Transformation of Strategy and Structure of Japanese companies in the 1990s: theoretical analysis and a case study about Sony's structural change.

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This study examines how Japanese companies changed their strategies, structures, and management systems in 1990s, using some statistical data and a case focusing on Sony's structural change.

Japanese companies in the 1990s are characterized by an expansion in scale through active diversification of operations, as well as a contraction of scale due to restructuring of large-scale enterprises. Looking at the timing of these changes reveals delays in strategy transitions and a herd mentality. The principles of organizational behavior, i.e. changing strategy and behavior as needed to adapt to changes in the organizational environment, do not necessarily apply. Mismatches among strategy, organization, and environment that many Japanese companies faced in the 1990s were not caused simply because they could not read how their organizational environments were changing. They were too sensitive to change, and thus they over-adapted or maladapted to their environment as well as ignoring their organizational problems.

Based on these points mentioned above, I will first observe an outline of the sequence of events, from diversification to restructuring. Then, introducing Sony's challenge of organizational change, I will discuss the difficulty and problems which are caused when companies adapt to their environment. Finally, I will make some comments about future trends of organization of Japanese companies and their management.

1 From Diversification to Integration

(1) Overview

Based on research on the trends of diversification of leading companies (Itami, 2001; Yoshiwara et al., 1981), the methods of business development of Japanese companies changed as follows after the bubble economy.

The percentage of "specialized" un-diversified enterprises that concentrate operations on a single area, and the percentage of "vertically integrated" diversified enterprises that are closely connected to all production processes from raw materials to completed products, even when there are many products, accounted for about 30% of all companies prior to the start of the bubble in 1986~87. This has dropped to around 17% since 1993. In comparison, the percentage of "unrelated" diversification through operations with little relevance to each other was around 5% before the bubble, and 17% after the bubble in 1993, growing to 20% in 1998. Combining this with the "related but distributed" type of diversification, where there is little sharing of operating resources among operations that are strongly connected, the percentage grew from about 31% in 1983 to nearly half of the total in 1998 at 46%.

The active diversification of business was implemented because it was considered to be extremely important for strategic reasons. A survey of major manufacturing companies in the USA and Japan conducted in 1989 by the (then) Ministry of International Trade and Industry[1] revealed that was a gradual shift in corporate objectives,

[1] Ministry of International Trade and Industry Industrial Policy Office report "Comparison of Japanese and American Company

from maximization of sales and increased market share to maximization of profit. Specific measures to achieve this included enhancement of technology development capability, a switch to high added-value, internationalization of the business, and diversification. The answers also indicated that there was active investment in new products and advancement of operations, as well as involvement in products and operations that were related to future or current business, even if they were not expected to be profitable at the time. The advancement of projects that were not expected to be profitable within 3 years and the investment in new products that were not expected to have high returns is contrasted to the passive American companies. In addition to the priority placed on diversification as an important strategy, the active involvement in new operations is also considered to have pushed the expansion of operations from diversification.

The transition to an expansion path and the restructuring of operations by companies began in earnest after 1998. A distinctive characteristic of the business restructuring that occurred at that turning point was that most companies started reorganization at nearly the same time. The reorganization was at the overall company level, including the groups of subsidiary companies, and there began to be consolidation that went beyond the organizational framework. Since 2000 the efforts on reformation between groups has been striking.[2].

Looking at the overall trends in business restructuring in recent years, there has been a declining trend since 1999 for market withdrawals, sales and mergers, and since 2000 for alliances; while there has been an increasing trend in buying and capital participation (Itami, 2002). In the midst of this there has been active restructuring of operations with consideration given to the strategic necessity, such as reduction of operations with poor future prospects, unprofitable operations, and operations that have no direct relationship to the core business. In addition, it has not been uncommon for there to be consolidations of operations or management among business peers seeking relief from worsening business situations, such as for trading companies and construction. With regard to internal group structure, although the integration of subsidiaries and affiliates, mergers (ex: Asahi Beer), and de-listings (ex: Matsushita Electric Industrial Co.) due to a complete break up into subsidiary companies have been conspicuous, there are also cases of operations restructuring in cooperation with rival companies from the perspective of competition with foreign enterprises (ex: establishment of Elpida Memory by Hitachi and NEC).

(2) Strategy transition delays

Looking at the above changes in organization and strategy of Japanese business, it is clear that for at least 5 ~ 6 years after the collapse of the bubble Japanese companies continued to pursue an unrelated diversification strategy that was the same as during the bubble period, and did not begin practical revisions until 1998. Considering the speed of the changes in the business environment in the 90s, it can only be concluded that the response was far too slow.

In order for an organization to change their current behavior and strategy it is first and foremost necessary for the organization to recognize the need for change. If the environment changes slowly and there are only small effects from the environmental changes, it is possible that it will not be possible to recognize. In the case of

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Activities" 1989. This questionnaire survey was conducted at Japanese companies in the top 300 in sales in 1987 and having capitalization of at least 100 million yen (202 valid responses) and at American companies listed in the 1986 Forbes ranking of the top 500 mining and engineering companies and the top 300 in sales in the manufacturing industry (56 valid responses).

[2] For items related to the trends in business restructuring chapter 3 of Itami (2002) was used as a reference. With regard to specific examples, the Nihon Keizai Shimbun (2000 ~ 2003 article index) and the web sites of the various companies were used as references.

Japanese business, in the same way, as a reason for the delay in the strategy transitions perhaps one can argue that the impact from the bubble collapse was actually minimal, so there was no sense of a need to change the existing strategy. However, looking only at the changes in corporate earning negates such a possibility.

Figure 1 shows the trends in sales and ordinary profit. This reveals that sales and profits at many Japanese companies were both affected by the bubble collapse. Ordinary profits peaked in the middle of the bubble in 1989, and then began to fall. Immediately after the bubble collapse in 1992, in comparison to the previous year there was an overall drop of nearly 40%. Subsequently, there have been ups and downs in response to changes in external factors, such as the consumption tax increase to 5% in 1997, and the financial crisis in 1998 in which large banks faced bankruptcy. In 1991 ~ 92 after the bubble collapse, sales decreased somewhat, but there was no particularly large drop, and sales were relatively firm in 1996 ~ 97. However, since that time overall there has been stagnation or a slight downward trend, and it is still difficult to expect growth in the near future.

A crisis in the form of declining profits has been manifest since 1989, and signs of the crisis have been apparent since before the bubble. Looking at the total asset turnover, indicating the investment efficiency of the company, it is clear that in 1980, before the bubble, there was already the start of a decline for all industries, and that this decline continues even today (Figure 2). For manufacturing companies with funding of at least 100 million yen the total asset turnover rate reached a peak of 1.29 in 1981, decreasing to 0.85 by 2002. Currently for 2003 this has recovered to 0.96. Among non-manufacturing companies with funding of at least 100 million yen the peak was 1.74, after which there have been continuing small fluctuations down and up, with an overall decline to around 1 in 2003.

The sluggish performance of Japanese business actually had already begun before the bubble. Since about 1990 this has been apparent in the form of declining profits. If a company is sensitive to change, it seems there should be an awareness of the signs of their own declining performance, and implementation of some kind of countermeasures. However, in fact, many companies not only were not aware until the problems were obvious, but put off taking any action to resolve the problems once they became apparent. As a second possibility, there may have been a recognition that changes were necessary, but could not be implemented for some reason.

According to the population ecology model (Hannan & Freeman, 1977; 1984) which proposes that there is an evolutionary relationship for organization and the environment, there is structural inertia acting on organizations, making it difficult for an organization to independently change behavior, structure, rules, procedures, values, etc., even when subjected to changes in the external environment. The factors that give rise to the inertia are both internal and external to the organization. Internal factors include sunk costs that arise when past investment is uncollected, restrictions on usable information, political elements within the organization, tradition, and culture. External factors include the height of the barriers to market entry and withdrawal, and the demands for fairness from the external environment[3] (Kuwata・Tao, 1998). These become factors that hinder any change.

Elimination and consolidation of businesses is organizational redesign, and means a sweeping revision of all the organizational formations for implementing the strategies and tactics that have been used by the company up

[3] This means the demands to fulfill certain duties and obligations as a member acting in the social environment, for example, continuing to always provide consistent quality products to consumers and continuing to pay the wages to employees. In order to ensure fairness from the outside it is necessary to stabilize the relationship with the stakeholders over the long term, and maintain consistent behavior. This contributes to the inertia for the organization.

until that time. Japanese companies during the bubble focused more on future prospects and connections to existing operations rather than on profitability when entering a market. Instead of asking whether it was necessary for the company, the concern was on the power hierarchy between business units and the tendencies of rival companies, leading to support of easy expansion routes. The expanded operations included those that were unprofitable or lost money. In many cases, these became a source of pressure on corporate profits after the collapse of the bubble. In this way, it is likely that there were a variety of factors causing organizational inertia in Japanese companies after the bubble collapse, including sunk costs, information limitations, and organizational politics. For many companies the reason that the losses from the bubble period caused irrecoverably-large amounts of damage is that the changes in the external environment were so severe that they could not be handled. In addition, the limitations created by the organizations themselves became a strong force of resistance to change.

(3) Pressure on operation integration

The strategy shift from diversification to integration that occurred nearly in unison in 1998 was primarily influenced by large changes in the external environment. One of these changes was the financial crisis both inside and outside Japan that occurred from ’97 to ’98, including the Asian currency crisis and the failures of major banks. The series of financial crises caused many companies to increase their awareness of the risks of international business development, and to change the relationship with the financial agencies that were the destination for funding procurement. Previously, for a large Japanese company operations were stabilized by building a close relationship, both financially and personally, with a principle trading partner bank. However, after the bubble collapse, there was a weakening of the relationships with the trading partner banks. In particular, this tendency accelerated after the financial crisis, and there was a rapid drop in the stable holding rates and crossholdings rates of financial institutions and corporations (NLI RESEARCH Report, 2003). The amount of capital held by companies steadily decreased due to worsening profits after the bubble collapse, falling below the pre-bubble levels in 1998 (Itami, 2002). As a result of changes in the environment for obtaining funds many companies became unable to continue an active diversification strategy that placed a priority on future promise rather than profits. More effective, results-oriented organizational management became the goal, and there began to be drastic eliminations and consolidations of operations.

The second factor motivating strategy transitions by the organizations was changes in the legal and regulatory environment for business. Specifically, this includes accounting system changes to focus on consolidated accounts, increases in the scope of consolidation of subsidiaries, and the introduction of current valuation of pension benefit accounts, financial products and owned stock[4]. The successive implementation of these from 2000 through 2003 was announced by the (then) Ministry of Finance in 1997. The purpose was to clarify the profits and losses included in the stock and operating situation of the subsidiaries that were essentially supporting the corporation, and to appropriately make the financial information of the corporation more transparent. A series of regulatory changes eliminated the effects of subterfuges like intentionally cutting the connection with subsidiaries established to hide losses and absorb excess personnel, or selling off assets with unrealized capital gains, adding it to profits and calling it a restructuring expense. In 1998 many Japanese companies became

[4] Reference to Shukan Toyo Keizai, 1999.Jan .9; Nikkei Sangyo Shimbun, 1999.March.16; Mainichi Economist, 2000.March.28

unable to deal with the bad debt and unprofitable operations that they had brought on themselves through the diversification during the bubble period. After the regulatory changes the operating situation of each entire corporate group became clear, including the existence of these problems. This makes it more difficult to obtain operating resources, such as capital and raw materials, and in the worst cases, creates a danger of bankruptcy. This feeling of crisis motivated many companies to withdraw from unprofitable operations and dealing with the subsidiary companies, and became the reason for taking the plunge into large-scale restructuring of operations.

In restructuring there are active measures taken to further develop future prospects, as well as defensive measures for issues that can no longer be postponed. For many companies the environmental changes that occurred in 1998 became the impetus for restructuring for both these reasons.

The above summarizes the trends in strategy and organization of Japanese business in the 1990s. Looking only at this, it seems clear that many companies not only did not respond to environmental changes, but also lost the ability to act quickly as a result of restrictions and problems that they caused for themselves. However, there were companies that actively started on reforms immediately after the collapse of the bubble. One such company is Sony. Sony took the lead in introducing the company system, and conducted an organizational reform coordinated with the changes in the surrounding environment and strategy shifts, in accordance with Chandler's proposition that "organization follows strategy". Here, we will trace Sony's organizational reform, and discuss how Sony responded to environmental changes after the bubble collapse, as well as how they handled the various problems that arose during this process.

2 Sony Organizational Reform [5]

(1) From a business group system to a divisional company system

Sony introduced the business group system in 1983. Prior to that time Sony had utilized a function-specific organization, in which the departments for development, manufacturing, and sales each handled all products. However, an increasing number of employees and a growing product lineup could not be handled with the function-specific organization. In addition, since the key audio business was falling into a slump due to a worldwide recession, it was decided in 1983 to introduce a business group system. The goal was to increase the maneuverability and efficiency of each post and the entire organization by clearly defining the roles of headquarters and each business group, and by transferring authority to each of the business group head offices. First, the entire organization was reorganized into four business groups divided according to the key product lines, and the top management of each business group was given the full authority and responsibility for the entire process, from development through sales. Headquarters assumed the responsibility of creating the corporate-wide strategies. By forming organizations separately for each business group there was clarification of the roles that each business group should fill in order to achieve the goals of the entire organization, as well as of the environment of the business groups and the relationships between business groups; and the goal of the introduction of the business group system was essentially achieved.

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[5] As for the story about Sony mentioned in this section, article index (1994-2003) of Nihon Keizai Shinbun and Nikkei Sangyo Shinbun, and "Sony History" in Sony's web site were used as references.

Sony's next large-scale reorganization was in 1994 (Figure. 3). After the introduction of the business group system in '83, Sony continued to diversify, and expanded both the range of operations and the scale of the organization. Moreover, escalating problems began to become apparent, such as delays in decision-making due to the existence of many levels in the organizational hierarchy, and overlaps between products and functions between business units. Therefore, in 1994, the company system was introduced. Along with the restructuring of the bloated organization, it was decided to make the profitability of each operation completely independent and to clarify their responsibilities.

At the time of the organizational reform Sony had 19 business unit head offices with more than 50 operating units under their control, as well as 8 other operating divisions. These were reorganized into 3 group companies and 5 division companies. The functions of the headquarters were trimmed down to focus on strategic planning for the entire corporation and R&D. Each company had their own accounting, personnel and planning departments that were independent of the departments at headquarters. The top position at each company was designated the president, and given greater powers than those previously held by the heads. Specifically, the upper limit for decisions involving money was raised from 500 million yen to 1 billion yen, and they were empowered to make important decisions, such as determining the investment details related to individual projects.

In 1994 several problems with the company system appeared. The first was an overlap in the decision-making functions. In 1994 there was overlap between the people responsible for the decision-making for the entire organization and for the decision-making at the company level, creating ambiguity about where priorities and loyalties lay. The decision-making for the entire organization was the responsibility of a management council composed of 10 executives who were vice-presidents or higher. Three members of the council were also company presidents. The concurrent responsibilities not only made it impossible to be fully committed to either level of decision making, but also created difficulties in weighing arguments and making evaluations as a decision-maker in cases where the interest of the corporation as a whole conflicted with the interests of a company. If the decision-making function is damaged by redundant management, there is a danger that this will have a negative impact, such as functional impairment of the entire organization.

The second problem was an overlap between indirect departments, including personnel, planning and accounting. For example, a shift in personnel within a company was handled under the authority of the company president, while a personnel shift between companies was the responsibility of the personnel department at headquarters. The optimal allocation of human resources within a company did not always coincide with the optimal allocation of human resources for the organization as a whole. In particular, during periodic personnel shifts involving corporate-wide reallocation of human resources there was a risk of creating temporary disruptions in the operations within each company. The question of how to perform this kind of management on a corporate level as well as within each company is one key in determining the rights and wrongs of the company system.

(2) Company system revision

In 1996, just 2 years after it was introduced, the company system was revised. Actually, there were small changes being made during the period from the introduction until the first revision in 1996. The division of responsibilities and clarification of duties was carefully applied throughout the entire corporation, including the introduction of a project team system at the central research lab affiliated with headquarters in 1995, and the adoption of a research system with flexible responsibilities for each research topic. On the other hand, problems began to appear as the business domains changed and the existing company framework could not be adapted to match. Specifically, although there was a pressing demand for a fusion of the growth field of telecommunications and AV technology, the growth in the key AV markets was waning. In order to adapt to these changes, an organization-spanning project team was established for corporate development in 1995, and the DVD business center was established in February 1996. This was an organization-spanning, special project group created in order to create a DVD business; a virtual company that did not actually exist.

In this way, transverse organizations gradually developed to complement the existing organizational framework; and, in April 1996, the existing company system was officially revised (Figure. 4). With the reformation in 1996 the number of companies increased from 8 to 10, broadly classified into 5 categories. Among the companies there are some that followed existing categories, and some that were reorganized. The fields expected to have future growth, like mobile telephones and car navigation, and fields requiring stronger operations, like PCs, were handled by establishing independent companies, and characterized by thorough "selection and concentration". In addition, an executive board was established to enhance the corporate strategy planning function, and research and business operations were focused at headquarters. As discussed later, these strengthened the functions of the headquarters and supported the transition from decentralization to concentration of authority.

In 1997 a new executive director system was introduced and there was a reorganization of the top management layer. Specifically, there was a division between the line of the board of directors – management council occupied with the management at the corporate level, and the management committee (renamed executive board) covering the companies. In 1998 there was a reconstruction of the companies and the establishment of a new Digital Network Solutions (DNS) company to handle network-related business. In addition, two existing companies were merged to form the Broadcast & Professional Systems (B&P) company. There was also a reorganization of the operating units within the Display company.

(3) Company system re-revision

In 1999 Sony conducted a large-scale revision of the company system for the second time (Figure. 5). The aim of '99 revision was to strengthen the core business in electronics. Specifically, companies were reorganized, subsidiaries were combined and a distinctive character was created with a 3 point restructuring.

Ten existing companies were reorganized into 4 business units, and DNS was elevated to an organization under the direct control of headquarters. Three companies listed on the second tier of the exchange, Sony Music Entertainment (SME), Sony Chemical, and Sony Precision Technology (SPT), were converted into wholly-owned subsidiaries. When SME became a wholly-owned subsidiary, Sony Computer Entertainment (SCE), which had been established jointly by Sony and SME in 1993, also formally became a wholly-owned subsidiary. The printed circuit board technology that was a strength of Sony Chemical, and the ultra-precise measurement and recording technology of SPT were fused with the core Sony technologies, with the expectation of being utilized for new business creation.

The restructuring focused on a reduction in manufacturing bases and employees, and a distribution of some headquarter functions. At the end of the 2002 fiscal year 70 factories throughout the world had been consolidated into 55, and 17,000 of the 170,000 employees in the entire group (10%) were eliminated, mainly through natural attrition. Furthermore, the headquarter departments for accounting, personnel, general affairs and information systems functions were broken up into branches in July 1999. The specific numerical targets for the head count reduction measures were revealed at the beginning of 1999 (Nikkei Sangyo Shimbun 1993. March. 10). It was planned to reduce the staff at the headquarters, which was 2600 in 1999, to around 700 ~ 800.

Even after the major revision of the company system Sony has continued to conduct organizational reform. In October 1999 the Broadcast & Professional Systems company and DNS were combined, and the Communication Network company (CSNC) was newly established. There was another company reorganization in April 2001, including promotion of the mobile telephone department to a key business unit, and the splitting of the PC business into desktop and notebook divisions.

(4) Discussion

The process of organizational reform at Sony illustrates the intensity of the changes in the business environment since the 90s, and the difficulty of designing organizations to adapt to these changes. There was a period of approximately 10 years from the business unit system until the transition to the company system. Over the next 10 years at least 3 major reforms were conducted, including the introduction of an executive director system. Tracing the process leading to each of these reforms shows that new companies were established immediately after organizational reforms in order to meet the growing demands for new products, such as mobile telephones, DVD, car navigation and game systems, and that organization-spanning project teams were formed complementing the existing organizational framework.

It has been pointed out by Kusunoki (2003) that one reason Sony was forced to make such frequent organizational changes is that the transition from analog to digital technology was accompanied by changes in business models. In the analog era, technical advancement was slow, and a business model of taking the lead and hanging on with each successive idea was established. In the digital era, new products could be immediately copied by other companies since the products could be created by assembling widely-available parts, so there was a danger of becoming embroiled in price wars (Kusunoki 2003). In order to avoid this, it is necessary to adapt to changes even more rapidly than before, so that other companies cannot keep up. Sony's introduction of the company system before other businesses was a response to qualitative changes in the competitive environment.

The organizational reform process of Sony was a repetition of trial and error in order to enjoy the advantages of both decentralized and centralized authority as fully as possible. The main benefit of decentralization is the heightened mobility of the lower levels of the organization through the granting of authority. Specifically, there is more rapid decision-making and problem solving at the level, and there is personnel development through increased learning opportunities. The main benefit of centralization is that authority is concentrated at the top, and the entire organization is controlled through strong leadership from above. For example, there is rapid decision-making through a top-down approach, and minimized cost for internal adjustments, allowing the realization of an entire organization with improved maneuverability. It is difficult to obtain the benefits of both decentralization and centralization. Pursuing both carries the risk of actually impairing the functions of the organization. Has Sony been able to avoid these problems through the repeated organizational reforms?

The introduction of the company system in 1994 was primarily for the purpose of obtaining the advantages of decentralization. Each company was boldly entrusted with some of the authority of the head of the company. There were also policies made to increase the mobility and autonomy of each operating unit for the entire process from development to sales, such as the establishment of indirect department functions, like personnel and accounting. However, there was subsequently the start of a gradual shift toward centralization.

The organizational reform in 1996 was intended to obtain the benefits of both decentralization and centralization. The decentralization was performed by reorganizing into self-contained, market-responsive companies; while the centralization was performed by strengthening the headquarter functions. One step in enhancing headquarter functions was the establishment of the executive board. The aim was to increase the unity and sense of purpose at the top levels and improve the effectiveness and efficiency of decision making. In addition, a strengthening of the power at the top strengthened the management within the organization that had been decentralized by the introduction of the company system. There was a sense of urgency about the decrease in centripetal force due to the decentralization, and it was thought that “centrifugal forces are a hindrance to the management of the entire operation in response to market changes while also maintaining the brand image and quality” (Nikkei Sangyo Shimbun 1996.July.24). Centralizing business operations and research directly related to product development and sales was believed to be a manifestation of this kind of thinking at the top levels.

With the reorganization in 1999 the headquarter functions were strengthened another step, and the centralization trend became stronger. The conversion of SCE to a subsidiary and the effective merger with the headquarter electronics operations, as well as the placement of DNS under direct control of the headquarters showed that headquarters intended to actively participate in strategic business operations. It was also decided to introduce performance indicators in 1999. The purpose was to increase the autonomy of and clarify the profit responsibilities of each company, as well as to facilitate the reallocation of resources and reconstruction of operations according to headquarter initiatives by making it possible to convert the degree of goal achievement of each company into indices and make comparisons. As centralization has continued at Sony the goal is to proceed with centralization of headquarters while maintaining company autonomy, and to strengthen group administration. In the conventional company system, there is also an issue over the “tendency to chase short-term sales and profits”. (Nikkei Sangyo Shimbun 1993.March.10).

3 Summary

The structural change from diversification to restructuring of Japanese companies in 1990 and Sony's case shows that centralization and decentralization complement each other and how to keep balance between them is a managerial challenge for many companies.

Every organization has adaptability which reacts to changes in their organizational environment smoothly and positively and internal power which resists change and maintains current behaviors and systems. All divisions and units in organization, in greater or lesser degree, have both adaptability and resistance power. They have formal and informal effects on decision making processes, procedures, human relations, and group relations and behaviors in organization. If companies neglect these internal forces, they might simply downplay signs of slowdown or postpone decisions even though they know what is happening and know it needs a swift resolution.

In organization studies, many of which are concerned with lateral organizations and network organizations, decentralization is necessary for companies to break organizational inertia and adapt their environment quickly and flexibly. However, Sony's case shows us the more companies decentralize their hierarchy, the stronger top management controlling and commanding total organization is required.

Japanese companies are now recovering from the long downturn of the 1990s and revising their management systems by redesigning their organizations. For example, some companies introduced a company system in the same way that Sony did. As for each business unit level, they delegate authority and responsibility to each division. As for the corporate level, they clarify the role and responsibility of the top in order to make them concentrate on total management. This is what many Japanese companies haven't accomplished under the divisional organization system. Now they are trying to get rid of the old-fashioned Japanese management styles which are often characterized by ambiguous responsibility or group-based decision making, and this movement is likely to continue for a while.

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