

## Track #6- Internationalization of Services

### Interactive Poster Session

#### ABSTRACT

An analysis of primary and contributing success factors for 10 successfully operating service sector businesses started in Japan by foreigners was made from August 2003-August 2004. The most important success factor was application of a business practice common in the founder's home country but innovative within the Japanese service sector. This "arbitrage" was the primary success factor in 5 of the 10 companies studied. Application of an advanced service methodology was the second most important factor, followed by transparency of pricing and/or information. The results highlight both the deficiencies in Japan's domestic service sector offerings and the value of the perspective foreigners bring to the problem.

In this study, the full version of which will be released in book form with extensive citations later in 2005, the authors note the importance to success in many of the cases of low context cultural elements (Hall) applied within Japan's high context society. The catalytic role in Japan of foreign

multinational companies as demand drivers for innovative services is discussed, as is the pressing need for service sector innovations to make Japan more appealing to the skilled foreign workers it must attract in the future.

# Business Practice Arbitrage as a Success Factor in Service Sector Entrepreneurship by Foreigners in Japan

## INTRODUCTION

What factors make foreign service providers successful in Japan? The authors attempted to answer this question through an inductive synthesis study using in-depth interviews with successful foreign service providers, primary data from government and private think tanks and consultancies, and secondary data from business magazines and daily newspapers. They focused on small businesses that grew successfully without the benefits of global brands, massive financial backing, or home-country management or technical support. The authors identified "arbitrage" in Japan of business practices already proven effective overseas as the single most important success factor, followed by 2) application of an advanced service methodology, and 3) pricing and information transparency. The findings are significant in light of the sub par performance of domestic providers in the "mission critical" service sectors that are the focus of this study—healthcare, finance, real estate and information technology—and suggest Japan must dramatically improve quality and efficiency in its multi-trillion dollar service markets if it is to meet the challenges presented by a rapidly globalizing service economy and the world's oldest

population. The authors suggest “transplanted” overseas business practices and service methodologies are increasingly important if Japan is to become internationally competitive as a destination attracting the very professionals who can help globalize its service economy. The full version of this study will be released later in 2005 in a book of approximately 53,000 words with 150 citations.

## BACKGROUND

Power relationships in the manufacturing industries, where Japanese companies are strong globally and outsiders struggle for market share in Japan, are reversed in the service sector. Foreign insurance companies, real estate firms, venture capitalists, and consulting firms compete effectively in Japan while facing little Japanese competition in their home countries. This difference can be explained partly by Japan’s relative linguistic isolation, which has kept the country out of the mainstream flow of new service business models, best practices and world standards. Another factor is Japan’s uchi-soto (insider/outsider) cultural mentality, which results in a lack of confidence and an unclear framework for dealing face-to-face with non-Japanese people. Successful service businesses must have keen insight into their customer’s needs and behaviors, as well as great skill at organizing and managing their own employees to deliver

services while interacting with customers; an inability to deal well with foreigners certainly represents a major obstacle to successful launching of a service business in foreign countries. Finally, Japan's hardware exporters, who compete globally, have long been subject to the rigors of international price and quality competition, while domestic service providers enjoy both a natural protective linguistic barrier and protectionist government policies shielding them from international competition. This combination keeps them weak and inefficient.

The lack of a dynamic service sector in Japan condemns the nation's consumers to inferior outcomes in high-value finance, home buying, and health care transactions. Customers for such services in Japan experience poor quality, a narrow range of choices, little convenience, and low value compared to their counterparts in other industrialized nations. Foreigners living in Japan, while praising many elements of Japanese life, frequently express astonishment and frustration at how poorly Japan's "mission-critical" services compare to offerings back home.

For a few foreigners, these conditions act as a stimulus to start service businesses that address sector problems. The authors interviewed ten such entrepreneurs in-depth, analyzing each founder's core strategy as well as that strategy's relationship to both sector-specific problems and broader problems in the larger service economy. This paper reports and analyzes the data

gathered by the authors, highlights broader issues in Japan's service sector, and suggests possible areas for follow-up research.

The authors' definition of "service industry" excludes restaurants, retail shops, tutoring, coaching, and other personal services and small businesses, which, if counted, would add many more examples of successful foreign service entrepreneurship in Japan. The authors focused on foreign entrepreneurs providing "mission-critical" services in finance, health care, real estate, and information technology.

## METHODOLOGY

The authors identified fifteen service businesses started and run by foreigners in Japan that had achieved annual revenues equivalent to at least one million U.S. dollars and which served primarily Japanese, not foreign, customers. (However, the important role played by a large foreign customer as an "enabling account" was noted in several instances.) In selecting the interviewees, the authors also used subjective criteria such as uniqueness of the business model, the degree to which members of the business community pointed to them as positive examples, and the degree to which the founder personally expressed interest in remedying what most

foreigners and many Japanese identify as a “sub-par” service experience of some kind. This paper presents ten of the cases in summary form.

The authors personally approached the entrepreneurs, all of whom agreed to in-depth interviews and in many cases extensive follow-up e-mail communications (only one entrepreneur requested a pseudonym and is identified as such in this paper; all other names are real). The interviews took place between August 2003 and August 2004 with some follow-up as late as October 2004. While the interview questions did not follow a strictly scripted sequence, each interview covered essentially the same areas. This paper reports the results for the first time in a form suitable for treatment as synthesis and for presentation as material to encourage further, more empirical study.

## RESULTS

Summaries of the ten cases follow:

### 1. Colby Group International

Mark Colby is a U.S.-trained dentist who first moved to Japan to study judo as a hobby. While in

Japan, Colby identified a number of niche areas related to health care in Japan and started a company in 1991 to address them. He now operates several businesses with combined annual revenues approaching \$7 million. Colby's first insight came when he realized that the quintessential foreign customer, the U.S. military, was having trouble finding medical laboratories to process samples, such as blood tests, in accordance with accuracy standards common in the United States and required by the military wherever it operates worldwide. Colby converted this insight into a business by becoming a consultant to Japanese labs, helping them understand the business value of meeting the U.S. standard and guiding them through the internal changes and qualification process needed to become a certified outsourced laboratory. Later he developed training materials, packaging the same advice for a wider range of laboratories. Colby applied a similar approach to a crucial problem within Japan's domestic health care system: the high incidence of hospital-acquired infections. Colby proselytized the need for Japan to raise hospital safety standards to global levels, and helped promulgate in Japan a U.S. designed to address this problem. Again, Colby derived revenue from consulting and training, while developing and selling software that helped laboratories monitor compliance with the standard.

Colby identified problems in Japan that had already been addressed in his home country through the creation and implementation of accepted standards. He then worked to have the same

standards recognized in Japan, finding various ways to earn revenue from the process (in their book the authors point out structural factors in Japan's medical sector that explain why Japan lagged in addressing these problems, but the sector-specific analysis of this and other cases presented is beyond the scope of this paper.) A recent Colby Group initiative is to serve as the outsourced training department for various Japanese medical societies that lack infrastructure to offer newly-required continuing education services to their member physicians.

## 2. Ashisuto

In 1972 Bill Totten quit his job as the Japan representative of a U.S. software programming company in order to start Japan's first packaged software reseller. His insight that information technology (IT) in Japan would head in the same direction as in the U.S.—away from custom solutions towards off-the-shelf packages—proved prescient enough to allow Totten to build a company that reached annual sales of several hundred million dollars at its peak. The company, now in its third decade, still employs over 500 people.

While custom programming did not give way to packaged solutions overnight even in the United States, certain culture factors further slowed the transition in Japan. For example, large Japanese companies in the 1970s and 1980s prided themselves on being vertically integrated and doing

everything in-house. Thus, rather than an attempt to gain efficiencies through use of industry-standard methodologies and best practices, IT's initial introduction to the enterprise often involved merely replicating in software idiosyncratic or even dysfunctional business processes institutionalized amid inwardly-focused corporate cultures. Totten persisted in the face of this and other challenges, scoring breakthroughs first in the system management and large database markets, where even the most stubborn homegrown logic couldn't stifle the speed and cost-saving benefits of using packaged solutions.

3. Jeff Donaldson's commercial real estate brokerage service (pseudonym used at interviewee's request)

In the early 1990s Jeff Donaldson pioneered in Japan the concept of exclusive lessee representation in commercial real estate rental transactions (exclusive agency). The standard Japanese practice even today is for the broker to represent and collect fees from both parties in a transaction (dual agency). Assuming the broker is completely neutral, this system might seem to be a fast and efficient way to match building owners and tenants. In practice, however, brokers naturally favor building owners—who bring them business on a repeated basis—over tenants, who are unlikely to become customers again until they need to change offices years later. Donaldson had worked at a commercial brokerage in the U.S. where single agency—not dual

agency—is the norm, and where it is commonly assumed that each side’s broker will try to negotiate the best possible deal in an openly adversarial forum. Both parties enjoy free access to data of comparable transactions, enabling a rational process of closing in on an appropriate price determined by market forces. By contrast, in Japan brokers hoard such information to strengthen their negotiating positions.

Many of the large foreign financial institutions that moved into Tokyo in large numbers in the early 1990s shared Donaldson’s astonishment at what he saw in Japan. They refused to accept the results of rental deals brokered based on factors invisible to them under Japan’s traditional relationship-driven, high-context culture, where negotiations are conducted by multiple layers of mysterious intermediaries behind closed doors. The foreigners wanted a forum for direct, open adversarial negotiation where they could attempt to maximize their own interests, and they latched onto Donaldson as their tool to achieve this. Mustering both the courage and the patience to try to “change the rules of the game,” and enjoying a strong tailwind from falling demand for commercial properties, Donaldson eventually prevailed, bursting the bubble of invincibility around the Japanese brokers and attracting a significant number of Japanese customers. Donaldson secured below “market” terms for his clients, demonstrating that broker hoarding of transaction information was fostering an inefficient market. Donaldson eventually sold his

practice for a handsome sum to a large overseas brokerage that wanted to enter the Japanese market quickly without struggling to decipher the implicit rules of the game.

Donaldson's case provides a clear example of "arbitraging" in Japan a business practice that has long been standard procedure abroad. While dual agency remains the norm in Japan's residential real estate industry, growing numbers of commercial transactions, including many involving Japanese tenants and buyers, employ the exclusive representation concept Donaldson pioneered in Japan.

#### 4. Softbrain

In the early 1990s Song Wen Zhou traveled to Japan as a graduate student in computer science. After graduating, he joined a Japanese custom software developer, then launched out on his own, scoring a small success with a civil engineering software application. Song set his sights on a larger market in 2000 when he founded a new company, Softbrain, aimed at the sales force support software market. Song had observed that while Japan's manufactured products were world class, the methods used to sell those products were rote patterns developed in the 1950s, and out of step with changing purchasing behaviors and modern sales management techniques. Softbrain's software enabled real-time, from-the-field sales activity reporting whereby

salespeople employ easy-to-use pull-down menus on their Internet-enabled cell phones to transmit results using exclusively numerical—not text—data. The tool forces both salespeople and their managers to create and act upon explicit, goal-oriented information—represented by data values linked to specific “next step” choices rather than descriptive text that usually fails to prescribe appropriate next actions. It also makes salespeople clearly accountable for reporting and producing results on an individual basis in a country where sales performance is often judged tacitly and the locus of performance responsibility is diffused across groups.

Song keenly observed entrenched business behaviors that were comfortable for Japan’s salespeople within Japan’s cultural context, but clearly inefficient and uncompetitive from an outsider’s perspective. He offers a clear example of successfully combining an advanced service methodology with information transparency to create, in a sense, new business practices related to the selling process in Japan.

## 5. All Nations Society

While studying for his MBA in Tokyo, John Kamm noticed how dramatically Japanese funeral business practices differed compared to what he had known at the funeral home run by his parents in Colorado. Service content and projected prices were defined vaguely and often resulted

in expensive surprises for Japanese families when the rites were concluded. Funeral home operators routinely bribed local hospital staff to encourage—and sometimes almost coerce—distraught families to use their services. Kamm stayed in Japan after graduating and founded All Nations Society, a funeral home service franchising business that requires franchisees to adhere to clearly defined service and pricing menus and strict ethics concerning disclosure, transparency, and consultations with bereaved families. Kamm also pioneered a system for arranging and paying for funeral services well ahead of time, in a culture where speaking of death before the fact is often taboo.

While information and pricing transparency were the key success factors in Kamm's business, he also introduced advanced service methodologies—such as how to protect against infectious diseases like AIDS when embalming—that were unknown in Japan and bolstered market perception of All Nations as a leading-edge business.

## 6. Softbridge

Prashant Jain is an entrepreneur of Indian heritage who perceived that Japan greatly lagged the United States in outsourcing software development to skilled, low-cost developers in India. Jain reasoned that global Japanese companies failing to exploit such outsourcing opportunities would

soon suffer cost disadvantages compared to more nimble, less parochial competitors. While Japanese companies outsourced some work to China, Jain believed Indian firms offered superior capability to deliver complex projects in a professional, secure, and reliable manner.

Jain diagnosed and set out to overcome the various linguistic, cultural, and organizational barriers to successful Japan-to-India outsourcing. He hired Indian software engineers, gave them Japanese language training, and brought them to Japan to work on IT projects inside Japanese companies. While more costly than true offshore outsourcing, this arrangement gave Japanese companies access to Indian software engineers' experience and cutting-edge skills at lower cost compared to local Japanese engineers with comparable skill levels, who tend to be in short supply. As these engineers became integrated into their Japanese corporate environments, some became capable of playing bilingual project manager roles, helping Jain facilitate true outsourcing to India.

Meanwhile, Jain discovered another Japanese company need for which India represented a solution: Japanese companies were urgently seeking fast, low cost ways to upgrade employee IT skills, English language ability, and general global awareness. Jain set up a center in India where Japanese companies could send both newly hired college graduates and mid-career employees for a month or more of IT and English immersion training. Even taking into account air travel, food,

and lodging, the on-site training is cost-competitive with Japan-based programs and has attracted large domestic IT players such as Toshiba. Jain's key insight was that Japan's cultural "allergy" to dealing with foreigners had simply grown too costly. His solution, which bridges language and cultural barriers by combining IT and English language training in a stimulating foreign environment, has created a scalable business with excellent growth prospects.

Jain's business offers a strong advanced service methodology component; client employees learn global-standard software methodologies such as the Capability Maturity Model (CMM), which is still not widely practiced in Japan. Meanwhile, rather than "arbitraging" specific overseas business methodologies, Jain focuses on helping his clients acquire general socio-cultural business skills.

## 7. Pacifica Malls

Chicago-born Seth Sulkin worked both as a manager in third world infrastructure construction projects and as a Wall Street Journal reporter before starting his company in Japan. For years he consulted for U.S. and Japanese retailers and mall developers, but in 2002 he started planning and developing his own shopping mall, which opened in Chiba in December 2004. Sulkin is a "merchant developer," a type of shopping mall developer well understood in the United States

but almost unknown in Japan. A merchant developer undertakes the planning, development, and operation of a commercial property such as a shopping mall with the goal of maximizing profitability. In Japan, malls were typically developed by subsidiaries of companies owning large general merchandise stores that become the mall's sole large tenant. The mall developer thus has mixed loyalties, and may be more concerned with the parent company's store needs than with overall mall profitability. The needs of other stores in the mall—and perhaps most important, consumer shopper needs—tend to be overlooked. Much inefficiency arises as a result, leaving room for Pacifica to offer a superior mall experience and still make an acceptable profit.

Large Japanese developers typically rotate personnel every few years to new positions, so few employees build the expertise and judgment for commercial and retail development that one sees at U.S. developers such as Simon, one firm upon which Sulkin models his company. Central to Sulkin's philosophy is the belief that creating something as complex as a shopping mall, which must balance the needs of many stakeholders, requires one person to act as a "master architect" who creates a core concept and ensures that the project remains true to the original vision. Lacking experienced master architects, the large, bureaucratic developers with whom Sulkin competes in Japan have trouble producing and maintaining this kind of vision.

Sulkin's success is yet another clear example of arbitrage: the implementing of a business practice commonplace in the entrepreneur's home country but innovative in Japan. The main constraint on Sulkin's success is likely to be access to capital and political and/or "old boy" clout in securing prime locations in land-scarce Japan. These are areas where competitors gain advantages through sheer size despite lack of innovation or nimbleness. But the growing power of some foreign banks in Japan—including Shinsei, a backer of Pacifica's first mall—may help entrepreneurs like Sulkin speed their implementation of overseas business models in Japan on a larger scale.

## 8. Sunbridge

As the first employee of database giant Oracle's Japan subsidiary, American Allen Miner clearly knows something about managing a growing business. With personal proceeds from Oracle Japan's successful IPO, Miner formed SunBridge, a venture capital firm focused on early-stage technology startups. Drawing on the Silicon Valley venture capital model, Miner focuses on technology areas where SunBridge can exercise expert judgment and provide industry contacts and hands-on operational assistance. He concentrates investments in a small number of firms and pushes SunBridge portfolio companies to make decisions and act more rapidly than domestic competitors, giving them one advantage in the quickly evolving global technology marketplace.

SunBridge stands in stark contrast to the typical Japanese venture capital firm, which differs greatly from the U.S. model. First, Japanese VCs are often subsidiaries of banks, insurance companies, and other bureaucratic financial institutions with little sector-specific expertise or capability to judge high risk/high return scenarios. Typical staff rotation in these firms makes it difficult to develop seasoned experts who can make the right calls in the short time frames the field requires. Secondly, some so-called venture financing in Japan takes the form of loans, backed by personal guarantees of the founders, instead of the equity investment more appropriate to high-potential startups. Japanese VCs also tend to invest in a wide range of companies in many fields in an attempt to spread risk, an approach cynics label "casino capitalism." The result: each investee company receives too little money and insufficient expertise.

Miner's success, validated by several successful IPOs and SunBridge's profitability amid a poorly performing venture capital sector in Japan, offers another example of effectively arbitraging an established overseas business practice in Japan. SunBridge also employs advanced service methodologies. For example, the company was a leader in devising a government-approved method for avoiding the minimum 50,000 yen per share paid-in value requirement that had previously restrained startup capitalizations and share issuances in Japan.

## 9. Linc Computer

New Zealander Terrie Lloyd is a well-known entrepreneur in Tokyo, having started many companies, a few of which have been very successful. In 1990 he founded Linc Computer, which he sold for an eight-figure dollar price to EDS in 1995. As corporate PC use exploded in Japan in the 1990s, the demand for various support services grew apace. Japanese IT vendors, operating under the “hardware mentality” of an economy that had prospered for 40 years by selling manufactured goods, typically billed for support and repair services by charging clients a percentage of the original cost of the equipment—billed annually. Support was delivered under an industrial equipment servicing model whereby technicians were dispatched to client sites from service centers scattered around the country. Technicians would analyze the problem, return to their offices for parts (which could take several days in some cases), then revisit the client site to fix the broken equipment.

To U.S. financial institutions rapidly adding Japan office staff in the early 1990s, this model seemed needlessly slow. These companies could not afford having traders, who earned half a million dollars a year and could generate millions of dollars of profit in a single day, idled for days—or even hours—while a computer was fixed. Lloyd’s first innovation was to place entire

spare computers on site so that the customer's employees could continue to work uninterrupted if their PCs failed. He also placed dedicated staff on-site at large clients to improve responsiveness. Despite the cost of these dedicated people, Lloyd's flexible approach helped him control overall costs. Since Japanese competitors were, in fact, overcharging clients for the level of service they delivered, Lloyd could offer more yet still be amply profitable. His business strategy was validated in tangible terms when EDS bought his company in 1995 in order to gain quick access to the lucrative foreign client IT market in Japan.

The authors categorize Lloyd's success not as a case of successful introduction of a home country methodology or business practice, but rather as a case, evident in several other companies studied, where the entrepreneur succeeded through a simple pragmatic flexibility. He focused on what was truly valuable from the customer's viewpoint, rather than relying, as Japanese rivals did, on a set pattern, or kata, of rigidly prescribed steps in which a process—in this case computer support—should be executed.

#### 10. Imahima

Neeraj Jhanji is an Indian entrepreneur in Japan's mobile phone services industry. He left his position as a consultant at a large U.S. technology strategy consulting firm in Tokyo to become a

developer of software applications for mobile devices. His company's name, which means "I'm available now," derived from his first product, which uses GPS technology to allow groups of friends to track each other's locations in the crowded streets of Tokyo and agree to meet when they are close by. His company also developed mobile applications for customers such as AOL and currently is adapting a popular European on-line avatar environment for Japan's mobile market.

Jhanji, like a few of the foreign entrepreneurs interviewed, did not implement a business model from his home country. Rather, he is part of a small group of entrepreneurs who came to Japan and innovated in the nation's highly dynamic Internet-enabled mobile telephone sector. Put another way, it is unlikely Jhanji and others like him could have done the same thing at home because no overseas mobile telephone market is as highly developed as Japan's.

We included an entrepreneurs like Jhanji in our research as a reminder that it is misleading to lump all "foreign entrepreneurs" into a single category. In this limited synthesis study we can do little more than raise questions, but future research might distinguish between foreign entrepreneurs who are introducing established models from source countries as innovations into target countries and cases where the innovator is coincidentally a foreigner but where there is no

importing of a business strategy from back home. Rather, these latter cases are more truly examples of technical innovation, creating something new, rather than importing and adapting. Such cases may in fact be more interesting as technical achievements but offer less of interest to those researching entrepreneurship by foreigners in Japan.

## DISCUSSION

The authors studied 10 service sector companies in Japan that had been started by foreign entrepreneurs, analyzing the core strategy and postulating success factors in each case. In five of the ten cases (#1,2,3,7,8) success at the most basic level was characterized as a kind of arbitrage, employing skillful introduction into Japan of a service sector business model or methodology that was common practice in the entrepreneur's home country, but which represented significant departure from typical Japanese practice. In one case (#4) success was primarily attributed to application of an advanced service methodology; this factor was judged to be a contributing factor in three other cases (#5,6,8). In one case (#5) pricing and/or information transparency was judged to be the primary success factor. In three cases (#6,9,10) it was difficult to assign a primary success factor that was meaningfully definable within the scope of this research.

The arbitrage seen in the majority of cases was often possible due to practices in Japan's domestic service sector that lag behind those in other industrialized nations. While the authors attempt to analyze the factors behind this lag, which is seen repeatedly in the finance, real estate, health care and information technology sectors, the circumstances that led to such poor availability of service choices in a multi-trillion dollar services economy clearly deserve further, empirical study.

Hall's continuum of cultures ranks Japan as one of the world's "highest context" societies, where implicit communication, tacit understanding, reliance on the spoken rather than written word, and emphasis on relationships over contracts are the norm. Yet we found that foreign entrepreneurs offering extremely "low context" services—characterized by explicit communications, written contracts, price and information transparency, and rational service methodologies as was common in their home countries—met with strong approval from Japanese consumers and businesses alike. Indeed, when it comes to spending money for "mission-critical," high-value services, Japan's customers suddenly seem to favor the low context approach. This very basic observation might prove an interesting starting point for further research.

One sub-theme running throughout the interviews was the catalytic role played by foreign

companies in Japan as customers demanding services on a par with home-country levels. Such companies (in one case the U.S. military) often represented the key enabling account for start-up service companies that needed both a large customer to generate revenue and a well-known client reference to use to build credibility among Japanese prospects. Scholars examining global service businesses may find some value in exploring this phenomenon.

Finally, global corporations often deploy at locations worldwide highly educated, skilled professionals who are largely home country- and nationality-independent, so to speak. Thus a U.S. technology strategy consultancy might have an Indian analyst working in its Tokyo office. If Japan wants to remain competitive as an Asian services “hub” it will have to offer a lifestyle and society attractive to non-Japanese young professionals who will likely have similar assignments available to them in locations such as Singapore, Shanghai, and Hong Kong, not to mention New York, London, or San Francisco. While Japan excels in manufacturing products, unless it can raise the level of its service offerings in "mission-critical" lifestyle areas such as health care, finance, and real estate, foreign professionals working for large firms may increasingly pass up assignments in Japan in favor of places they judge to be more comfortable and appealing. Thus in some sense the globalization Japan so badly needs may be seen as closely intertwined with the fate of its multi-trillion dollar services economy.