Reinventing Quality, Round Two— A New Twenty-First Century Business Model?

Thirty years ago, leading Japanese companies reinvented quality. Now they are doing it again. Only this time, an unanticipated driver is at the core–a new business model grounded in environmental and social realities.

The whole world knows that several decades ago Japanese companies (heeding Deming's advice) reinvented quality and beat America to the punch. In hindsight, the formula was so simple: treat all defects as waste and change your processes to prevent defects in the first place.

Leading Japanese companies are at it again. But, as hard as it is to imagine, this time the implications for U.S. businesses and companies in the rest of the world may be much more significant.

What is the driver? A new business model grounded in twenty-first century environmental and social realities.

Japan's Insight

NEC, the computer maker, aims to be "climate neutral" by 2010 and is already five years into a major transformation to deliver on this promise.

Climate neutral? NEC wants to reduce the full life-cycle environmental impacts of its products and (increasingly) services—both manufacturing *and* customer use of its products. The very idea would boggle the mind of most U.S. CEOs.

What's Going on Here?

Leading Japanese companies view the world as an island. They see decoupling revenues and profits from life-cycle environmental impact as fundamental to twenty-first century success.

A few U.S. companies have recognized this already. They are anticipating the future pricing of resources (water, soil, carbon, etc.) that are now regarded as cheap or even free. But most U.S. companies remain in the dark.

CEOs who get this before their competitors will be tomorrow's winners. Does that seem a bit farfetched right now? We don't think so. Instead, it sounds like smart business.

Formula for Transformation

For the past 5-10 years, leading companies and their advisors have been talking about new, more "sustainable" business models. They have focused on how to transform businesses that have been successful in the past into reinvented ones that will drive success toward 2020...or thereabouts.

Industry has seen a lot of talk—and some action. For the most part, however, this has bred thick "sustainability" reports and a lot of confusion:

- Many early leaders (Monsanto, Interface, Ford, Shell) have stumbled.
- Other early leaders (Electrolux, Unilever, Xerox) simply became quiet.
- A few visible leaders (BP and DuPont among others) still garner their share of skepticism.

So when will the winning formula become clear? The solution is starting to emerge, not from a single company, but rather from leading practices of multinational technology companies, led by the Japanese. This formula has five key elements.

The Winning Formula

1. Look 2020, not 20/20
2. Get environmental governance right
3. Set very bold long-term goals
4. Build full environmental life-cycle planning and accounting systems
5. Rethink communication

1. **Look 2020, not 20/20.** While Wall Street and U.S. executives look with zest at last quarter's results, Japanese electronic equipment manufacturer Ricoh looks ahead: "*Global environmental conservation is the most important issue that all of mankind must face.*"

Japanese companies see huge growth opportunities in China, and recognize that the twentieth century oil-based model is coming unglued. So these companies are reinventing themselves to radically reduce the full life-cycle environmental and social impacts of their products and (increasingly) services per dollar of sales.

2. **Get environmental governance right.** In November 2004, the *Financial Times* ranked Toyota as one of the top three global companies on governance (along with GE and IBM). Toyota was also rated in Japan as having the best environmental brand image. Toyota also bypassed Ford as the #2 U.S. car maker. Is there a connection here?

   Toyota and other Japanese leaders (like DuPont and GE in the U.S.) are driving CEO-led initiatives that engage the board, spur radical innovation, change the culture, and completely rethink environmental and social assurance systems.

3. **Set very bold long-term goals.** NEC's "climate neutral by 2010" goal is backed by new business offerings (e.g., PC Refresher Service), mandatory employee training, and a range of new "Eco-IT Solutions."

   Canon wants to lead the manufacturing industry *worldwide* in using resources efficiently and preserving the environment. Canon and Sony have set 10-year goals to cut life-cycle environmental impacts per dollar of revenues and profits by 50%. And they are tracking progress toward the goals.

   Forward-thinking Japanese companies are developing new technologies. Tokyo Gas, for example, has co-developed the first fuel cell cogeneration system for residential use that employs a polymer electrolyte fuel cell.

4. **Build full environmental life-cycle planning and accounting systems.** Japanese companies are years ahead of U.S. leaders in identifying, planning for, and quantifying environmental impacts. In 2001, Japan's Ministry of Environment issued Environmental Accounting Guidelines. NEC, Canon, and Sony have gone a big step further to quantify and reduce full life-cycle environmental impacts. The formula is simple: increased sales and profits, and a smaller environmental footprint. The best U.S. companies (e.g., Baxter and IBM) are far behind Japanese companies in what they publicly report—which wasn't always so.

5. **Rethink communication.** Canon devoted up to 40% of the opening pages of its latest annual reports (we're not talking here about its sustainability reports!) to the environment. In stark contrast, most U.S. annual reports note EHS as a token page at the back of the report.

Conclusion

For more than a decade, U.S. companies have stumbled again and again as they tried to turn themselves into sustainable companies. In fact, no clear success models have emerged. Moreover, most signals from Washington and Wall Street run counter to global environmental and social trends. As a result, most leading U.S. companies have muddled along, improving modestly environmentally while cutting costs.

Meanwhile, leading Japanese companies are taking the long-term view—while also seeing the huge growth opportunities in China and India. These companies have embarked down a leaner, fitter path that *some day* will seem obvious to others—especially U.S. companies.

Zero defects: round two. Déjà vu?

About the Author

Gib Hedstrom has 25 years of experience in helping CEOs, senior executives and boards of directors manage environmental and social issues to reduce cost, limit risk, and strengthen reputation and shareholder value. Mr. Hedstrom led Arthur D. Little's EHS auditing, strategy, and governance work, and also led the corporate environmental and sustainable development practices at PA Consulting. He founded Hedstrom Associates in 2004.

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