



The Internet in Japan: Catalyst for Change?

Executive Summary

Introduction

Japan's insularity and resistance to change have exasperated Japanese internationalists and reformers for nearly two centuries. However, notwithstanding the country's abiding conservatism, at a few key junctures in Japan's history, revolutionary reforms have been implemented with dramatic speed. A recurrent sense of falling behind the rest of the world has driven many of Japan's most successful economic and technological transformations, including the Meiji Restoration itself. Today many Japanese observers believe their country is on the verge of another such revolution – this one driven by a perceived lag in information technologies – that, if reversed through an embrace of the Internet and ecommerce, will lift Japan out of its protracted recession, sweep away obsolete economic arrangements, and catapult the country into a position of world leadership in information technology.

Evidence of Changing Established Structures

Japan's belated embrace of the Internet may well produce what some Japanese analysts are already proclaiming as a "paradigm shift" – a dramatic departure from practices and patterns of doing business that have characterized the Japanese economy since the War. There has been no shortage of predictions to this effect: "For scores of Japanese middlemen, then, the rise of the Internet industry threatens the end of an era," the Financial Times wrote last year.

Startling changes in the Japanese business world and in the broader society are indeed already observable. These developments reinforce the view that the country really is in the process of shedding the tangled array of outmoded practices, arrangements, and attitudes blamed by many for its current economic stagnation. Some of these changes include introduction of market forces into the financial system; unwinding of keiretsu relationships that have long constituted an impediment to mergers, acquisitions and other forms of restructuring; a far more receptive stance toward foreign direct investment, at one time viewed by bureaucrats and business leaders as a threat to be contained; potentially greater emphasis on more vigorous and transparent enforcement of the Antimonopoly Law in the telecommunications field; greater use by the Japanese government and corporations of foreign advisors, who traditionally have not been employed in a strategic capacity, to master the new Internet technologies; and a significantly augmented profile in the ebusiness realm for Japanese women, who have long found their business opportunities sharply curtailed.

Evidence of changing established structures is also apparent in Japan's new IT Basic Strategy and Basic Law, which embody the Japanese government's strategy for promoting Internet usage in Japan. They represent a departure, in one very substantial respect, from most of the industrial promotion programs Japan has implemented since the end of the Occupation. Japanese industrial policy has traditionally been characterized by government guidance of industry with respect to investment, research targets, "industrial structure" (e.g., the size of enterprises and their interrelationships) and the relative intensity of domestic competition. Japan's new information technology strategy, by contrast, emphasizes three features: that the anticipated growth in the IT sector be private-sector driven, that there be market-based competition, and that there be transparency of administrative rules. The government's stated role is merely to ensure that free and fair competition can occur and that the adoption of the new technologies not be impeded unnecessarily by existing laws and regulations; a feature which has mandated revisions to dozens of laws in 2000 and 2001.

The promotional measures implemented in conjunction with the IT Strategy and Basic Law and some others implemented earlier, are consistent with this departure, and are thus far focused on support for research and development and the funding of basic infrastructure, such as the fiber optics network. Certainly, this

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government involvement in creating the broadband environment will make Japan's broadband environment distinguishable from that in the United States. As a result of this involvement, Japan's broadband environment may be far more heavily weighted toward non-PC "information appliances," in which Japanese manufacturers excel, and toward B-ISDN as a leading broadband distribution technology. Japan's broadband environment is likely also to involve much quicker adoption of mobile broadband access and to continue to feature Nippon Telephone and Telegraph (NTT) as the dominant player in providing broadband distribution services, in contrast to the United States where the broadband distribution market is more highly fragmented. Japan's investment in broadband will work to the advantage of many local and foreign firms whose commercial strategies are based on, in whole or part, ecommerce. The current policies, if implemented according to the three-pronged framework established in 2000, will be not unlike the market-driven information technology policies that have been pursued by the United States with spectacular success in the 1990s.

Finally, one of the clearest indicators of the government intention to use the Internet to promote fundamental change in Japan is its undertaking to enact new laws to promote ecommerce and its massive revision of existing laws to clear away regulatory impediments to ecommerce. By all accounts, these legislative initiatives represent the potential for radical change as they are intended to increase online commercial activity. Recent legislation introduced or enacted with the intention to boost consumer confidence and promote a safer environment for online commerce includes the Digital Signatures Law, which will come into effect in April 2001, and the Ecommerce Contracts and proposed Basic Privacy laws, which will be considered by the Diet this Spring. In addition, an unprecedented number of laws have been, or are currently being amended. According to a recent survey by the Japanese government, no less than 124 laws and 733 regulations circumscribe Japanese business activity on the Internet, where they have been perceived to impede the growth of ecommerce. Japan's restrictive domain name policy, for example, which limited the number of domain names an entity could register and the transfer of domain names between parties, is being slightly relaxed. The E-notification Law, passed in 2000, amends some 50 laws to facilitate ebusiness transactions. Among them, noteworthy amendments with clear potential to boost online activity across sectors include the Door-to-Door Sales Law, which will allow email to serve as hard copy confirmation of many purchases, and the Installment Sales Law, which will allow cardless purchases.

Some Established Structures Remain Unchanged

Notwithstanding these numerous signs that Japan is undergoing fundamental change, it is not at all clear that the paradigm-shattering, Internet-driven upheaval sought by the current generation of reformers will actually occur. The advent of the Internet is destabilizing to a number of domestic vested interests, and, if the past is a guide, existing dominant players will not passively accept their own obsolescence. Threatened constituencies may, and some are, resisting rapid change or are seeking to gain control of the new technologies in a manner that minimizes disruption of established relationships and arrangements. In the telecommunications sector, which must provide the infrastructure for the diffusion of the new technologies, the abiding dominance of NTT raises significant questions as to whether the highly competitive, Internet-driven economy envisioned by the reformers can actually be achieved.

Most of the Japanese leaders who are promoting ecommerce as a means of restructuring the economy regard the relative lack of competition in the telecommunications sector as the principal impediment to reform and the country's efforts to utilize the new technologies to revitalize its economy. In the trenchant words of Sony's Nobuyuki Idei, "the government has talked loudly about the proliferation and uses of the Internet, but has done nothing about the Law on Nippon Telephone and Telegraph." NTT's comparatively high wholesale interconnect fees and local phone fees have kept more users from logging on in Japan. And it has been charged that NTT has impeded market entry by rival DSL service providers. NTT's defenders point out that higher interconnection charges have funded massive investments in research and development and is providing Japan with a state-of-the-art telecommunications infrastructure. NTT has indicated a readiness to be flexible with respect to interconnection charges, which are being reduced, but that it does not wish to cut those charges

so drastically that its ability to undertake such investment is undermined. And, in defense of Japan's telecommunications policies, it is posited that Japan's leading position in mobile communications is attributable, in substantial part, to regulatory policies that produced a single wireless standard. NTT Docomo's rise to the number one ISP position in Japan in just eighteen months, by providing a proprietary, mobile Internet experience largely walled off from the traditional open Internet, is perhaps the best example of the unusual twists which growth in Japan's Internet economy have taken as a result of regulatory policy.

Evidence that established structures and relationships are not being wholly refashioned is emerging in certain areas of online activity as well. Notwithstanding predictions by Japanese and Western observers that the Internet signifies the end of an era of middlemen, the advent of the Internet has produced only mixed results in transforming the distribution of consumer products. The outsized influence of convenience stores, a regulatory legacy of the *Daitenho*, as a centralizing dimension by virtue of alliances with large Japanese trading companies in Japan's B2C segment, is not apparent in the highly fragmented U.S. B2C market. This dynamic represents another twist, rather than revolutionary change in established economic relationships, as Japan's large trading companies embrace the convenience store initiatives for strategic purposes. In so far as convenience store trading company alliances represent old economy players refashioning themselves as new economy players, they do not represent evidence of a paradigm shift. Another such example is online book sales, which embody features characteristic of a number of consumer product segments, where new market entrants, including high-profile foreign online booksellers and domestic firms unrelated to the book industry, would suggest the possibility of significant potential change, but where established structures appear at this stage to remain largely unchallenged. Of the approximately 17 ebook sites that currently dominate, none, alone or in combination, has led a successful challenge to the Resale Price Maintenance framework that prevents discounting of books in Japan, the glue which has cemented existing publisher-supplier relationships in Japan's book industry since shortly after the War.

Finally, despite the fact that numerous aforementioned legislative initiatives are both welcome and necessary if the Internet is to act as a catalyst for change, in some areas where legislative or regulatory reform could have occurred, there still appears to be room to go further. The failure of the revised domain name policy to abandon the physical presence requirement; or the failure of the E-Notification Law to go the next step in amending all 83 laws previously under investigation, including, for example, the Money Lending Business Law, which governs online lending activity, and the Law Pertaining to Used Goods, which affects online auctions, are both examples of how regulatory revision still needs to go further if the stated objective of unleashing the power of the Internet is to be achieved.

Conclusion

Japan is at a critical juncture. Japan seeks to embrace the Internet and ecommerce to lift it out of its protracted recession, sweep away obsolete economic arrangements, and catapult the country into a position of world leadership in information technology. The Internet currently presents an opportunity to do so not available at any other time during Japan's "lost decade." This new environment may open up unprecedented opportunities for new market entrants as well. At the same time, the advent of the Internet is potentially destabilizing to a number of domestic vested interests. If, at this critical juncture, the incentives for change are insufficient, the opportunity presented by the Internet and ecommerce may be lost.

Dewey Ballantine LLP's International Trade Group (www.dbtrade.com), based in Washington, D.C., includes a "think tank" function which produces analytical studies and offers economic consulting services with respect to foreign markets and government policies. The Group has analyzed the international trade and competitive environment in individual industries, as well as the trade, industrial, and regulatory policies of China, Japan, Russia, Korea, Taiwan, the European Union, Brazil and many other countries. Tom Howell, a partner, oversees a group of economists and trade specialists with foreign language and area expertise. Eight of the Trade Group's professionals are fluent in East Asian languages, including Japanese, Mandarin and Korean. Mr. Howell and Maki Hishikawa, the firm's Director of Japanese Research, are currently working on a book on the liberalization of trade and investment policy in Japan from the Occupation to the present, based on Japanese language sources. Jennifer Danner Riccardi, a senior associate in the Trade Group, most recently worked on a study entitled "The Horse Racing Industry in the Age of the Internet."

Cyberworks Japan (www.cyberworksjapan.com) maps the available Internet space for foreign companies going online in Japan. CWJ assumes that the Internet is a unique marketing route - a potentially open, efficient, and culturally neutral distribution channel - but that foreign firms will need more than technology for lasting success in Japan's online marketplace. Rachel Howe has specialized in research and analysis of Japan market access issues while Managing Partner of DSA Analytics, Trade Specialist in the International Trade Group of Dewey Ballantine, and Information Officer in the East Asia Group at the CIA. Ms. Howe holds a B.A. from Smith College, an M.A. from Yale University, and is an American Translators Association credited translator.

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The Internet in Japan: Catalyst for Change? provides a more complete understanding of the regulatory and business issues shaping the growth of ecommerce in Japan. Please note that the study is not intended for use as an authoritative treatise on Japanese law; rather, it is intended as a general guide outlining emerging issues in ecommerce in Japan. In addition, it should be noted that no attorney licensed to practice law in Japan reviewed the included summaries of Japanese law.