

# Introduction: What Is Innovation?



## Schumpeter, Kirzner, and Christensen

**Abstract** This section serves as an introduction to this book, which discusses Japan's economic development by focusing on changes in the nature of innovation and framing them with the theories of Joseph A. Schumpeter, Israel M. Kirzner and Clayton M. Christensen.

### The Aim of This Book: Three Questions

This book aims to clarify the course of Japan's economic development by focusing on changes in the nature of innovation. To do so, I focus on activities of trailblazing entrepreneurs who became the standard bearers of innovation in Japan.

It is important for a business historian to show major economic development trends in the past along with contemporary entrepreneurs' activities. As a member of the academic community involved in the study of business history, I decided to tackle this fascinating task, while drawing insights from the work of my predecessors.

When looking back at the business history of Japan, there are three questions that need to be answered.

First, why was it possible for Japan to get on a growth path so early? True, the Japanese economy took off later than that of the Western industrialized nations but Japan's economic ascent was the earliest among late developers. What made this early takeoff possible? To answer this question, we need to turn back the clock to the Edo period when the prerequisites for an early takeoff were developed.

Second, once on a growth path, how was the Japanese economy able to sustain one of the highest rates of growth in world history over an extended period of time? Having undergone its own industrial revolution in the early twentieth century, Japan went on to maintain the highest economic growth rate in the world from the 1910s through the 1980s. This rapid growth, although temporarily set back by the defeat in World War II in 1945, continued for almost 80 years in total. It is important to identify the factors that explain this resiliency and constancy.

Third, after the prolonged period of relatively high growth ended with the burst of the asset-inflated economic bubble in the early 1990s, why has the post-bubble

stagnation continued to this day? The 1990s were dubbed the “Lost Decade,” but soon it became the “Lost 20 Years,” then the “Lost 30 Years,” and continues to date. Uncovering the true causes of Japan’s economic slowdown is an essential task for a business historian in order to explore ways to revive Japan’s economy.

## What Is Innovation: Three Views

To answer these questions, this book pays attention to the changing nature of innovation—first by clarifying what is meant by innovation. Broadly speaking, there are two distinct views of innovation: that of Joseph A. Schumpeter and that of Israel M. Kirzner.<sup>1</sup>

In a series of works, including “The Theory of Economic Development,”<sup>2</sup> “Business Cycles,”<sup>3</sup> and “Capitalism, Socialism, and Democracy,”<sup>4</sup> Schumpeter proposed a dynamic view of innovation whose central feature is “creative destruction.” His concept of innovation emphasizes a new fusion of: (1) development of new products; (2) development of new manufacturing methods; (3) cultivation of new markets; (4) cultivation of new raw materials markets; and (5) organizational renewal. Such innovation can be characterized as “breakthrough innovation” or “radical innovation”—one that destroys the existing equilibrium.

Alternatively, in his book “Competition and Entrepreneurship,”<sup>5</sup> Kirzner presents a view of innovation that assumes imbalance as an underlying condition, emphasizing a competitive process that aims for an optimal equilibrium. What is important is not the destruction of equilibrium, but rather the cumulative, gradual innovation process that creates equilibrium, or “incremental innovation.”

Of course, in real historical processes breakthrough innovations and incremental innovations can occur simultaneously i.e., these two distinct views of innovation can

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<sup>1</sup>The following explanation of views of innovation by Schumpeter and Kirzner is primarily from Abe, E. (1995). “Kakushin no gainen to keieishi” (*The concept of innovation and business history*) in Meiji University, Keiei ronshu (*Collection of papers on management*), 42(1). Note that in this paper, the term “kakushin (reformation)” is used rather than “innovation.”

<sup>2</sup>Schumpeter, J. A., (1977). *Keizai hatten no riron (jo) (Theory of economic development: A study of entrepreneurs’ profits, capital, credit, interest and economic rotation (I))* (Shionoya, Y., & Nakayama, I. & S. Tohata trans.). Iwanami Shoten Publishers.

<sup>3</sup>Schumpeter, J. A., (1958). *Keiki jyunkan ron (I) (Economic cycle theory: Theoretical, historical and statistical analysis of capitalism processes (I))* (The Japan Research Institute of Financial and Economic trans.; S. Yoshida supervisor). Yuhikaku Publishing Co., Ltd.

<sup>4</sup>Schumpeter, J. A., (1995). *Shihon-shugi, shakai-shugi, minshu-shugi (Capitalism, socialism and democracy)* (Nakayama, I., & S. Tohata, trans.). Toyo Keizai Inc.

<sup>5</sup>Kirzner, I. M. (1985). *Kyoso to kigyoka seishin: Bencha no keizai riron (Competition and business spirit: Ventures’ economic theory)* (Y. Tajima supervisor; M. Eda, I. Kobayashi, S. Sasaki, & T. Noguchi, co-trans.). Tokyo: Chikura Publishing Company. By contrast, Kirzner’s view of innovation prioritizes processes of competition toward optimal balance, assuming that imbalance exists.

coexist. Recently, however, a third, completely different view has emerged: “disruptive innovation,” advocated by Clayton M. Christensen of Harvard University in his 1997 book, “The Innovator’s Dilemma” (Harvard Business School Press).<sup>6</sup>

“Disruptive innovation” renders existing products obsolete and creates entirely new value, as opposed to incremental innovation that strives to continuously improve upon an existing product. Every so often, a low-priced new product is launched in a market filled with conventional products that are undergoing continuous quality improvement through incremental innovation. These newly introduced products are cheap, but their quality is so low that they are not initially taken seriously. However, the quality of such new products occasionally do reach a level that meets the minimum needs of the mass consumers in the market. At that point, the conventional, existing products still possess higher quality and price, but once the new disruptive product meets the consumers’ minimum needs, price competitiveness comes into play and the newcomer rapidly gains market share. Existing products then lose out devastatingly. This is the mechanism of “disruptive innovation” explained by Christensen.

Disruptive innovation, therefore, can be considered the “third view” on innovation, after breakthrough innovation and incremental innovation. In this book, cases with these three views of innovation in mind will be analyzed.

## The Book’s Structure: Three Time Periods

This book will analyze the process of Japan’s economic development from the Edo period to the present, with the entire process divided into three time periods.

First, Part I covers the Edo period through the postwar period after the Russo-Japanese War (1904–1905). The reason for choosing the post Russo-Japanese War period as the period’s end point is that Japan’s Industrial Revolution was completed around the latter half of 1900s. Part I examines the first question: “Why was the Japanese economy able to take off so early and get on a growth path?”

Second, Part II encompasses the second time period from the 1910s to the 1980s when the Japanese economy maintained a high rate of economic growth relative to other major economies, with the exception of the 1940s when Japan was engaged in, and lost, World War II. Part II examines the second question: “How was it possible for Japan’s economy to sustain high growth over a long period of time, a rarity in world history?”

Third, Part III covers the period from the 1990s until the present. When the Japanese economy came to a standstill in the 1990s, it was dubbed the “Lost

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<sup>6</sup>Christensen, C. M. (2011). *Inobeshon no jirenma: Gijutsukakushin ga kyodaikigyo wo horobosutoki zohokaiteiban (The enlarged and revised edition of the innovator’s dilemma: When technological innovation destroys a business giant)* (S. Tamada, Supervisor; Y. Izuhara, Trans.). Tokyo: Shoeisha Publisher.

Decade,” but the slump continued and before long it became known as the “Lost 20 Years” and even the “Lost 30 Years.” Part III examines the third question: “After the prolonged period of relatively high growth came to an end with the burst of the economic bubble in the early 1990s, why has the Japanese economy continued to stagnate to this day?”

Looking back at the entire process with the three types of innovation in mind, the first period can be roughly defined as the era of breakthrough innovation, the second as the era of incremental innovation, and the third as the era that was caught between breakthrough innovation and disruptive innovation. The reasons will be explained in detail following the analysis in each section.

Each part is further divided into three sections. The “Overview” section provides historical background for each period. The “Case Study” section profiles leading entrepreneurs and examines how they realized their innovations. The “Discussion Point” section highlights the characteristics of each period in terms of the nature of innovation. The book’s “Conclusion” summarizes findings from the various analyses offered throughout the book.

The “Case” sections focusing on the activities of trailblazing entrepreneurs comprise the central narrative. In business history and related academic fields, a vast number of case studies have been conducted on the innovative activities of entrepreneurs. While respecting the findings of case studies from existing scholarship, I add my own interpretations and finally articulate the broader historical picture. These are the quintessential methods that have underpinned the development of business history studies. Thus, I will first present the case study findings on the respective entrepreneurs from existing scholarship. I will then add my own interpretation to the best of my ability, to present a comprehensive picture of the history of Japanese innovation.

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