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## Case #2: International Economy

### NETWORKS: ASSET OR LIABILITY

Tom Brown braced himself as the JAL plane made a perfectly smooth landing. Narita Airport. As the plane pulled to a stop he again felt reassured at Japan's ability to perform. Despite the recession, Japan was still Japan, he mused, remembering JAL's genial service, tasty food and beautifully designed footrests. AMERICAN ELECTRONICS was betting on Japan's capability to make a comeback. Now was the time to invest and invest big.

Tom contemplated his assignment. It wasn't going to be easy but then Jim Blaire's assignments never were. "I've watched you Tom. You have an engineer's eye for detail, a lawyer's mind for argument, and an AMERICAN ELECTRONICS man's 'can do' mentality. You're my man." Jim Blaire, President of AMERICAN ELECTRONICS, had said these words while standing in his office high above New York overlooking the Hudson River. Tom had nodded, knowing that this was his chance to prove what he could do for AMERICAN ELECTRONICS.

Then Jim had thrown his classic Blaire curve ball. "I know you've been working hard on creating a wholly-owned subsidiary for us in Japan with Ito," he said in his man-to-man voice. "Ito is a good man. I worked with him for years when he was managing Sango Trading Company in New York. Ito knows our business and would make a great Japanese representative. Besides we've had good luck in the past with our wholly owned international business. But something new has come up and I want you to look into it."

Tom was openly astonished as Jim described the deal that Tim Jones, Managing Director of Morgan Ashley, had just brought him. In fact, he'd recently met Tim Jones to discuss AMERICAN ELECTRONICS's entry into Japan. Apparently Tim had just now gotten word that TOA, one of Japan's leading high tech companies, needed some outside cash and was willing to sell AMERICAN ELECTRONICS a 34% controlling interest in their SuperConductor Division (JAPAN SUPERCONDUCTOR DIVISION), headed by Mori. "We know Mori-san from his METI days. Quite a coincidence, Mori turning up as Executive Vice President of JAPAN SUPERCONDUCTOR DIVISION." Jim's voice dropped as he described the possibility of acquiring 34% for just 150 million dollars or even less. "Tim told me he thought of us first because you had recently met with him. Our plan with Ito would cost at least \$250 million – with no profits for at least five years. Compared to that the TOA option looks golden."

Jim went on to describe the JAPAN SUPERCONDUCTOR DIVISION opportunity as the ultimate insider deal. Alex Underwood, an up-and-coming Morgan Ashley investment banker, had been instrumental in bringing in the deal. “Alex is very bright, speaks Japanese, and played a key role when Mikoshi sold off its computer division last year,” Jim explained. “Tim and Alex didn’t want the whole world picking TOA over. That would be bad for morale at JAPAN SUPERCONDUCTOR DIVISION, so they’ve given us two weeks to look at it before they bring it to anyone else. They’ve got a \$12 million fee riding on this so don’t be surprised if Alex is pretty aggressive about pushing it. Morgan Ashley is doing great business in Japan helping US firms buy assets cheap.” Tom nodded. He knew Alex from a prior chemicals deal. Some piece of work, he thought, remembering Alex’s \$2 million dollar cut on that \$15 million dollar deal.

“But,” Jim repeated slowly as though validating Tom’s work over the last six months. “AMERICAN ELECTRONICS could also go it alone with Ito. Ito helped me sell into Japan when he was managing Sango Trading. Great guy! He’s in Tokyo with nothing to do. You know they force managers to retire much too early in Japan.”

Tom nodded. Ito and Mori. Both were compelling men. Mori had a wide range of experience, including a career at METI before coming to TOA as Vice President of its SuperConductor Division. Ito’s career in Sango Trading Company was equally impressive. He had worked with some of the best companies in Japan and in the States before that. Tom was elated. Either way he was sure he would be asked to be CEO of the whole operation, if he pulled it off well.

“Welcome to Japan,” the immigration officer stamped his passport and smiled. Minutes later Tom walked through the “nothing to declare” customs line and waved at Alex who’d come to the airport to meet him. Tom smiled but was already irritated. The last time they’d worked together he’d found Alex’s frequent repetition of his favorite phrase “34% and you’re golden” totally exasperating. Life wasn’t that simple despite the fact that 34% share ownership could confer total operating control of a Japanese company. *Déjà vu* all over again.

“Tom, good to see you,” Alex’s boyish face broke into a grin. Tom returned his handshake as Alex made arrangements with his driver in Japanese. Alex had come a long way. He’d come to Japan to teach high school English in the Japanese government JET Program and had stayed on. He had a business degree from Stanford University and had worked in Japan for Morgan Ashley for the last six years. Alex knew Japan. Everyone said that “The Japanese love Alex and Alex loves the Japanese.”

“We have a busy schedule,” Alex said quickly as they followed the driver out of the airport. On the way into Tokyo Alex described the array of meetings he had set up with different people associated with the TOA deal. In the morning Tom would meet with Mori-san, then TOA’s bankers. He had also set up meetings with other TOA managers and engineers, METI, and finally he had asked for attendance at a special TOA board meeting. “All in two weeks”, Alex said simply, as if the deal were done. “We begin with Mori-san for breakfast.”

Irritated already with Alex’s smug tone, Tom stared out the window at the Tokyo’s neon landscape. Tall buildings pushed against short ones—old merged with new. TOA was in trouble because it had borrowed heavily against the real estate that was still one of TOA’s main assets and real estates values had fallen. Like AMERICAN ELECTRONICS, TOA’s old product lines were declining in importance and it was counting on heavy investment in superconducting materials to make it a leader in this most promising new technology. But unlike AMERICAN ELECTRONICS, it had not taken advantage of the 1999 American stock boom to raise equity. AMERICAN ELECTRONICS had. They had raised over \$2 billion and were still sitting nearly \$1.5 billion as a war chest for new opportunities like this one. In contrast to this, according to Alex, TOA was selling a controlling interest in its SuperConductor Division (JAPAN SUPERCONDUCTOR DIVISION) to pay down some of its real estate loans and invest in its other main new business: fuel cells. Its plan was to use the funds to keep TOA solvent, concentrate on fuel cells where they had an even stronger technology position, and retain a significant minority stake in JAPAN SUPERCONDUCTOR DIVISION.

“You don’t need to worry about the future of TOA. It’s bottomed out,” Alex said with a smile. “You’re buying in at a bargain-basement price and your getting a lot of value-plus a network that can’t be beat. Besides, the whole Japanese economy is ready to pick up. Look around! Japan has infrastructure, education, discipline and design capability. It’s all here waiting to happen and AMERICAN ELECTRONICS is getting in on the ground floor. 34% and you’re golden!” Tom nodded.

Mori arrived promptly at 7:30 for their meeting in the Dai-Ichi Hotel restaurant. Tom was pleased that Mori had requested the meeting. They needed time together to go over JAPAN SUPERCONDUCTOR DIVISION’s plans in detail and determine what it was going to take to buy into JAPAN SUPERCONDUCTOR DIVISION, transform it into a free-standing company run by AMERICAN ELECTRONICS, and make it the undisputed industry leader in Japan.

“Well Tom, good see you,” Mori greeted him in his imperfect English. Alex has told me lot about AMERICAN ELECTRONICS and about you.”

“I’m pleased to be here,” Tom replied.

“I’ve arranged many meeting,” Mori said as soon as they’d ordered. “First meeting is with Hattori who is official of Niginko, TOA’s bank. Hattori is an old friend of mine from METI. He made *amakudari* at the same time as me three years ago. Niginko is TOA’s bank so we have continued our relationship.”

How nice, Tom thought, wondering what *amakudari* was.

“We Japanese have a custom,” Mori seemed to read Tom’s thoughts. “At retirement from companies, we bureaucrats often move to companies that we have regulated. Japan is a very wet place,” he laughed, criss-crossing his fingers. “We are all connected. Hattori and I worked on the National Superconductor Project at METI. It was quite natural that we both made *amakudari* to firms working in that area. Japan is like a family.”

Tom nodded slowly, thinking of his own family and all the secrets and tiptoeing that went on. His sister Nancy played the role of go-between with his parents, grand parents, aunts and uncles. No one discussed the fact that his brother was gay or that his father had two bankruptcies. The list went on and on. Mori’s Japanese family must be different, he thought, noting that Mori looked actually pleased when he mentioned his Japanese family.

Tom’s thoughts turned to Ito. On Tom’s recent visit to Japan, he too had discussed Japan as a family. “Just let me handle things, Tom,” he’d often said in his perfect English. “The Japanese system means that we Japanese know how to get things done. I’m used to helping Americans make their way here from my days with the trading company.” When Tom insisted that he wanted to meet the Japanese involved, Ito looked annoyed and he hadn’t set up any meetings. In contrast Mori seemed transparent.

By 10:42 they were at the Niginko bank. Tom was reassured by the warmth between the men and by Hattori’s apparent acceptance of AMERICAN ELECTRONICS’s interest in acquiring a controlling percentage of JAPAN SUPERCONDUCTOR DIVISION, taking pains to reassure Tom that the relationship between the bank and TOA was close, that they’d worked together for a long time and that despite the recession’s tight money environment the bank would continue to lend to JAPAN SUPERCONDUCTOR DIVISION. “We are very pleased that we own 10% of TOA—including JAPAN SUPERCONDUCTOR DIVISION—and we understand that TOA must invest in the future through R&D,” Hattori said softly. “We also understand that

Japan's future depends on energy. Superconductors are key to that. At METI there were many such government projects. Mori-san and I worked on some very good projects," he concluded.

Mori looked pleased and the meeting ended with Hattori's invitation to lunch at the bank's top floor skyline restaurant. The conversation proceeded smoothly over lunch. Tom learned that both men had studied economics at University of Tokyo and had entered METI within two years of each other. As the lunch progressed it became obvious that they knew each other's lives. Mori's son had refused to take a steady job after graduating from college and Hattori's son was currently studying in America after failing his university entrance exams. The men looked concerned about their children and the conversation was warm and accepting. After the lunch Tom felt better about the use of the word family. Perhaps this great family of Japan was different from any family he'd ever known. He had a great deal to learn about Japan.

Over the next two days Tom and Mori met with many people associated with the JAPAN SUPERCONDUCTOR DIVISION, ranging from managers to engineers to accountants, and finally a meeting with all the general managers. Most of the meetings were held in small groups or in pairs and the atmosphere continued to be genial. As they talked and reviewed documents, Tom was impressed that JAPAN SUPERCONDUCTOR DIVISION's plans made a lot of sense. R&D and engineering had been well funded. They had applied for more than 40 patents, some of which looked very interesting and one or two—that he was not permitted to see in detail despite their non-disclosure agreement—seemed to represent real breakthroughs. Their new full-scale plant was under construction and used the most modern designs in its equipment. Meanwhile, the test plant was turning out sample quantities of several kinds of wire and QC reports showed that they were achieving reject rates of under 2%—much better than the 15% to 20% that CVX was achieving on its best days. The sales force managers believed that they could ramp up sales rapidly to over \$100 million in 2 years and \$500 million in 4 years. Not bad, Tom thought, with expected profits running at 20% of sales.

Tom was surprised that so many people knew that CXD was considering becoming the controlling shareholder in JAPAN SUPERCONDUCTOR DIVISION and was impressed that managers were more concerned with their customers than their own benefits. It doesn't make sense, he thought, as he waited for an aggressive question about how the firm would be managed or about employment security, but that question never came.

Tom also met with some key TOA suppliers. He expected that, given the economic situation, JAPAN SUPERCONDUCTOR DIVISION might be cutting back its orders and the meetings would be tense. He was aware that TOA had factories for some of its older products in Taiwan, Thailand and China. He also knew that TOA had contributed funds and equipment to universities in the region, guaranteeing access to their centers of technological excellence. So he assumed that TOA was ordering cheaper parts from these countries.

AMERICAN ELECTRONICS too wanted to expand its supply chains in Asia and that had been a reason for wanting to invest in Japan.

Much to Tom's surprise, the meeting with suppliers was amicable. They took place at factory sites and Tom was impressed with the up-to-date equipment and the familiarity with which Mori was greeted. Manager, accountants and engineers answered Tom's questions. Finally at a small SONE factory in Kanasawa, Tom turned to Mori. "Ask the manager if his orders from JAPAN SUPERCONDUCTOR DIVISION have been cut back since the downturn. Ask him how he remains competitive with lower cost products from Asia.

The manager, Sato, smiled and answered Tom's questions with considerable knowledge of TOA. He had been a TOA executive, Sato explained. TOA was a 10% shareholder in SONE. Many of his managers and engineers had also worked at TOA and this made for a good working relationship between SONE and TOA.

Tom sat back. He'd heard of the close relations between subsidiaries and the mother company, but he had not expected that it would be this tight. Using the same tone as the bank manager, Sato kept repeating that TOA and SONE were like a family, with shareholding by TOA, use of the TOA distribution system, even buying trucks from the same vendor at TOA's negotiated price. Everyone left the meeting smiling.

With considerable effort between meetings with TOA, Tom met daily with Ito to continue his exploration of the plan to set up an AMERICAN ELECTRONICS subsidiary. They confirmed most aspects of the plan and developed details for several of the key budget items. In all, Ito expected that a start-up could be on line in two years with the investment of about \$200 million, plus some \$40 million in Japanese government grants that had already been promised. Ito was certain that he could induce the key engineers and managers he had identified to join the company. Following American practice, he would use stock options to attract them and he was sure they would respond. As they talked Tom felt very reassured about the quality of their plan.

Ito knew the technology very well and his plan reflected this knowledge. He would immediately build a team of 40 top engineers around a core group of well-known professionals and top researchers who were close

to retirement age and had worked on the National Project. They were tops in the field and had been named on many patents.

Then he would create a small pilot plant, just outside Tokyo, in an area where there were many experienced metal workers, jet engine machinists, and hydraulics workers who were currently unemployed or looking to change jobs due to the economic downturn. They could be quickly re-trained for superconductor cable production.

Finally, he would recruit a top notch, high-level sales team from among soon-to- retire aerospace and telecom executives he knew well. They had great contacts throughout Japanese industry. Tom was impressed. The budgets looked solid. Ito had thought of everything.

They went for dinner almost every night, then out for late drinks. Ito spoke openly of his conflicts in coming back to Japan. His wife had stayed in America and refused to join him for two years. Only when he threatened to cut her off financially did she return and they were now doing well together. Meeting late at night, Tom felt fully relaxed listening to Ito's troubles and plans expressed, in perfect English, but he continued to be concerned about Ito's hesitancy in sharing contacts. But Ito insisted, "Only a Japanese can understand."

From the start Alex had dismissed Ito as a professional who had worked for a second tier trading company, who "had spent too much time in America". He had little respect for someone who did not come from a first rate Japanese university. Several times Alex had emphasized that trading company professionals would be reluctant to share their networks. Sadly, Tom realized, Alex might be right. It was going to be hard to assess what it would really be like to put Ito in charge.

Two days before Tom was to leave Japan, Mori arranged for Tom to attend the TOA board meeting. These meetings were held quarterly and the board was pleased to have Tom present. Tom was delighted. He was given translated copies of the all the meeting documents and as he studied the background of the members carefully he was surprised to find that the board was made up entirely of TOA insiders. It was astounding, he thought.

The board meeting was held at 2 pm in the main down town office building. All twelve board members attended. Tom was introduced by Saito-san, the chairman, and provided with a personal translator. "You've come a long way baby," he thought to himself. Saito-san gave background on Tom and his company and



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The morning of Tom's departure he met Alex for breakfast. Alex's business like face made Tom immediately resentful. If it weren't for Alex, he would have never have been introduced to TAO and would have happily signed a contract with Ito. They would have set up AMERICAN ELECTRONICS KK office and Tom would have been president of AMERICAN ELECTRONICS KK.

"Tom," Alex began in a low sympathetic man-to-man voice. "TOA is still interested."

"In what?" Tom asked incredulously.

"In the deal," Alex's voice dropped to a whisper. "They will sell for nothing—nothing. We can get 34% for 50 million or less. Saito got the ax. There will be a new chairman Fuji-san tomorrow. It's the deal of the century," he repeated.

"Alex, what are you talking about?" Tom said harshly. "AMERICAN ELECTRONICS is a credible company. We don't hide defects. We are honest and stockholder sensitive. We believe in our products and what we do. I know that the engineers at TAO blew the whistle. That's good. But the situation looks rotten through and through. Too many connections in this famous Japanese family."

"Ford?"

"What?" Tom asked.

"Tires? Or was it the Ford engineers?" Alex lowered his voice again. "Everyone knew. But Ford is America's best."

"Well, I'm not in the business of buying Ford either."

"Think it over, Tom," Alex said softly. "You can't do better than TOA. This recession is a window of opportunity. The TOA cover up compounded that opportunity. The price is nothing. Do you think your going to change the way the world works? Be smart. Change with Japan's best—be on the inside—move with the flow—don't miss this chance!"