

Penetrating the Japanese Market

The Case of Scitex

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Overview

This case examines how Scitex, a small Israeli hi-tech company, penetrated the Japanese market during the 1980s and 1990s. The case highlights not only the political and economic obstacles faced by Scitex, but also outlines the structure and unique business culture of the Japanese market, which foreign concerns, both big and small, often fail to fully factor into their marketing strategies. The case highlights what firms must do to adapt to overseas markets. It is of particular importance as it shows that, despite formidable obstacles, a small, foreign company can break into the Japanese market, which is notoriously difficult to penetrate. It also indicates what firms must do to continue to survive in Japan's cut-throat commercial environment.

Scitex first entered the Japanese market in 1980, when it opened a small branch in Tokyo, first specialising in selling to and servicing its existing customers. The company initially evolved a successful strategy for the Japanese market and later restructured itself to meet the challenges of that market. However, Scitex subsequently lost its dominant market position in its own very lucrative niche market.

Scitex in Israel

Efraim Arzi, an Israeli businessman, founded Scitex in 1968. The company, originally named Scientific Technology Ltd., specialised in developing image-processing technologies for the vibrant local defence market. In 1971, the company's name was changed to Scitex, (Scientific Textiles), as its main production lines were developing workstations for textile patterns. Today Scitex is an Israeli corporation, which designs, manufactures and markets digital visual information communication systems for the digital pre-print and digital printing market.

The early 1970s were a particularly good time for the company; whose R&D section developed new mapping electronic laser-based workshops and pre-press workstations. The company enjoyed rapid success in the local market and soon expanded overseas - to Europe, North America and, eventually, Japan.

The company now had a firm international foothold to build on. In the late 1970s, its R&D section developed more marketable products, based on cutting edge technology. Their graphic workstations, based on pre printing graphic technology, allowed them to make

lucrative alliances in all of its markets, including Japan.

Although firmly placed at the cutting edge of its industrial niche, Scitex eventually found the innovations of its competitors eroding its dominant market position. The mid 1980s, for example, saw the explosive growth of personal computers - good news for the consumer but bad news for Scitex. These innovations caused Scitex to lose its technological advantage in the computerised technology world. Further bad news followed. From the early 1990s, competition in Scitex' key sales area - graphic work stations, intensified, forcing the company to adopt new strategies such as joint venture operations, to survive. As a result of this change of direction, Scitex became primarily a service provider rather than a small technology innovator in its key markets of North America, Europe and Japan.

Despite this change of focus, Scitex survived by selling and providing services to large corporations and printing companies. However, in April 2000, Creo, Scitex' biggest competitor in the graphic art preparing technology, bought a large division of the company and merged the two into Creo Scitex. Although this merged entity took over most of Scitex' business, some divisions - the digital printing system, and the Vio joint venture operation with British Telecom, being pertinent examples - remained independent.

Scitex in Japan

Like any other company aspiring to a global presence, Scitex was well aware of the importance of the Japanese market. Japan is not only second in overall market size to the United States but in the areas of interest to Scitex, it is the world's leader with firms such as Canon and Panasonic setting the pace of innovation, research and development. However, the Japanese market is also notoriously difficult to enter. Regardless of which area of Japanese industry we examine, for example; cars, cameras, or optical equipment, - firms must usually be extremely big, extremely innovative and extremely responsive to the needs of their customers, to survive. Or else their competitors will marginalise, if not obliterate, them.

The problems for foreign companies trying to enter the Japanese market are, immense. Although these strong competitive forces are one important current, there is another, flowing in the opposite direction. Japanese businesses have also formed long-term alliances with domestic allied companies and these alliances generally hold firm both in good times and bad. These alliances guarantee logistical supplies and, though the lack of competition in sourcing supplies from a variety of companies might increase costs, it has the advantage of removing many imponderables from the strategic chessboard. Thus, once a Japanese company has cemented their relationships and alliances, they can concentrate on marketing their product and achieving targets such as market share, that will guarantee them long-term profits. These alliances take time to build and, from the point of view of the foreign company operating in Japan, they can be extremely frustrating. Not only has the Japanese Government traditionally encouraged this Japanese mutual aid system by discouraging sourcing to non-Japanese companies but other key components of the Japanese system tend to lock out the foreign concern as well. Chief of these is the keiretsu system.

Scitex versus the Keiretsus

Scitex' successes in penetrating the Japanese market were primarily related to its dexterity in navigating the keiretsu system, which lies at the centre of corporate Japan. In essence, keiretsus are affiliated companies with gentleman's agreements to lend mutual assistance.

Keiretsus can be either vertically or horizontally integrated. Horizontally connected groups involve themselves over a wide spectrum of industries around banks and general trading firms and also encompass large vertical groups. Horizontally connected groups include Mitsubishi, Mitsui, Sumitomo, Fuyo, DKB, Sanwa, Tokai and the Industrial Bank of Japan (IBJ) group. The latter two were traditionally much smaller than the others. However, all of them are formidable corporate entities and have been central to Japan's emergence as the second largest economy in the world. Mitsubishi, for example, make everything from paper napkins to nuclear power stations and small 'run around' cars. The keiretsu system allowed Mitsubishi's stronger sections to support their small car section. To cite another example, Nissan's heavy truck division has lost money every year for the last twenty-five years. In the West, this section would be abandoned. In Japan, the rest of the keiretsu support it until it can again begin to make profits. To take another example, Toyota, now one of the world's four most important auto companies, still works with weak companies, which provided them with vital help in the late 1940s. In summary, the keiretsu system stresses long term relationships for mutual benefit at the expense of outsiders. Scitex was an outsider to this system - and a particularly small and seemingly insignificant one. That being so, Scitex should not have survived or thrived in the Japanese market place.

Vertically integrated groups are the other major source of keiretsu to be found in Japan. These entities gather around their parents' core business activities. Vertically integrated groups include Toyota, Daiei, Ito-Yokado, Taisei, Kajima, Simizu, Kirin Brewery, Nippon Oil, Cosmo Oil, Showa Shell Sekiyu, Nippon Steel, NKK, Kobe Steel, Sumitomo Metal Industries, Mitsubishi Heavy Industries, Hitachi, Matsushita, Toshiba, NEC, Mitsubishi Electric, Fujitsu, Sanyo Electric, Sony, Sharp, Toyota, Nissan, Honda, Mitsubishi Motor, Isuzu Motor, NTT and Nippon Express Group. Many of these are household names throughout the world. All of them are formidable competitors on their domestic front. The keiretsus prefer to trade within the group, even at substantial losses. They freeze out foreign firms, and they have been identified by American presidents, including Bill Clinton and Ronald Reagan, as a major tariff barrier.

In short, they present a convoy defense that no small foreign company should have been able to penetrate. The system is designed in such a way that products and new innovations can swiftly come on stream. As R&D costs are not an inhibiting factor and as a major bank usually lies at the heart of each keiretsu, financial considerations are usually subordinated to the goal of achieving market share. Scitex should not, therefore, have been able to penetrate the market to the extent they did.

Against this backdrop, the success of Scitex seems all the more remarkable on first

inspection. However, a more in-depth analysis shows how Scitex was successful and how its strategy was ultimately doomed. The company's first success was to approach a keiretsu-linked company with their own unique technology which had already been developed, tried and tested in the incubator of Israel, and later successfully exported to the U.S and Western Europe.

Scitex had a distinct technological advantage over potential Japanese rivals who had not yet developed comparable printing and publishing technology. Scitex had the further advantage that their technology had been tried and tested in the West.

This was the closed and competitive market Scitex hoped to enter in 1980, when Scitex management decided to import to Japan its graphic and colour separation systems. As is obvious from the above, the Japanese market presented Scitex with new challenges it had not previously experienced in its western marketing operations. To overcome - or at least to minimise - these formidable obstacles, Scitex chose Toyo, a local ink company, as a strategic partner.

When a firm ventures abroad, it must choose whether to operate independently or to work through an agent. Until recently, there was no choice in Japan. The keiretsu convoy system meant that an agent was essential in order to have any chance of success. In Toyo, Scitex obtained a particularly well connected one and this allowed Scitex to circumvent the problem the keiretsu system might have otherwise presented.

Toyo

Toyo, founded in 1896, was by then a major player in Japan's printing and publishing markets, with more than 2,500 employees. It was a key player in the Japanese printing industry, providing ink chemicals and other products and services to major Japanese companies. Scitex used Toyo's business relations in the local business community to exhibit and promote its technology in the very competitive environment that is corporate Japan. The fact that Scitex' technology was unique helped to alleviate the damage the barriers to market entry might have otherwise presented.

So too did the Toyo alliance. Toyo was a well-established Japanese company, totally familiar with the particular business codes of the domestic Japanese printing and publishing market. Toyo provided ink to most major Japanese printing companies, thereby giving Scitex the opportunity to deal with a whole range of well-connected Japanese businesses. This allowed Scitex an immediate insight into the structure of the entire market as well as the varying strengths and weaknesses of the different players in that market. They were also able to build a range of personal contacts that their salespeople could later exploit. Although this proved an initial advantage, it later proved a liability. Scitex wanted to expand according to Western business principles and Toyo wanted to solidify according to Japanese business principles.

The Golden Years

From 1980 to 1985, Scitex marketed its products to the Japanese market using Toyo's services as a promoter and key adviser. The response system - a massive graphic art system, aimed at skilled graphic art professionals with no special penchant for electronics or computing - proved particularly viable. In its first year in Japan, Scitex sold over a dozen response systems to local companies, thereby making Japan its third biggest market after North America and Europe with \$4,133,300 net sales. Scitex and Toyo were extremely pleased with their initial performance.

Their success was reflected on their balance sheet. Net revenues from its Japanese operations almost doubled from \$6,643,000 in 1982 to \$12,031,000 in 1984. Although growth for the company was more pronounced elsewhere, it looked like Scitex' biggest revenue source would be in Japan, the world's second largest market. Scitex began to plan accordingly. The alliance with Toyo increased in strategic importance in Scitex' global plans.

Joint Venture

To further capitalise on their blossoming relationship, Scitex and Toyo signed a joint venture agreement in 1985. This joint venture was designed, from the point of view of Scitex, to subsume their corporate identity under that of Toyo. Toyo would, in other words, be fully responsible for marketing. Scitex hoped that this would remove the stigma of being a foreign competitor in the Japanese market. Any concerns were swept aside in the initial euphoria. Both were confident that their alliance would bring even greater success in the following years. Scitex felt assured that Toyo would be able to better promote Scitex in the future and Toyo believed that they had a lucrative and exclusive franchise in the Scitex brand.

Scitex now felt that they had secured all their key markets, Japan included. The collapse of the Soviet Union and the beginning of the peace process in the Middle East led to a gradual easing of the embargo on Israeli products, the U.S economy was recovering, the Japanese economy was booming and new markets were opening up in Asia and Eastern Europe. Scitex increased its R&D expenditures on graphic printing processes in order to take full advantage of this wealth of opportunities.

Scitex confidently felt that it could recoup its massive R&D investments. Central to this confidence was its Japanese experiences. Scitex' joint venture with Toyo was going from strength to strength. Between 1986 and 1996, for example, sales in Japan rose from \$10,627,36 to \$110,211,000. Based on these figures, Scitex believed that the Japanese market was going to remain central to its growth. That said, they did recognise the need for change. Although local competition forced it to sell off some of its technology patent rights to Toyo in 1988, Scitex was looking for new ways to operate in Japan. Five years later, in 1993, they seemed to have hit the jackpot when they bought a black and white graphic division of Kodak.

Scitex used Kodak's market connections to institute a series of lucrative deals such as it signed with N.T.T, the giant Japanese telecom company, to provide Inject Digital systems to print NTT's bills for the local market. Scitex used Kodak's local salespeople to promote the company, while Scitex' management concentrated on the strategic side. As part of this process, an independent division of Scitex Japan was set up to capitalise on the opportunities presented by this new technology. One indication of the importance of this breakthrough was that sales from the new division, which had only 30 employees, exceeded the joint venture operations with Toyo, which tied down 160 employees. As a result of these cost disparities, Scitex started to minimise its joint venture operations with Toyo.

Scitex - Last Years of Independence

From 1996 to 1998, Scitex' global sales dropped dramatically from \$730,287,000 to \$640,000,000 world wide and in Japan from \$110,210,000 to \$64,573,000. Quite simply, when things were going well, Scitex did not make contingency plans for the inevitable downswing. The Japanese recession of the early 1990s, coupled with increased competition, undermined Scitex' market position. The high yen level - it soared 50% to reach 79 yen to the dollar at one stage - caused Scitex' operating costs in Japan to explode. The end result was that Scitex lost its commanding position in the niche market it had previously dominated.

Scitex Today

Scitex continues to thrive even though it will not reach the unrealistic goals set by earlier analysts and observers. Today, the company is a relatively complex maze of joint ventures and private divisions around the world. For example, it is engaged in a variety of operations with British Telecom, and the German printing company K.B.A.

Scitex and the Canadian based Creo company now operate jointly in many of Scitex' former activities, including the Toyo joint venture operation in Japan. Scitex also conducts several operations independently of its partners.

The Japanese Business World

Scitex' strategic map has to be inputted with the local Japanese business conditions. The structure of corporate Japan is such that innovation and imitation are ongoing. A company - least of all a small foreign company - cannot expect to hold on to a technological lead for long. The keiretsu system is structured so that vast amounts of funds can be channelled into applied research, even if there is no immediate prospects of a financial return. This is in contrast to the Western model, where planning and investment horizons tend to be concentrated on more short-term returns. Therefore, once Scitex' Japanese competitors saw that there was an evolving commercially exploitable technology, they developed competing products.

Although this scenario could be said to pertain to all large markets, Japan is an extreme case

for several important reasons. The keiretsu system allows Japanese firms to respond more quickly to competition and to adopt a longer-term view. In essence, this means that small, foreign firms such as Scitex cannot be expected to maintain a technological lead in Japan for long. Further, Japan's management techniques, pioneered by such famous companies as Toyota and Sony, guarantees high production quality. When coupled with their ability to simplify a complicated technology, they are often able to refine, modify and improve on competing models and do so at a cheaper cost. The message for Scitex should have been clear. They should not have expected their Japanese competitors to allow them to rest on their laurels.

This Japanese competition at the micro level is reinforced by Japan's corporate strategy at the macro level. Japanese firms tend to emphasise long-term relationships and considerable time and expense is invested in cultivating links, which are expected to bear fruit over time. In the case of Scitex, this meant that a superior product was not enough. Their small size meant that they could not cultivate the all round relationships that are such an integral part of corporate Japan. This left them exposed to their Japanese competitors.

In the early days, this did not seem to matter so much. There was no local competition factor and Scitex had a superior product. The only competitor for Scitex in the early years was 'Hell', a German company. The market was large enough to allow both companies to grow without fear of being outflanked by domestic competition. Even so, Hell has since been taken over.

Scitex was not ignored either. Its halcyon days ended in the mid 1980s, when Dainippon Screen (D.S), a local Japanese company, developed products that could compete with all of the Scitex products sold in Japan. (The issue of copyright violation, which was so prominent at the time between the USA and Japan will not be discussed here). Unlike Scitex, D.S had the advantage of a more intimate knowledge of the local market's needs, which was less focused on Japan. Whereas Scitex was tending to the diverse needs of Americans, Israelis and Europeans, as well as the Japanese, DS tailored everything, from its programs and operating systems to its paper size, to the needs of the local market. D.S also had the advantage of being a local company with a broader and more diversified market share than the Israeli company, which was limited to Toyo's narrower range of contacts. Whereas the Scitex joint venture company had to buy its products from Scitex Israel and pay for the costs and inconveniences of importing them, D.S could produce its products in Japan. This meant that D.S. not only had cheaper and more efficient logistic lines but it was more in tune with the needs of its clients. Scitex were clearly in trouble.

D.S. was only the beginning of the competition. Bigger firms were to follow, including Fuji Film, a part of the giant Fuyo keiretsu. Fuji Film had long been providing chemicals and negatives to the local printing industry. In true Japanese fashion, it had also been providing a range of other services to its clients to guarantee its own market share. As part of this process, Fuji Film developed technology similar to the one Scitex was selling in Japan. However, unlike Scitex, it provided the machinery to its clients at 'cost' prices.

This allowed it to solidify its long-term relationships. It should have also relegated Scitex to eventual oblivion.

Scitex, however, saw how the market was evolving and took appropriate measures. They saw that their technological lead was fast evaporating. Although Scitex was still manufacturing machinery and providing services to Toyo's clients in Japan, it wanted to eliminate unprofitable production lines such as the one it sold to Toyo for \$1.5 million.

This made sound sense by Western opinion. It allowed Scitex to deal with the evolving technological developments in the graphic world as well as the threat the growing use of personal computers presented to its core business. As part of this realignment, it started to reconstruct its production lines and R&D operations in order to regain technological advantages in newer areas.

Though it made sense by Western standards, it made less sense by Japanese ones. Toyo bought the product to solidify its mutual obligations to previous buyers of Scitex products. Whereas Scitex were thinking over the short term, Toyo were working to a much longer time scale.

The Kodak Opportunity

The Toyo alliance had proved very beneficial to Scitex, allowing it to gain valuable experience of the Japanese keiretsu system. Scitex was to later turn this experience to advantage by operating independently in Japan. Quite simply, the Japanese are formidable competitors, most especially in Japan itself. At the time, the idea of a small, foreign company carving out a niche market for itself seemed remote in the extreme. Chastened by its experience, Scitex was looking for ways to expand its market share beyond Toyo's limited sphere and to increase its profits by operating as an independent provider of its new products. As part of this process, Scitex opened a new office in Tokyo, which was not part of its joint venture with Toyo and which used a separate sales staff to promote its solo activities in Japan.

In 1993, Scitex bought one of Kodak's divisions - a black and white ink injecting system. Scitex attached the new purchase to its independent Nihon Scitex operations, and it began promoting the product using Kodak's existing relations in the market. One of the system's buyers was N.T.T, the former Japanese telecommunications monopoly, which used the system to print its telephone bills.

This venture proved to be very lucrative. Therefore, although Scitex continued with its joint venture operations with Toyo, it saw its major profits coming from solo operations in the future. Scitex used its decade of experience of corporate Japan together with Kodak's deep penetration of the local market to crack new market fields and make increased profits. Today Scitex continues to operate with Toyo but it is also increasing its solo operations with its Kodak related products.

Scitex' Joint Ventures in Strategic Profile

As part of its international strategy, Scitex embarked on a series of joint ventures with firms such as British Telecom, Creo and Toyo. With the exception of its Japanese adventures, all of these joint ventures were based on the western economic concepts of developing new technologies and expanding market share by creating joint R&D operations and continuously exploring new market shares and customers. For its Vio graphic world Internet site, Scitex joined British Telecom, who provided the telecommunications and Scitex provided the graphic technology. With the German K.B.A printing company, Scitex provided the software and the German company provided the hardware. In Israel, meanwhile, an advertising company was helping Scitex to develop public printing machinery and Creo used Scitex's global marketing abilities and advanced graphic technology to upgrade its performances in the international arena.

Although all of these were based on sound Western strategic reasons, Scitex' Japanese alliance was not. Scitex had been looking for a local business guide and sponsor while Toyo was interested in benefiting from Scitex' technological innovations in the printing industry. Lack of effective competition allowed both firms to make sizeable profits until the mid 1980's. This pattern was reversed in the mid-1990s, when the competitive nature of corporate Japan reasserted itself. At this time the Japanese recession hit the printing industry particularly hard. The recession, coupled with increased competition, weakened the alliance between Scitex and Toyo. Their differing perspectives towards customer loyalty would also put a strain on their alliance.

The recession accentuated the differences in their strategic approaches. One pertinent example occurred in 1988, when Scitex stopped selling electric circuits, which were produced to support its products. They did this for the sound commercial reason that local Japanese companies, like Matsushita Electronics, were providing a better and cheaper product that matched their systems' needs. Toyo responded by buying Scitex's production line; they did this to ensure a continuity of supply of circuits and technological services for their former customers. Toyo's engineers continued to service the needs of their former customers, even though they had abandoned Toyo for cheaper rivals. Toyo, in other words, continued to act as a traditional Japanese company, whereas Scitex were trying to concentrate on the bottom line, as understood in the West. This was a strategic misfit.

In general, Scitex is concentrating on developing new technologies, and selling those technologies into receptive markets at a premium. As part of this process, it tries to phase out its older technologies as quickly as practicable. Although this would be a common business practice in the West, in Japan it runs the risk of alienating clients. In a joint venture, such as the one Scitex has pursued with Toyo, it runs the risk of straining the relationship. Scitex could not impress on Toyo that continuing to supply obsolete parts made them uncompetitive. Toyo, cosseted perhaps by Japan's keiretsu system, could not appreciate the need to abandon the old for the new and to shed a few customers in the process. Scitex did not see the need to emulate Toyo and incur long term losses to ensure long term customer

loyalty.

Japanese Sales Staff and Scitex

Japan presents a myriad of challenges for the small to medium sized foreign firm. Most apparent are the barriers to entry. These barriers include the Japanese corporate culture and the Japanese language, which ensures that Japanese sales staff will have to be employed. Japan does not have many lawyers and contracts are generally vague and verbal in nature, cemented more by personal contacts and long term agreements than by dry legal codes. Success is therefore dependent upon developing personal relations and that takes considerable time. It also takes a commitment to be able to share the good times and the bad and to share the costs of downturns and technological changes. From Toyo's perspective, Scitex were slow to do that.

The Toyo alliance initially allowed Scitex to evade most of the considerable problems dealing in a very foreign and unique business culture such as Japan would have otherwise presented. The increased competition of the mid-1980s strained this relationship. Toyo were primarily interested in only promoting Scitex' products to their own customers and were reluctant to commit resources to seeking new customers. As a result, Scitex lost considerable market share when D.S and Fuji entered the market. Scitex, however, were able to build lucrative new ventures on the back of its Kodak related ventures.

The Implications of the Scitex Case

Scitex was an Israeli company that managed to make inroads into corporate Japan at a time when the Japanese need for Arab oil made Israel unpopular in Japan. Furthermore, Scitex faced the considerable barriers to entry presented by Japanese corporate culture and epitomised in the keiretsus.

Scitex survived mainly because it was able to transform the initial advantage of its technological edge, into a valuable alliance. The alliance in turn gave it the necessary time window to establish a viable presence in Japan.

Summarising Scitex' case in Japan we may highlight the following actions the company took to enter and later to survive in the last 20 years:

1. Scitex chose a local company to enter Japan's market, bypassing the problems the keiretsu-dominated business culture unique to Japan would have otherwise presented. This alliance also helped to neutralise the disadvantage of the company's relatively small size.
2. The Toyo alliance gave Scitex credibility with other Japanese companies.
3. The company could streamline its operations when the Japanese recession was at its most severe. This put a strain on its relationships with Toyo.

4. The damage was contained because Scitex could develop new areas of business.

Japan is changing and Scitex is changing along with it. That said, traditional business culture dominates Japan's policy and relations. The keiretsu and the unique trust codes, which are derivatives of its business culture, remain key factors to understanding corporate Japan. Even after the penetration stage, a foreign company is exposed to sustained competition from local Japanese companies, which can eliminate its initial advantages. Scitex, like all foreign companies in Japan, will have to continue to evolve if it wishes to survive.