How the Japanese Manage Risk

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Americans hear so much about Japan as the success story of the international economy, they sometimes forget that the Japanese have economic problems of their own. Japan has its declining industries such as steel and its low-wage competitors such as South Korea and Taiwan. And in an era of fast-paced economic change – exemplified by the recent loss of advantage in international markets caused by the high yen – it also has its problems of social adjustment. But what is so remarkable about the Japanese economy is its capacity to address such difficulties and adapt to change while remaining productive. On a recent trip to Japan, I came to the conclusion that if there is any one secret to this success, it lies in the way Japanese manufacturers manage risk.

The Hot-Potato Approach

Most large U.S. corporations try to insulate themselves from risk. They position themselves to unload unexpected costs onto others like a hot potato. Companies pass increased costs on to consumers by raising prices when they can, play one subcontractor against another in search of the cheapest parts, and „whip-saw" workers in one plant against those in another to gain wage concessions. This approach to risk may have worked well in the past – at least for stockholders – but, given the new realities of the world economy, it has become a recipe for disaster. As international competition grows stronger, saddling consumers with increased costs is more difficult. And shifting economic risks onto subcontractors and workers, the groups least able to resist, certainly doesn't encourage the high levels of trust that more and more observers see as necessary to improve productivity and increase innovation.

In fact, the tendency to hand risk off to others is the main reason that – to put it bluntly – American workers generally don't trust their bosses. Without that trust, the sharing of information, the commitment to quality, and the idea of industrial „teamwork" just aren't going to happen in the United States.

Finally, because U.S. companies are so averse to risk, they tend to shortchange their employees – and ultimately themselves – by skimping on training. In the past decade, some businesses have made substantial investments in new workplace technologies. But these have not been matched by equivalent investments in worker training. As a result, U.S. firms have not been able to take full advantage of these technologies to increase productivity and improve quality.

Sharing Risk Instead of Avoiding It

In key sectors of their economy, the Japanese behave differently. Rather than avoid risk, they manage it by sharing the unanticipated costs of economic change. In one large steel company that I visited, production workers whose jobs were eliminated at one mill were quickly placed by management in new jobs – either elsewhere in the corporation or at a subcontractor's shop, or with a local government agency such as the public works authority. The primary subcontractors of large Japanese corporations often receive a great deal of financial and technical support from the core firm. This encourages small companies to experiment and innovate because they know that the penalties for failure seldom include outright termination of the relationship. Likewise, if a risky R&D project undertaken by a subcontractor does produce a breakthrough, the gains are shared throughout the production system, not appropriated entirely by the large firm. This holds true even if, as is common, the core firm has financed much of the cost of doing the research in the first place. And everybody in the system receives a *lot* of training.

The result of this very different organizational philosophy – risk sharing, as opposed to risk avoidance – is maximized exchange of information among producers. Suppliers routinely participate in product and process design. And because information among suppliers flows relatively freely, managers at any one are free to specialize in particular products or components without having to „bet the firm." Since gains from any particular technological breakthrough tend to be shared by everyone involved, information produced by one business is less likely to be hoarded and is more often shared at an early stage of innovation. Regular meetings between a large firm and research personnel from its leading subcontractors encourage this process. All of this allows the leading firms to mobilize the capabilities of many companies early in the cycle of new product development. The result is higher product quality and shorter development time.

Through practices such as risk sharing and greater diffusion of information, the Japanese have succeeded in incorporating the pre-capitalist principle of „reciprocity" into what is arguably the most successful capitalist production system in the modern world. Such reciprocity makes linkages among large firms and small far tighter than in the United States, and the assumption that „we're all in this together" much stronger. This makes it easier for Japanese businesses to take advantage of the information and expertise embedded in the network of small suppliers. Ultimately, that information is the key to higher productivity and long-run economic growth.

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