers of carefully curated customer relationships, facilitating experiences across an ecosystem of products, services and engagement possibilities. Supported by a range of new and emergent technologies, leaders work to conceive new ways to deliver deeper, richer experiences. They continuously investigate new trends and possibilities, leveraging techniques such as design thinking to understand customers' deeper aspirations with a view on staying ahead of changing desires and expectations (see Figure 7).

Globally, companies across industries have embraced deep reimagining of customer experience to create something entirely new and compelling. For example, in eyewear, Warby Parker transformed the physical process of shopping for glasses into a highly engaging digital experience.²¹ And in the sports clothing and accessories space, Under Armour is broadening its business by extending the customer relationship (see sidebar: *Under Armour redefines its business and customer engagement models*).

Some Japanese businesses are also leading the way in reimagining customer experience. For example, Japan Post Service Company is reinventing its business, evolving from a traditional postal and financial services provider to become an integrated lifestyle support partner. Japan Post is employing a suite of digital technologies to deeply engage an elderly

customer base of more than 33 million people, which is expected to grow to 45 million by 2020. The company is partnering with global technology leaders to create sophisticated mobile and analytics capabilities to support provision of lifestyle solutions that address customer needs and aspirations. Extending its trusted brand and relationship, Japan Post is working to improve the health and wellness of seniors, supporting longer, healthier, more independent and higher-quality lives.²³

Figure 7

Experience-oriented innovation



Source: IBM Institute for Business Value.

Under Armour redefines its business and customer engagement models²²

Under Armour Inc. is reinventing its business, expanding from traditional sportswear manufacturing to digitally enabled fitness products and services. Under Armour is building new capabilities that support Connected Fitness, which helps customers track, analyze and share their fitness activities using connected devices and various apps. The company has plans to further expand its capabilities through a cognitive coaching system that could serve as an interactive personal consultant, trainer and coach, providing timely, evidence-based research and advice.

Key actions to redefine business ecosystems

Identify opportunities to collaborate and participate in ecosystems

Assess potential partnership opportunities that create higher mutual value, and recognize that new value may be attainable through both your organization's actions or by way of partner or shared activities through the ecosystem. Promote openness, transparency, agility and flexibility as central organizational principles or tenets.

Develop capabilities to create value from ecosystems

Don't assume your organization can and should do everything. Focus resources on specific areas of operational, organizational or strategic excellence, and seek partnerships with other complementary organizations that are similarly committed to exceptional performance. Form alliances and seek opportunities to create something entirely new within evolving ecosystem environments.

Build structures that promote ecosystem connectivity

Keep an eye on new and emerging technologies. Jointly identify opportunities for mutual gain with key partners, irrespective of whether those opportunities cut across regional, national or industry lines. And remain open to new ways of connecting and collaborating with new partners across the ecosystem.



Redefining business ecosystems

Japanese executives will be better equipped to build the right partnering arrangements by conceptualizing and defining business ecosystems. New ecosystems are emerging and, unlike traditional keiretsu arrangements, which rely on interwoven ownership, ecosystems are redefining traditional industries and business economics.

Sixty-nine percent of global CEOs rate ecosystems as the most important business trend impacting their business.²⁴ Fifty-three percent of global executives believe that boundaries between traditional industries are blurring, while 55 percent say that traditional value chains underpinning their businesses are being displaced.²⁵ Sixty-six percent of global executives believe that value creation within their industries will shift to ecosystems, while 80 percent believe that value allocation around economic activities will transition into ecosystem environments.²⁶

The most successful organizations understand the rapid fragmentation of traditional value chains. They also demonstrate willingness and commitment to participate in new or emergent ecosystems comprising multiple potential partners across industries. They pursue strategies aimed at increasing not only the individual success of their organizations, but the ecosystem as a whole. And they recognize that value creation no longer remains linear, but arises in new and different ways that would be near impossible if they were acting alone.

Some industries, such as healthcare and banking, have led the path toward realizing an ecosystem economy (see sidebar: *Barclays helps form a fintech-fueled ecosystem*). For example, Cleveland Clinic partnered with CVS, a drugstore chain, and American Wells, a technology company, to form a digital healthcare delivery ecosystem by using an innovative

mix of technology and healthcare assets. Depending on the severity of the condition of a customer visiting a CVS MinuteClinic, Cleveland Clinic is able to provide almost instant virtual access to one of its experts. This access is helping improve healthcare outcomes by increasing the probability of early diagnosis, as well as dramatically increasing efficiency by leveraging expert medical capabilities irrespective of distance and time.²⁷

In Japan, Takeda has been actively pursuing new global partnering and collaboration opportunities in the life sciences industry. Takeda, the largest pharmaceutical business in Japan and among the largest in the world, has been working to create a global ecosystem of external partners to enhance pharmaceutical research and accelerate time to market. As part of its ecosystem strategy, the company partnered with GE Healthcare to leverage imaging technology for liver disease research.²⁹ In addition, Takeda is creating a USD 10-million, five-year innovation alliance with the Sanford Consortium for Regenerative Medicine, a non profit organization comprising the University of California San Diego and four other institutes.³⁰

Barclays helps form a fintech-fueled ecosystem²⁸

In the banking industry, London-based Barclays has partnered with Techstars, a mentorship-driven startup accelerator, to launch a series of financial technology (fintech) accelerators across the globe. Through the accelerator program, Barclays has identified more than 30 startups with which to partner and collaborate. By partnering with startups, including Chainalysis for blockchain and Wave for peer-to-peer international trade finance, Barclays aims to mitigate rapidly accelerating challenges to traditional banking business models, and position itself as a central participant in a technology-fueled banking and financial ecosystem.

Key actions to revitalize innovation governance*Structure open forms of innovation to source new ideas*

Provide employees with the tools and physical/virtual environments they need to engage in open collaboration. Allow them to interact with a range of external parties, and establish clear governance to ensure regulatory compliance and protection of intellectual property.

Build dedicated teams and prioritize agility

Provide management and governance for the overall innovation program and actively encourage and support specific innovation activities. Provide skills needed to help everyone succeed in innovation, such as a dedicated team of innovation experts who can support teams, conduct ideation sessions, scope innovation projects or build business cases.

Secure stable innovation funding and quantitatively evaluate innovation initiatives

Create a formulaic self-sustaining funding source for innovation to protect it from the perils of quarterly budgeting decisions. At the same time, create clear financial and other metrics, such as market impact, that can be used to evaluate the impact and financial returns from innovation initiatives.



Revitalizing innovation governance

Japanese executives will be better able to deliver on the power of innovation if they embrace and revitalize innovation governance. The most successful organizations globally apply agile and open principles to their innovation (63 percent and 56 percent of the most successful global organizations respectively). They maintain separate budgets for innovation activities (42 percent of innovation leaders) and apply robust financial metrics to innovation outcomes (55 percent of innovation leaders).³¹

In so doing, the world's leading innovators are able to conduct innovation in a systematic, structured way (see sidebar: *Ford becomes a mobility services provider*). They explicitly balance their innovation portfolio across smaller, more immediate product and service innovations; deeper, more technical operational innovations; and potentially profound and disruptive business model innovations. Leading innovators place a premium on culture, creating an expectation that innovation will occur as part of employees' daily jobs, and provide the leadership needed to maintain innovation priorities despite day-to-day business pressures.

In Japan, Hitachi is promoting open innovation to solve complex business issues. A large Japanese multinational business, Hitachi recently established a dedicated facility for research and collaboration with partners in industry and academia.³³ The Global Center for Social Innovation North America is part of the company's continued commitment to its Social Innovation Business. This global initiative focuses on developing solutions to today's complex societal and business challenges by exploiting the company's diverse business platforms and broad range of partnerships.³⁴

Ford becomes a mobility services provider³²

Ford Motor Company is reinventing its business, evolving from a traditional automotive manufacturing company into a mobility services provider. Ford is building new expertise around vehicle connectivity, mobility, autonomous vehicles and big data. The company has formed a global ecosystem of startups and developers by inviting them to build innovative solutions as part of its Innovate Mobility Challenge Program.

Ford is reimagining the customer experience through new products such as FordPass, an app-based platform that lets users pay for parking, share vehicles and obtain virtual personal travel assistance.

Key actions to reinvent mindset and management*Break down cultural barriers*

Rethink how your organization and people engage with consumers and markets. Do not allow traditional views of what is possible today limit new initiatives for tomorrow.

Define provocative new business models, identify technical/organizational requirements, and develop the business case needed to realize new initiatives.

Accelerate new opportunities

Develop proficiency and understanding of new ecosystems as they emerge. Conceptualize and assess new sources of joint value that might not be pursuable operating alone. In addition, define where your organization might sit in relation to new partners, including what role it might play. Educate employees about strategies to anticipate new possibilities and potential threats.

Embrace new behaviors

Make innovation an integral part of everyone's job description. Ideas should be captured, evaluated and pursued if they prove useful, no matter the source. Reward value-generating behaviors such as collaboration, and support the emergence of a self-sustaining culture of innovation. Actively demonstrate that calculated risk taking is not only tolerated, but celebrated.

Reinventing mindset and management

To successfully advance new strategies around customers, ecosystems and innovation, Japanese organizations also need to fundamentally rethink their organizational culture and structure. Reinventing mindset and management is essential for Japanese organizations wishing to transform.

The most successful global organizations support creation of an open and entrepreneurial business environment, encouraging disruptive thinking and agile strategies in pursuit of new opportunities to drive growth. They democratize decision making and empower employees to contribute fully in generating new value and eliminating impediments. And they encourage behaviors and expectations that promote communication and collaboration across and beyond the enterprise.

Days of future past

Japan has now experienced economic doldrums for more than two decades. However, decline need not be permanent. Japanese businesses can be among the most innovative in the world. By opening up organizational innovation, culture and engagement, Japan's businesses can become central protagonists in new global business ecosystems. Those that can adjust and transform will find themselves not only playing a part in the new ecosystem economy, but serving as leaders.

Key questions to consider

- How is your organization building a culture of openness and agility to create more value?
- How is your organization exploiting new and emerging technologies to build deeper, richer and more engaging customer experiences?
- How do you plan to connect with ecosystem partners to explore new markets, delivery channels and other opportunities?
- In what ways does your organization promote innovation as a core business activity and sustain innovation momentum?

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