Strategic Management of Japanese Companies in East Asia

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Strategic Management of Japanese Companies in East Asia*

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Summary

Building foreign subsidiaries, Japanese companies were inclined to directly invest into locations covered with capsules which are prepared by East Asian countries under the condition of favorite fair wind that we call 'folklore of Asian economic development'.

The capsule means various ways to seal off the core business process from local environmental influences.

In the mid of 90's the folklores became hot and caused the boom of foreign direct investment into East Asian countries. However, the Asian economic crisis faded not only the folklores but also the capsule effect. Japanese companies were forced to rebuild their business process so as to adapt to local business environments. The relatively big companies that are resourceful enough to make the capsule by themselves are able to keep their strong control over the foreign subsidiaries, and still develop the ethnocentric management. But the regional small and medium sized companies with less management resources braked hard to a stop of foreign direct investment.

We conducted the research on what medium and small companies of the northern Kyushu went on their foreign business with their foreign partners in Korea and China without the capsule prepared by the government.

We found that some companies made up the unique management style through adaptation to the local environment in Asian country. We classified them into four management styles along the capsule effect and corporate governance. We think the process-oriented management promoted by voluntary action chains will implicate the important way of management for foreign subsidiaries of regional companies after the Asian economic crisis.

1. Globalization in Asia and Economic Folklores

(1) Favorable winds of foreign direct investment in Asia

After extremely rapid raise of foreign exchange rate of Japanese yen against U.S. dollar in the beginning of 1990s in Japan, it was said that the key word of 1990s' economy was "globalization". Although economic globalization became inevitable in Japan, it was impossible that every company developed global business all of a sudden. Such sudden foreign direct investment (FDI as abbreviation for foreign direct investment) caused a radical change of the management system.

As the radical change is apt to overthrow the established management system, a

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company will pay not only the cost of risk taking of new business but also the cost of failure of existing business. Therefore a company usually prefers to the incremental change as adaptive strategy against the big trend of globalization. However, a company should speed up the change of management style to adapt the globalization. It seems important that in anticipation of the trend of globalization a company elaborates the efforts for the change carefully (Kogut, 1989; Root, F. & K. Visudtibhan, 1992).

Japan was fortunate that she is geographically close to East Asia. Needless to say electronics companies and automobile companies which already developed large-scale production system there, small and medium sized companies thought that East Asia was very favorable countries for FDI to relocate their production overseas. East Asia shares the same kind of culture with Japan, and the total money needed for direct investment was small compared to U.S. and E.U. Japanese companies could bring the old machines after depreciation into the Asian subsidiaries. Before anything else, Japanese overseas companies could expect the stable business transaction with the subsidiaries of their parent companies. These conditions in East Asia brought such effects for small and medium sized companies as an incubator for the beginners and experiment room for trial of international management. These conditions promoted the incremental change of small and medium sized companies so as to catch up the globalization of business activities.

Three kinds of strong favorite winds blew from in side and out side Japan as the promoter of FDI in East Asia (Shiotsugu, 1995). One was the support of financial institute, because Japanese government pushed forward the policy that FDI was right to take a balance of trade. The companies which relocated their production system to East Asia could enjoy good business results under the condition of dynamism of economic activities by native firms and overseas. Only a few companies went wrong until the early '90s.

Another wind flew from East Asia such as "Look East Policy" of Singapore. Countries in East Asia tried to attract FDI from Japan for their economic development. These countries provided abundant labor force and factory sites with excellent infrastructure at the modest price, and applied favorable treatment of taxation for FDI. These favorable treatments sealed off the factories of foreign companies from local social economic conditions. The factories could enjoy good performance. As a result, East Asian countries realized rapid economic development as foreign companies start operations.

The third wind blew from China. The economic reform program has started since 1979. In terms of the open-door policy, based on successful result of pilot experiment of economic special zones in Shenzhen province, the Chinese government and local government began to construct a large number of economic development zones for FDI along the Chinese coast. Foreign companies could easily employ excellent young people at the low wage and even small foreign companies could get the factory site there.

China has begun to reform the managerial mechanism of enterprises. After the 14th National Congress of the Chinese Communist Party in 1992 the principle of market socialism was written into the Chinese Constitution. Along the marketization policy, tremendous means were taken as followings: reformation of state enterprise by separation of management right from state ownership and reorganizing it into joint-stock corporation, establishment of stock exchange market in Shenzhen and Shanghai, promotion of township enterprise development, use of market mechanism for distribution and labor market, and so on. Chinese economic reform policy was accelerated and the attraction policy of FDI was promoted more positively. Foreign companies have the special expectation to potentiality of domestic market with more than thirteen hundred million people.

(2) Economic folklores and Asian fever

As FDI in East Asia became active, economic folklores in terms of success story of Asian economic development seemed to be established in the middle of 90s.

Folklore is a tradition that has the interpretative function of unusual events behind the usual life. It contains irrational and mysterious stories or taboo, while the economic folklore of Asian development was filled with success stories.

As shown the figure 1, the Asian economic folklore was consisted by three sub folklores: ① folklore regarding the miracle of economic development of Asian (Asia is the growth center of world economy), ②folklore of unique regional economy (Asia will develop network economy by itself), ③ folklore of global economy (globalization of Asian economy will promote the development of regional economy)

After emergence of these folklores, the context weaved out by it became to lead the sense of FDI. In the middle 90s people was inclined to lose a cool judgment on FDI. FDI in East Asia heated up. We call such FDI boom "Asian fever".

However, Asian fever did not continue long because of Asian currency crisis in 1997. The number of FDI decreased suddenly as shown in table 1. Companies became too cool to relocate their production system into East Asian countries. On the other hand, after the currency crisis these countries began to reconsider the incentives in order to attract FDI.

Now the conditions of FDI changed drastically. Japanese companies are forced to cultivate their own way of FDI and suitable management style of foreign subsidiaries. By comparison of the way of FDI before and after 1997, some types of FDI modes can be distinguished.

2. Internationalization by Capsule Effect and Governance

(1) Reasons of FDI of small and medium sized companies

As mentioned above, Japanese FDI increased rapidly since the Plaza agreement of G5 in 1985. During these ten years Japanese economy experienced the skyrocketed appreciation of yen twice: the first appreciation was from 1985 to 1988 and the second one was from 1992 to 1995. Due to these appreciation of yen Japanese export oriented firms had to shift their internationalization strategy from by trade to by FDI.

Such shift also compelled small and medium sized companies to FDI. Especially subsidiary companies under the umbrella of vertical systematization by the huge company, that is Keiretsu, had to follow the parent company's FDI policy in order to adapt the decreasing order. On the other hand independent small and medium sized companies also faced the same kind of difficulties. They had to seek the new way of low cost production in order to keep doing business with their customers and to compete with low price goods from Asian countries. But it should be paid attention to another side of the high evaluation of yen.

It also created a new opportunity for small and medium sized companies to enter into emergent markets in East Asia by FDI. During the middle of 1980's Japanese FDI was led by relatively large sized export oriented companies, and since around 1990 almost all type companies rushed in FDI (Ha J., K. Shiotsugu & H. Kim, 2001).

By the way after the marketization policy China arranged favorable conditions for foreign investors, even for small and medium sized firms. Small and medium sized compa-

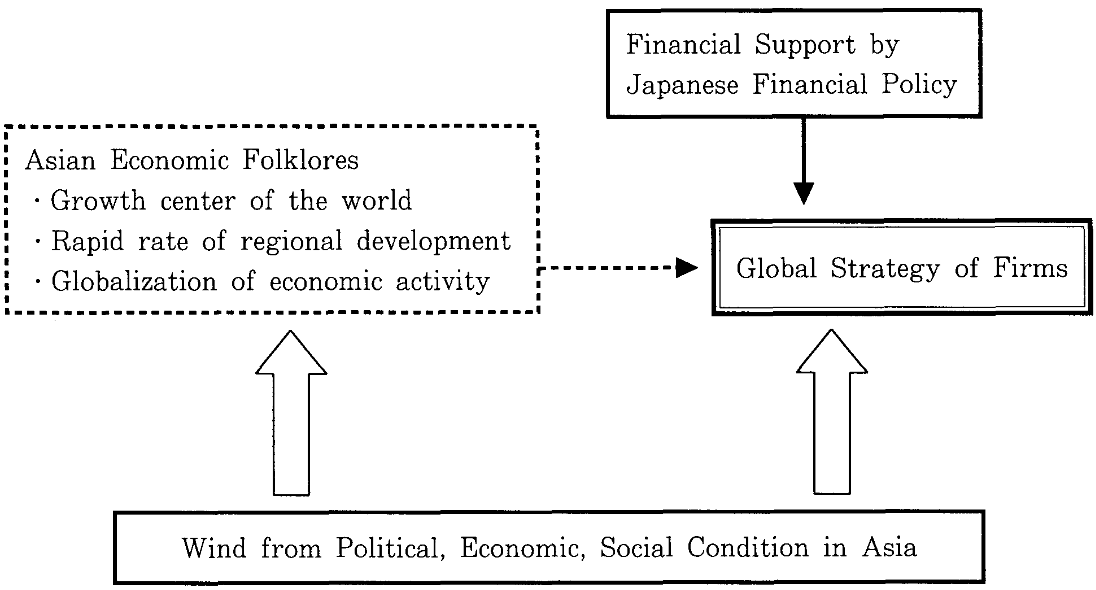

Fig.1 Economic folklores and Asian fever Source: Shiotsugu, 1995, p.134.

Table 1. Index of Internationalization of Japan

Year	'85	'86	'87	'88	'89	'90	'91	'92	'93	'94	'95	'96	'97	'98
Yen-$.Rate	238	168	144	128	138	145	135	126	111	102	94	109	121	131
FDI (m$)	12217	22320	33364	47022	67540	56911	41584	34138	36025	41051	50694	49172	54773	39824
%US/FDI	45	47	46	47	50	48	45	43	42	43	45	48	40	27
%Asia/FDI	12	10	15	12	12	12	14	19	18	24	24	24	22	16
#Subsidiary	—	743	1044	1361	1352	1245	1245	1029	1020	1291	1809	1577	1159	682
North America	—	652	278	355	440	410	366	188	143	133	214	239	218	146
Asia	—	192	398	544	506	461	498	532	656	922	1344	1026	688	329
China	—	33	33	63	60	44	103	173	315	460	647	317	183	109

Source: Various data from Japanese Government Statistics

nies, which were tiding over the hollowing out crisis by the cut down of production cost, were attracted to China.

By the way, Japanese FDI to Korea decreased since enforcement of the Labor Union Act in 1987. Major reason was frequent labor dispute occurrence after the Act as shown table 2.

Table 2. Frequency of Labor Disputes in Korea

Year	1988	1989	1990	1991	1992	1993	1994
Frequency	1,973	1,616	322	234	235	143	121

Source : Korean Government Statistics

(2) Capsule Effect

Small and medium sized companies had not enough resources for overseas direct investment. If some trouble happened on their overseas factory, these companies could not deal with it. What was important was that they could establish their own management style in foreign countries so as to adapt to troubles caused by local political, economic, social conditions.

Therefore small and medium sized companies selected the location prepared with many kinds of favorite incentives, and tried to establish the strong control of their overseas subsidiaries, or invested in order to maintain stable transaction in the same countries that their parent company or business partners were already operating. These were based on the common expectation that they could seal off their overseas subsidiaries from the local environment with high uncertainty.

According to Thompson (1967), companies should seal off the technical core from environmental disturbance in order to keep their stable operation. Companies try to control transaction with environment through boundary spanner. We call the favorite conditions "capsule" that are prepared by local government or by companies. Because capsule shows the same function of boundary spanner and covers the overseas subsidiaries with somehow protection mechanism prepared by the local government.

Looking back development of FDI, most companies chose their foreign location along the degree of strength of capsule. Especially this tendency of small and medium sized companies was very distinguished.

Japanese companies were forced to rebuild their business process so as to keep their adaptability to local business environments. The relatively big companies that are resourceful enough to make the capsule by themselves are able to keep their strong control over the foreign subsidiaries, and still develop the ethnocentric management. But small and medium sized companies with less management resources are braked hard to a stop of foreign direct investment. If there is a strong capsule, these companies will be able to invest there to establish overseas subsidiaries relatively easy. And they can apply their own Japanese management to their overseas subsidiaries.

East Asian countries and China provided attractive capsules to foreign companies at the peak of Asian fever. Many capsules from Asia were the favorite wind for FDI. If Asian economic folklore or cultural bound caused by similarity of way of thinking among Japan and Asian countries was the strong psychological motivator for FDI, the capsules prepared by these countries were the incentive which was used to judge the economic rationality of FDI.

(3) Governance of Overseas Subsidiaries

Another condition is governance of overseas subsidiaries. Here, Governance means the possibility of control of overseas subsidiaries directly. Strong governance is indispensable to keep the control right over overseas subsidiaries independently.

Perfect ownership is the best way to secure the management control of overseas subsidiaries. However, such type subsidiaries are not good at doing business based on enough knowledge of local business practices and rules. Accordingly joint venture becomes the effective option.

In case of joint venture, not only the necessary information about business environment but also the know-how for business operation is usually provided by local partner. For such companies that are unfamiliar with overseas business and have not enough management resources for overseas business operation, joint venture with influential partner should be considered first of all. They can expect reciprocity of management resource with partner.

Aside from it, most developing countries restrict the perfect ownership by foreign companies and only permit joint venture as the corporate form for foreign companies in order to protect domestic companies. So joint venture is quite popular in Asia.

Anyway governance of overseas subsidiaries becomes unstable by participation of partners. On the other hand joint venture is effective if companies can establish good relationship with local partner. Joint venture also cultivates new management way that is adaptive to local conditions, and promotes localization of subsidiaries.

Any way of governance has both sides of control. It is not useful to discuss the right side of governance. What is important is to recognize which option is good, perfect ownership or joint partnership. Option of governance of overseas subsidiaries is a typical strategic decision of global strategy.

3 . Managerial modes of overseas business

We think that capsule effect and governance are decisive factors for operation of overseas business. By crossing these two factors, four types of overseas management style are depicted as the figure 2. Each cell is explained along development process of overseas business.

(1) Cell I: Japanese Management by Ethnocentrism

Japanese management by ethnocentrism is the mode of strong management control from the headquarter office in Japan. Overseas subsidiaries are regarded as the same kind of business in host country, and are controlled by international division of the headquarter office along the corporate strategy. There is not much difference between overseas subsidiary management and divisional management within Japan.

		Governance of overseas subsidiaries	
		Perfect ownership	Joint venture
Capsule effect	Strong	I Japanese Management by Ethnocentrism	II Modified Japanese Management (Japanization)
	Weak	III Adaptive Management (Hybrid Management)	IV New Management by Voluntary Action

Fig 2. Management Modes of Overseas Development

In order to make such management possible, either a company can make a strong capsule by itself on the assumption that it has enough know-how to establish overseas subsidiaries of perfect ownership and to be able to manage local employees, or local government prepares it for foreign company.

Small and medium sized companies cannot afford to expense a large sum of money to make a strong capsule by themselves. But even such companies who wish to avoid outside un-economy brought about in overseas subsidiary dare to be engaged in making it for themselves.

Looking back upon Japanese FDI around the middle of 1990's, it was basically developed to construct production positions under the condition of the strong capsules prepared by the government of Asian countries. Such condition reinforced the managerial ethnocentrism of Japanese overseas subsidiary.

Japanese management system can be wholly transferred to an overseas subsidiary perfectly owned by Japanese parent company and massively protected by the capsule provided by the local government. Core system of production is extremely similar to the Japanese one, and the management team of the overseas subsidiary turns its face to Japanese parent company. But it should be paid attention that some aspects of Japanese management like small group activity which is deeply involved humanity seem not easy to be transferred. Because these aspects will cause serious cultural conflict between Japanese way of management and labor mind of local employees (Aboh, *et.al.*, 1991; Oliver, Nick & B. Wilkinson 1992).

(2) Cell II: Modified Japanese Management (Japanization)

Cell II is the international management that positively intends to transfer Japanese management to overseas joint venture through making the most of capsule effects. This type of joint venture will be adopted to local market when an overseas subsidiary can reduce the country risk of FDI under the guide of a general trading company that will have enough know-how of FDI, or tries to avoid frictions with local economic society through supportive cooperation by influential local partners in order to make its operating core work smoothly.

Even though a joint venture will be adopted, the overseas subsidiary can expect the capsule effect provided by local partners. The subsidiary will try to transfer Japanese management from its parent company in order to improve the productivity of the shop.

Japanese companies usually started their overseas subsidiaries according to the requests from Asian partners so that they would transfer Japanese technology and management into their subsidiaries. Japanese companies scarcely happened to select the joint venture as the way of FDI because they were fascinated with the superior production system of Asian partners.

In this case, local partners would be expected to coordinate various kinds of interests from economic society or from local government, or to work with Japanese companies in order to maintain the favorable economic environment to develop joint business without any local troubles. If a local partner could build up the collaboration with an influential Japanese company, the joint venture would provide the attractive incentives of FDI to small and medium sized companies that lack management resources and know-how for international business.

But it is by no means easy to coordinate the conflicting interests among owner companies and to keep the stable collaboration with them. It is quite difficult to make joint decision without occurrence of cultural conflicts. Management of prevention and resolution of cultural conflicts is the important capability for international business.

(3) Cell III: Adaptive Management (Hybrid Management)

To the contrary the cell III and the cell IV are the FDI with no expectation of the capsule effect. In this case it becomes important to develop a new kind of adaptive management style to Asian countries. Especially the Japanese management will not be transferred at once to the adaptive management (hybrid management) based on perfect ownership by Japanese company as the case of cell III. Because this management style company will be requested the high capability to adapt to all aspects of managerial control from establishment of the overseas subsidiary to its daily operation of it. Therefore companies with abundant resource are inclined to use their resources to prevent from unfavorable influences of locals as possible as they can.

For example we can list such cases that foreign subsidiary tries to secure human resources and to keep the employment stable by means of enhancement of incentive expenditure to local workers, to educate not only production skill on the shop but also management method for office work earnestly, or to supply the necessary infrastructure to operate by itself. It is an adaptation that a foreign subsidiary tries to secure the stable operation basis by formation of the substitute for market in order to evade uneconomy of FDI. Rugman (1981) called it "internalization".

Economic rationality should be essential in the cases of Cell III and Cell IV. This rationality will be realized by the lower local production cost than the cost of internalization, by the entrance into the increasing local market, by keeping the competitive advantages superior to them of rival companies, or by structuring tight transaction network with local subsidiaries of the Keiretu (vertical network organized by a big parent company). As the situation that satisfies some of these elements simultaneously is easy to take place in Asian countries, many Japanese big companies have been branching out into the places covered with scarce capsule effect. The internalization is nothing but the construction of capsule at Japanese company's expense. The more possible the construction of the capsule by itself is, the weaker the necessity of building up the adaptive management to local environment is. In this case, Japanese overseas subsidiary can develop ethnocentric management and transfer Japanese management system directly without consideration of local social and economic conditions.

But it is quite difficult to think that regional small and medium sized companies in Japan can be charged with the cost for internalization. Important thing for these companies is to make their overseas subsidiaries adaptive to local environment.

What is the basic measure is that the overseas subsidiaries should directly confront the local situation, spend good deal of time on resolving local problems one by one, and promote mutual understanding with local people. The mutual trust based on mutual understanding brewed through resolution of local problems is critical to establish legitimacy of subsidiary's way of management.

(4) Cell IV: Management by Voluntary Action

In the case like the cell IV that Japanese and Asian companies jointly push the joint venture business by the management based on voluntary action, it seems to be still more difficult to build up the management style truly adaptive to the local environment. Because corporate governance becomes complex on account of the problem of coordination of conflicting managerial control rights among stake holders and the problem of jurisdiction over the workers who are employed by local partners.

Therefore there is not a little amount of cases that Japanese companies stay at the position as a technological supporter and leave the direct control of local workers to local partners. These cases often happen when Japanese companies enter into China.

China demanded the foreign companies to make joint ventures with Chinese partners from the end of 80s' to the first half of 90s'. During these years China started its economic reform and tried to transit to market economy according to the new policy of Dong Xiaoping. Although recent China has permitted the perfect ownership company by not only Chinese people but also foreign companies, almost all foreign companies are still joint ventures.

It should be paid much attention to some successful Chinese companies like the Hai'er that has developed the unique management practices of factory operation.

Its practices is different from Japanese one. And this kind of practices is prevailing in China rapidly. Recently Chinese companies uses the mixed payment system based on the payment at piece rate and on the payment of group productivity. Workers are asked not only to achieve assigned task for the day but also to contribute the high quality of production of the group, that is the low rate of defective product. The new management practices must be suitable to the people's mind that consists of Chinese groupism brewed by "danwei (単位)" and "guanxi(関係)" of state-ownership company, and individualism based on the mixture of "mianzi (面子)" and strong family tie.

Although "danwei" had been broken down through the reform of state-ownership company, people still seem to request high welfare treatment by the company indifferent from management performance. On the other hand, people are inclined to avoid the responsibility or to blame others in order to keep their own pride "mianzi".

Management by numerical results based on both individual and group performance is one resolution to satisfy these contradictory minds.

But Japanese management emphasizes the importance of work group as the unit of evaluation for payment and the unit of problem solving. It can be called "incremental groupism" for improvement of productivity by the mobilization of individual skills. The incremental groupism of Japanese is hardly familiar with Chinese people after the economic reform.

Japanese small and medium sized companies that started up their Chinese subsidiaries in 90s' sometimes face the difficulties in transference of their own management style. Some of them were unwilling to withdraw from China because the profitability of Chinese subsidiaries got worse dew to management failure.

It is very important to make inquiries into how to build up the successful joint venture through confrontation to the changing local environment and which type of management will be created without the capsule effect. The outcomes of inquiries will provide the interesting resolution for management localization in Japanese overseas subsidiaries.

Short case of Hokyuwa

The case of Hokyuwa in Shanghai, that is a relatively small joint venture by Chinese state-ownership company and two medium sized Japanese companies, seems to be promising to think this matter (Shiotusugu, 1996: 1998). The Hokyuwa faced the same problems above mentioned in term of development of adaptive management when we visited for the interviewing research.

We paid attention to the behaviors of three Japanese staffs until the joint business became well under way. They lived in the same apartment house with Chinese workers, did not take their position as Chinese workers' boss into consideration, came to the production sites and engineering office intently, made their efforts with Chinese workers to increase the productivity. They exposed themselves under the eyes of workers at the operation site everyday, and tried to communicate about the production technology and the method of problem solving through face to face contacts. They poured their hot passion for constructing cooperative relationship. And they kept their mind of "never give up" against conflicts caused by local workers and mangers.

Their behavior should be called "voluntary action". The voluntary action stimulated Chinese workers' mind deeply. On the other hand, the product that they concentrated on the improvement of quality as the same level as the Japanese one by using Chinese technology made successful bid for the Baoshan steel. This success was useful to make Chinese workers known the effectiveness of Japanese staffs' advice and their engineering capability.

The change of workers' behavior came out gradually. Chinese workers became to tackle their task subjectively, tried to improve job condition by themselves, and put confidence in Japanese staffs. The flow of voluntary actions between Japanese staffs and Chinese workers built up the collaboration, and it evolved into the new type of management. We call it the New Management by Voluntary Action.

Whether the new management through voluntary action will be success or not depends upon the capability of development of voluntary actions from actual daily operation sites. Therefore the will and ability of dispatched staffs coming from Japan, who are the pillars of voluntary actions, is very important.

If the company has the stock of talented persons with communication capability in foreign languages and high ability of management and engineering, it can develop FDI and the overseas subsidiary management independently. But most small and medium sized companies lack in such kind of human resources. Is it impossible for small and medium sized companies to manage the overseas subsidiaries?

Let's go back to the above case. Japanese dispatched staffs did not understand Chinese and engaged with the overseas business for the firs time. To my surprise, they tackled to produce the material for maintenance of the blast furnace that they had not been engaged in when they worked Japanese factory. Although they needed the technical advice for its production from the Japanese maker with which they kept a good connection, they were the men having extensive experience of the shop floor. Also they mastered the organizational management skills to propel the work meaningfully and to build up the cooperative relationship through increasing the cohesiveness of work group, and understood how to play the role as a leader.

But there was nothing more important than their passion to start up the useful business between Japan and China. This was the indispensable factor for developing influential voluntary actions. This hot passion was more essential than how to convey Japanese management to Chinese joint venture without troubles.

According to the context of these Japanese staffs' action, the development of voluntary action meant the construction of the framework of work for their belonging so that Chinese workers might be able to work autonomously without piecemeal payment by result that is often seen in the traditional Chinese work practices.

Scarcity of human resources for overseas business makes small and medium sized companies difficult to develop FDI. However any company must have the person who develop managerial actions with passion voluntarily. Japanese companies, that are operating on the base of small group activities, will bring up these persons subjectively. That is, any Japanese company will have high possibility to develop the new management by voluntary action through the operation of their overseas subsidiaries.

After the Asian economic crisis, the capsule strongly supported by the government becomes disappeared, and in China the protection policies for FDI from abroad also become unstable compared to them at the beginning of 90s'. FDI without the capsule effect will increase in the future. At the same time, it may be misunderstood that only big companies can develop FDI in Asia successfully. As far as there is a person who can develop voluntary action for building up collaboration with Asian workers, the regional small and medium sized companies have high possibility to make success of FDI. The new management by voluntary action will become the prototype of FDI among these companies.

4 . Discussion and Conclusion

We think that there is an appropriate management way contingent upon the overseas business conditions. Needless to say, different kinds of management resources and management know-how are necessary for international business, and competitive advantages beyond border of the nation is indispensable to get success. Therefore international business seems to be allowed only to big company. And academic interest is concentrated on multinational companies or global companies.

But globalization of Japanese economy since 90's involved small and medium sized companies. International business was not limited to big companies. Small and medium sized companies were also compelled to tackle the international business. They could conquer scarcity of resources for international business by neat capsules provided by East Asian countries, and developed overseas subsidiaries.

Although under the protection of the capsule Japanese companies could achieve relatively good results, after Asian crisis in 1997 economic situation changed. Capsule effect became weak or disappeared. Japanese companies hesitated to develop international business.

What we discussed here is some international management modes available to not only big companies but also small and medium sized companies that are not favored in terms of management resources for internationalization. It should not be compared differences among four modes to find out only one best way for FDI. We only mentioned that the mode of international management is different along the strategic choice of company, and that whether the mode of international management is appropriate depends upon the condition of capsule effect and strength of governance.

However, the mode is shifting steadily from the Japanese management by ethnocentrism to the adaptive management (hybrid management) or the management by voluntary action. We think that the FDI strategy is changing from the management covered with capsule to the management by voluntary action. What is needed for future FDI is to accumulate human resources for the new management by voluntary action.

We are conducting empirical researches: One is the collection of FDI in Asia cases through interviews with Japanese companies. Another is a questionnaire research in order to confirm the validity of figure 2 and to depict the trend of Japanese FDI.

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