BIG IN JAPAN

Under Abenomics, the country is ready to welcome foreign firms, but would-be shoguns should watch out for certain obstacles

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BY | GEOFF BOTTING

On the face of it, Japan is one the safest, most stable and most predictable societies on Earth. First-time visitors to Tokyo are awestruck by how such a sprawl of city (with a metro population roughly equal to all of Canada's) operates with the precision of a German rail schedule.

Japan's hard-working citizens are law-abiding and the vast majority consider themselves middle class. It's a nation that arguably cherishes control, discipline and predictability.

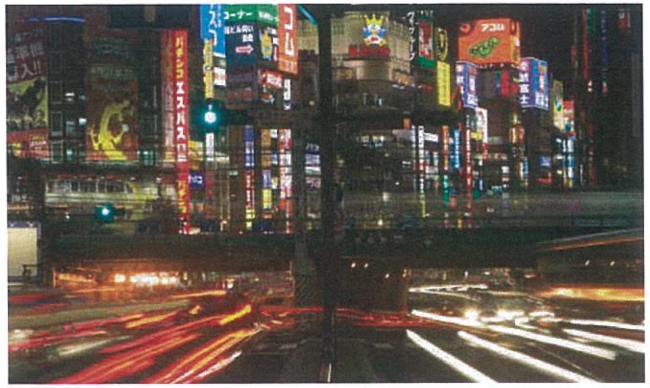
Yet, at the same time, investors and foreign businesses can face a number of challenges.

"For a developed country, there is a risk from lack of transparency, in terms of a lack of information on companies and individuals," says Stuart Witchell, senior managing director at FTI Consulting.

But the most serious and immediate risks by far come from Nature. After all, the Japanese archipelago sits in one of the most seismically active zones on the planet. The Earth gave it a humbling, violent reminder with the magnitude 9.0 earthquake on March 11, 2011 that killed close to 16,000 people and caused more than127,000 buildings to collapse.

The economy also took a big hit. The northeastern region is home to factories that make auto parts and electronic components that supply two of Japan's most important export industries. The quake and tsunami severed supply chains—revealing their weakest links—which meant costly suspensions in production for Toyota and some of Japan's other major manufacturers.

Yet three years later, the authorities and businesses have managed to take away valuable lessons. Toyota and others have not only mended the broken supply chains but reinforced the networks overall.



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There was relief, of course, that the quake didn't cause even more death and destruction. In densely packed Tokyo, where buildings were shaken for more than three minutes, literally knocking people off their feet, the damage was negligible.

"I think there were some surprises with what really happened, compared to what had been predicted," says Gordon Hatton, co-chair of the Architecture, Construction and Real Estate Committee of the American Chamber of Commerce in Japan. Hatton suggests risk managers should focus more on the damage a disaster could inflict on Japan's property market and economy overall.

"If there was a major earthquake in Tokyo, would that mean that a lot of the older buildings would be unusable, and therefore the rent on the good buildings would go up due to shortages and to demand? Or would that mean that a lot of companies would move away, and there would be no potential tenants?"

Hatton, a long-term Tokyo resident who hails from Regina, cites the example of the exodus of foreign businesses and people in the weeks after the 2011 disaster. A considerable number never returned.

At any rate, modern Japanese commercial buildings are generally robust, thanks to strict building codes first introduced in 1981. "Basically, no foreign firms would buy any buildings older than that," says Hatton, who as a licensed architect in both Japan and Canada also serves as vice president of a foreign real-estate investment office. He adds that the downtown cores of Japan's major cities are heavily concreted, reducing the risk of fire.

"Anti-Social Forces"

So with the building underpinnings in Tokyo's Shibuya neighborhood about as solid as they can be, that leaves concern over changing financial landscapes. Some experts point with alarm to Japan's perceived sovereign risk; Japan is the industrialized world's most heavily indebted country, fiscally speaking, with a debt-to-GDP ratio of a whopping 230 percent.

Remember that Greece and other countries have hit the wall at ratios much lower. Even so, Japan has some circumstances in its favor. Its debt is nearly all held internally, and it issues its own fiat currency (unlike Greece). That may, however, be only small comfort to economists, politicians and policymakers.

"There's something fundamentally wrong when the debt doubles in the fairly short period of time since I've been here," says William H. Saito, a Special Advisor to the Cabinet Office. Saito is a Japanese-American who moved here in 2005. He says senior officials in the Ministry of Finance and elsewhere worry the Bank of Japan's asset-buying program can't continue

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forever. Japan was the first country to practice quantitative easing in 2001.

The country's demographics are a big part of the problem: a quarter of all Japanese are aged 65 and older. As the number of working-age people declines, the tax base shrinks.

"This isn't something that would necessarily happen tomorrow, if it happens at all," says Nicholas Benes, representative director of the Board Director Training Institute of Japan and chair of the Growth Strategy Task Force of the American Chamber of Commerce in Japan. But he notes that Japan is facing "a headwind," made up in part by the demographics squeeze, in trying to pay down its massive debt. "We're going to get a lot closer to the cliff than we like, even if we don't go over it. The sense of urgency is still not high enough."

If sovereign debt is something for the back of the mind, there's another issue that can get squarely in your face. It's big and grim, and it can come with tattoos. In fact, the title of a recent speaking event held at the American Chamber of Commerce in Japan was "Yakuza and Anti-Social Forces: Any Involvement in Your Business?"

Stuart Witchell, who spoke at the event in May, says Japan's organized criminals can pose a threat to foreign investors, and the situation is possibly worse now than in recent years. "Police regulations have strengthened, and this is causing the organized crime groups to go farther underground...making them more opaque in terms of their visibility. Japanese and foreign companies are always encountering issues with organized crime." Witchell, now based in Hong Kong, was an original member of FTI Consulting's Tokyo office when it was founded, 14 years ago.

A fairly common scenario is a foreign investment bank buying properties in Japan. "The (crime) groups will appear, making it more problematic for those investments to continue at the pace they were intended to," he says. "The groups may install phony tenants, who may have forged leases, so it looks like they are officially allowed to stay there." Or the mob may sell units in buildings they don't own. "There are cases where forged documentation related to ownership is used. The reputational damage (for investors) of getting mixed up in something like this can be quite significant."

And you could get mixed up with local partners who have shady backgrounds.

That's where companies like Witchell's step in, to provide "investigative due diligence," digging into locals' backgrounds and whether they're involved in any corruption or bribery-related activities. "Companies like ours will use not only our analyst skill sets but also the networks we have externally."

Much of his office's efforts focus on corruption. About 50 to 60 percent of his clients are in financial services, either directly or through their clients.

Aside from the old-fashioned forms of corruption that crop up, there's also data corruption. Japan has a well-deserved reputation as a global leader in technology, yet many new arrivals are shocked by the widespread complacency toward data management.

Codes for Keyboards, Codes of Conduct

"The awareness over... cyber security is a lot lower in Japan than in other OECD countries, and the amount of importance the Japanese place on that data is of definite concern," says William H. Saito. He suggests that it has to compete with a host of other worries, from debt to rattling rooftops. "Cyber is near the bottom of the list."

IT governance simply hasn't made the kind of inroads it has in other Western countries. "If you take CIOs or CSOs, they are definitely lower in number compared to similar industrialized countries," says Saito. "But even if you do have them, the amount of powers given to them—budgets, resources—is infinitesimally small compared to their U.S. counterparts."

Little surprise then that IT executives are rarely given board seats. If a cyber-related problem does erupt, "it has to go through the COO or some filter, and by that time it's diluted and becomes a smaller issue," says Saito. He would know. He founded In Tecur, a Tokyo-based consultancy that covers innovative technologies and promotes entrepreneurship.

Culture may be the culprit here. Japanese companies value seniority over performance when it comes to promotions. Senior management is "senior" in the true sense of the word: a generation that often doesn't fully appreciate IT's impact on a company's operations.

That leads us back to our point at the beginning: control, discipline, predictability... Yet one objective of "Abenomics" —the economic policies spearheaded by Japanese Prime Minister Shinzo Abe—is more foreign investment. Add more foreigners, you'll

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Fukushima Daiichi Nuclear Power Plant's Unit 4, damaged by an explosion after the 2011 earthquake and tsunami.

DHL'S GRACE UNDER PRESSURE

In the days that followed Japan's triple disaster of an earthquake, tsunami and nuclear meltdown on March 11, 2011, many foreign companies famously pulled their people out of Japan and re-located them overseas to be a safe distance from the danger of the crippled Fukushima nuclear power plant.

Mark Slade, president of DHL Global Forwarding Japan, also jumped on a plane—and headed in the opposite direction.

Slade was in Europe on the day of the quake. He managed to get back three days later to his Tokyo office, which had been violently shaken by the jolt. He and his employees threw themselves into business-continuity mode.

"We had quite a challenge to deal with," recalls the Toronto native.

The Tokyo office set up a crisis management team comprising senior management. "We'd meet every morning for an hour," Slade says. Out came the satellite phones (which the office had stocked) and back-up power generators (which weren't needed, for the most part).

Their most challenging task was handling a sudden barrage of questions from stakeholders located throughout the world, many of whom seemed to be in panic mode despite being a safe distance away.

"They would ask us things like, 'What if we get contaminated!?' So we would say: 'What about us?'" Slade laughs.

It was clear that accurate and regular updates of the unfolding situation were needed. The CMT set up its own information-gathering and distribution service, which issued one report each day sent throughout the world.

"What we tried to do was provide as much transparent and objective information as possible. We issued daily reports. We produced a map that showed where we could and couldn't deliver. We had radiation monitoring (using government data) in the different prefectures, and we had our own monitors in our offices.

"We told people about road closures, where we could pick up or deliver, the backlogs, the airlines that were accepting freight. We tried to keep it very much focused on our business.

"This was a structured way for (our stakeholders) to deal with us," he says.

Slade, who has worked in Japan for the last seven years, says he came away from the experience with two main observations. First: "The farther someone is away from the actual problem, like overseas, the more they worry about it because they don't know the details," he says. "The closer you got to the action, the more composed people were. And that's a good thing."

His second observation was that mass media played up the "extreme outcomes" of the disaster. "I guess because those outcomes were the most compelling or interesting," Slade says. "We could see that there was a range of outcomes, from most likely to least likely."

The disaster also forced an inversion of the normal management dynamic. "Leadership and management today are very bottom-up and it's enabling and empowering people. But in this crisis situation, it's not. It's top-down. You have to be the classic, traditional leader. People turn to you and say, 'What do we do now?'"

"We never stopped operating (throughout the crisis)," the Canadian expat says. "I think that's been a real advantage for us."

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get a less predictable outcome. Still, the government wants to double inbound FDI by 2020, and it's working on a corporate governance code, expected to be unveiled next year. Among the proposals is a requirement for boards of listed companies to have independent outside directors.

Nicholas Benes says foreign investors probably won't be impressed if the future code requires only one outside director, not several, even though Japan's ruling party, the Liberal Democratic Party, proposed "mandatory adoption of multiple independent directors" when it campaigned in 2012. Several drafts have suggested a minimum number of at least one such director.

"The reason you need more than one is so you can form committees with these people to handle issues where you have to get the self-interested, inherently conflicted parties out of the room," explains Benes. "You're talking about the president's salary, or who should be nominated to the board, or you're deciding MBO (management buyout) pricing.

"How do you form committees if you have only one person to sit on them? If only one person made such decisions, would society trust them as much as decisions made by a group of persons? No developed nation has thought so."

And while we're on the issue of trust, Japan has that awkward problem of when (and how) to let go. "Firing people (in Japan) can be difficult if you don't know how to do it," says Tom Nevins, founder of TMT, a labor and personnel consultancy in Tokyo.

Throughout Japan's postwar era, lifetime employment was common. With recession, competition and globalization all taking their toll, some workers still steeped in the lifetime employment mindset refuse to budge when given notice. If cases go to court, they often get bogged down.

Nevins says many judges fail to take clear positions in favor of defendants. "They often tell the employer that if the employer doesn't agree to pay, say, a very large amount of the money the person is demanding, then (the judges) won't grant the termination."

He has his own quick but highly effective strategy to reach a settlement. First, he skirts around the lawyers, whom he says have a financial interest in dragging things out. Then: "I always come in (proposing) a modest severance package combined with the ability (for the employee) to stay on at a reduced salary level… and it works like a charm."

Japan's labor disputes might look daunting to foreign companies, but as Nevin points out, "in China, for example, you have people taking over factories, holding managers hostage. Over there, you need to look at physical violence, factories being torched and so on." Thailand remains under military rule, while Vietnam saw violent demonstrations this year targeting the offices of Chinese companies in reaction to an ongoing territorial dispute.

"Japan is still a good place," says Nevin. "These other countries have these big problems. So, still, I think it's not such a bad idea to work with Japanese people." R