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Emerging Power Builders: Japan's Transitional Housing Industry after the Lost Decade

Daisuke Sasatani, Ivan Eastin and Joseph Roos. 2010

Executive Summary

This study presents exploratory research about the transitional Japanese home building industry. The Japanese housing industry changed significantly during and since the “lost decade” of the 1990s because the business environment changed dramatically. The main goal of this study is to classify Japanese builders by their business strategies and business behaviors in order to provide a useful market segmentation strategy for forest products exporters targeting Japanese markets. In order to do so, we first collected extensive secondary information on the background of the Japanese housing industry. Then we surveyed Japanese large builders and analyzed the data.

After its bubble economy burst in the early 1990s, Japan experienced a serious economic slump that lasted over a decade. This period is called the “lost decade” in Japan. During the lost decade, Japan experienced deflationary pressure on land prices, securities, and consumer goods. The Bank of Japan set the interest rate essentially to zero in order to stimulate the economy, and the overnight call rate is still very low. In the past, Japan practiced unique business customs including *keiretsu* and interdependent collusion between politicians and business, which undermined competition. In order to recover from the economic slump, it was necessary to reform inefficient business practices in Japan. Although political uncertainty between reformists and anti-reformists within and outside the Liberal Democratic Party remains, Prime Minister Koizumi was able to reform some business practices and influence the vertical *keiretsu* structure, which has been weakening. As the market continues to liberalize, there should be fair competition for all participants, including small- to mid-size enterprises and foreigners, in the Japanese market. These socio-economic changes have contributed to the reform of the Japanese building industry and, as a result, some small- to mid-size builders have grown quickly.

The Japanese residential housing market underwent substantial change during the lost decade as well. The Kobe Earthquake in 1995 led to major changes in the Building Standards Law (BSL), which accelerated the adoption of pre-cut lumber. Pre-cut lumber allowed mid-size builders to lower the cost of post and beam (P&B) construction through labor efficiencies and reduced waste. Many mid-size builders contracted with *komuten* (small builders) or independent carpenters to expand their businesses. Demographic changes have also played a huge role in the changing housing market in Japan. For example, Japanese Echo baby boomers started buying their first homes, and some mid-size builders targeted their homes to this large population. Deflationary pressure on land values allowed builders to acquire large parcels of land in suburban Tokyo. Builders then subdivided these parcels and built tract spec P&B houses. Those builders were called “power builders,” and many small- and mid-size builders all over Japan have adopted their business strategy to survive.

The survey results show that many mid-size builders call themselves power builders, but we failed to find statistical significance of a common business strategy among power builders. Over the last few years, many small- and mid-size builders have tried to imitate the business strategies of the original power builders and to emulate one another in order to survive. However, it is not always possible to copy an entire business strategy from other firms. The power builder strategy is currently little more than a marketing slogan used by many firms to attract price-sensitive customers. Yet builders who build a lot of tract houses and have grown quickly in terms of the number of houses that they build still tend to refer to themselves as power builders.

The most important success factor of builders between 2001 and 2005 in Japan was how many tract houses they built. Interestingly, the prices of the homes were not significantly different from those of fast-growing builders and other builders. Tract house builders service a significantly higher percentage of first-time home buyers and tend to build smaller houses than do custom house builders. Other characteristics of tract house

builders are that most prefer to use glulam lumber, and that they do not have a defined land acquisition strategy, tending to acquire any available land in suburban areas.

Since the original power builders' success in the industry has attracted many imitators and undermined the old market traditions of the housing industry in Japan, it is not useful to focus on the traditional builders categories when developing a marketing strategy. The traditional categories were: 1) national home builders, 2) regional builders, and 3) *komuten*. In order to reflect the changing nature of the industry, we propose four new strategic groups of Japanese builders: 1) premium big builders, 2) economy big builders, 3) mid-size regional builders, and 4) *komuten* (independent carpenters).

Firms in the same strategic groups have similar business models, so their supply channel choices can also be expected to be similar. For example, *Komuten* or independent builders typically construct only a couple of houses a year, and our survey did not cover them. Mid-size regional builders construct between 25 and 100 houses per year and prefer domestic lumber such as *sugi* or *hinoki*. They are focused on a local market and usually build post and beam houses. Economy big builders tend to pursue a low-end pricing strategy and this segment of the market increased at an average annual rate of 10.4% between 2001 and 2005. Economy big builders usually build post and beam houses and tend not to import lumber or building materials directly from foreign countries. Finally, premium big builders tend to build value-added houses; they are interested in adopting a marketing strategy based on design differentiation and prominent advertising. Generally, premium big builders sell their houses at a premium price, although their growth rate is less than that of the economy big builders. Some of the premium big builders directly import lumber and building materials from foreign suppliers.

Currently, economy big builders have a strong market share, and this market has grown very quickly. However, they will face substantial difficulties in the near future. The industry is currently going through a period of consolidation, since many builders have attempted to imitate the power builders' business models. In addition, many echo baby boomers have already purchased their own houses, so this market segment has begun to shrink. Further, the high volatility of the foreign exchange rate creates uncertainties regarding the supply of raw materials. Builders need to re-create their business strategies and adapt to this changing market environment. Their success in changing their business strategies will depend on their management capabilities. U.S. forest products exporters may be able to inspire them, thus enjoying mutual benefits.

Our exploratory research has derived the following strategies for U.S. forest products and building materials exporters:

- U.S. exporters should target economy, big builders.
- U.S. exporters need to approach pre-cutters as well as builders.
- U.S. exporters need to promote the structural performance characteristics of U.S. forest products.
- U.S. exporters need to ensure the reliability of supply to their Japanese customers.
- U.S. exporters should take advantage of the weak U.S. Dollar versus the Japanese Yen to offset slowing lumber demand in the U.S.
- US exporters always need to keep in mind that the business environment is dynamic.

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