Japanese Economic Interest in Central Europe

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1. Growing Interest towards Central Europe: Small, but not insignificant

While the amount of Japanese investment into Central Europe is still of a relatively low level, Japanese foreign direct investment (FDI) towards Central Europe has been growing from year by year. Thus far, up to the end of 2000, roughly 2.5 billion USD has been invested into the three Central European countries (Hungary, Czech Republic, and Poland) as Japanese FDI: 1 billion USD into Hungary, 900 million USD into Czech Republic, and 600 million USD into Poland*.

* Official statistics by the Ministry of Finance in Japan reveal a different picture on the amount of FDI: roughly 560 million USD into Hungary, 160 million USD into Czech Republic and 250 million USD into Poland cumulated for 50 years from 1951-2000, though Japanese FDI to Central Europe actually began in the 1990's. According to the same statistics, Austria has received 550 million USD FDI from Japan during the same period. The discrepancy between official Japanese statistics and the data of receiving countries lies in the FDI made by foreign subsidiaries of Japanese companies, which is not included in the Japanese official statistics.

It may be assumed that the presence of Japanese companies is comparatively minor compared to the weight of Japanese economy in the world. This may well be true, though we should not underestimate the presence when we take into account the allocation of Japanese FDI around the world. For 50 years, Europe received an annual 20 % on average of total Japanese FDI. The main recipients within Europe have been, the United Kingdom and the Netherlands; with the two countries together occupying almost 15 % of worldwide Japanese FDI, and the residual 5 % has been shared by other European countries.

The cumulative amount of FDI from Japan into the three aforementioned Central European countries occupies about 0.15 % of the total amount of worldwide Japanese FDI for 50 years, and the figure is equivalent to half the amount injected into Italy.

It is almost certain that the share of Japanese FDI in Central Europe will increase steadily for the next 10 years, and the region will soon become the main target for Japanese investment within the European continent. Furthermore, EU membership is bound to accelerate the whole process of investment, and hence Japanese presence in Central Europe will be larger in future.

2. The Reasons for Japanese Investment: No Secret

There is no secret and no special strategy behind Japanese investment. If a company wants to be internationally competitive, then it is entirely natural to establish or move a production base to locations where labor costs are relatively low in terms of comparison to the labor skills acquired (reason 1). This is the reason for the investment of Suzuki in Hungary and that of Matsushita in Czech Republic, both of which are highly symbolic and are also the largest investments as Japanese FDI in these countries. Suzuki moved its production base from Spain to Hungary, and Matsushita moved a part of its production line from England to Czech Republic.

Once a large investment is made, subcontractors and parts producers may also follow the main investor (reason 2). Thus, a large investment possesses an accelerating and multiplying effect that boosts related investments, though each amount of accompanying investment is likely to be far smaller than the main investor's. However, this is how small and medium Japanese companies are able to come to Europe; otherwise there is no sense for these companies to come independently to Europe carrying their own risk. The recent rapid increase of Japanese FDI into Czech republic can be explained by the multiplying effect of the Matsushita investment.

Comparing the characteristics of Japanese FDI among the three countries, investment into Hungary is more varied in terms of the economic sectors and branches it affects. Some consumer electronics companies moved their production base from Asia to Europe due to increasing custom duties in the EU for Asian made products (reason 3). Sony in Hungary represents a typical case of this phenomena, and, interestingly enough, Japanese car-stereo manufacturers followed the same path. All four car-audio producers, Clarion, Alpine, Shinwa and Kenwood chose Hungary as their European production base for the European market.

The first Japanese investment into the R&D field was made by Furukawa Electronics in Hungary (reason 4). Furukawa bought out a part of research institute belonging to the Hungarian National Electricity company in 1992, and succeeded in continuing the then ongoing research into silicon insulators at its own risk. Furukawa's investment can be classified as pioneering investment in the R&D field from Japan.

3. What is so Special about Japanese FDI?

Is there any particular policy or common feature of Japanese FDI?

First, Green-field investment overwhelms "buy-out" type investment of existing companies. In other words, Japanese firms do not participate in the privatization of existing companies in Central Europe except in a few special cases. This is because Japanese companies do not have sufficient information to evaluate existing companies in this region, and consequently do not trust the organization and management of existing companies. Therefore, Japanese companies prefer to establish their own organizations and management according to their own standards taking on full risk, even without local partners.

Second, Japanese manufacturers are highly focussed on economizing costs, especially concerning labor costs. It means that, on one hand, the wage level of Japanese manufacturers never goes higher than the average level of the nation, and on the other hand, the number of Japanese expatriates is limited. For example, the Matsushita Czech Republic has less than 10 Japanese expatriates, out of a total of more than 1500 employees.

Third, Japanese manufacturers are strict when it comes to teaching work techniques and organizing tasks. Minute details are constantly promoted within company. Strict on the job training is a general practice of Japanese manufacturers, which was entirely lost in socialist state companies.

Fourth, neither an investment bank nor a consulting company, but Sogo-Shosha, a general trade company, intermediates Japanese FDI, because they have actual business information and experience of the given countries. Japanese manufacturers do not trust consulting companies, who demand a high amount of consultancy money for paper work. On the contrary, Sogo-Shosha does not demand any money for information, because it actively takes part in the investment.* Thus, Japanese manufacturers economize the informational cost.

* The fourth point is very important in examining role of the Sogo-Shosha. In fact, the role of Sogo-Shosha, at least in Central Europe, has been changing. The change seems to be not regionally concerned, but concerned with fundamental functions of Sogo-Shosha. For these years Sogo-Shosha has had difficulty in surviving as a mere trader in contemporary environments and is enforced to take over its own risk with its own capital for making its activity more profittable. The original function of Sogo-Shosha as the general trader of every commodity and service existing in markets has been changing. The fundamental change in its weight of activity from a huge wholesale trader to direct investor can be observed. The change of functions in Sogo-Shosha is very clear in Central Europe: some Sogo-Shoshas are increasing their activity and expatriates, like Itochu and Sumitomo, who have succeeded in inviting FDI and also in taking part in investment. On the other hand, the retreat from market has been compelled in other companies like Marubeni, Nissho-Iwai and Mitsubishi , who did not succeed in inviting FDI and therefore in participating in investment. They closed their offices and left Hungary.

4. Difference in Role and Function of Japanese FDI among Countries

There is interesting data on Japanese residents in Central European countries: 800 in Hungary, 450 in Czech Republic and 350 in Poland at the end of 2000. According to the number of businessman, Hungary is ranked in 9th position for all of Europe. Although the total amount of Japanese FDI is almost equal, the number of Japanese businessman in Hungary is far in excess of that in the Czech Republic. There are several reasons behind this difference.

First, the large part of Japanese FDI into the Czech Republic actually comes from the European subsidiaries of Japanese companies, and in this case number of Japanese expatriates can be reduced. In fact, Japanese investment in the Czech Republic has strong ties with German subsidiaries of Japanese companies, which can be explained by its geographical and economical relationship. On the contrary, Japanese FDI into Hungary comes directly from Japanese mother companies, and this brings about the difference in Japanese residents between the two countries.

Second, Japanese investment in Czech Republic is spread in terms of its nationwide scope, and most factories are far from the capital, Prague. In this case, it is quite difficult for a Japanese businessman to bring his family with him, because of difficulties with educating his children and daily living. This is the same in Poland, where the situation is yet more difficult for the Japanese businessman. The data on pupils attending Japanese schools shows this clearly: 60 pupils at the Budapest Supplementary Japanese School, 28 pupils at the Prague Japanese School, and 22 pupils at the Warsaw Japanese School.*

* The Vienna Japanese school has 55 Japanese pupils, the Bucharest Japanese school has 17 pupils and the Sofia Japanese Complementary School has 3 pupils.

Third, from the standpoint of cultural and geographical relationships, Hungary is perhaps the center of Japanese business for southeastern Europe. This makes Hungary a special destination for Japanese investment.

So far Poland is not attractive to Japanese companies. It is not because Poland defaulted in the past, but because Japanese companies are not aiming at its domestic market for selling their products. Central European countries remain production bases for Western Europe. The situation may change when the income level of Poland increases and its market becomes more lucrative.

5. Advantages for FDI receiving countries

The first advantage comes from so-called “green-field investment”: it generates employment and brings with it new productive equipment and technology. Its advantages are clear compared to investment in the form of privatization, which inherits the existing facilities and workforce.

The second advantage is the introduction of work culture in manufacturing. Re-establishing working discipline and moral are very important for the former-socialist society in order to emerge again in the world market. In this sense Japanese manufacturers are very good trainers for transferring working civilization to the country and society concerned.

The third advantage is the commitment to the economy invested. It is said that Japanese companies are slow to decide on their investments, and this is indeed true. However, once the decision has been made, every effort is devoted to the success of their undertakings and not for profit in the short run, but in the long run. In this sense, Japanese investment in manufacturing is favorable for the economy concerned.

6. Tasks for FDI receiving countries

It is not enough for the FDI receiving country to simply announce its preferential system to investors. The business of attracting FDI has become very competitive among transforming countries, especially in Central Europe. If the government is not sufficiently sensible in reviewing its invitation system, it will lose the opportunity. The following are typical problems for investors in transforming countries.

(1) Although government proclaims to welcome FDI, facilities for receiving foreign representatives are not well organized: obtaining residence and work permits is too complicated and takes a great deal of time.

(2) The level of personal income tax is extremely high in every country in question. The income of foreign representatives quickly reaches the highest taxation bracket. In this aspect, Holland has well-designed lessening-measures of personal income tax for foreign representatives.

(3) There is no counter-service for high tax paying foreigners, who have to pay additionally for health care and education of their children.

(4) As employers' contribution to social security and personal income tax is so high, labor costs are not as low as official statistics suggest.

(5) Living costs are not low as once thought, because imported consumer goods are at the same price level as in developed countries, and value-added tax is also high, ranging from 22% to 25%.

(6) Legal changes occur rather frequently, complicating lifestyles and confusing management.

(7) The customs system is badly organized, and therefore time and money needs to be spent on smooth customs clearance.

(8) "Hungry spirit", i.e. hard work for the sake of living, is not present in workers of Europe's transforming countries, which makes it difficult for Japanese investors to understand the way of thinking and the behavior of workers.

7. Tasks for Japanese Companies

The main merit that Japanese companies found in Central Europe is relatively low labor costs with good quality workers. However, there are dual shortcomings in their understandings.

First, although the level of wages is low enough according to official statistics, nobody lives only off the average income that statistics suggest. Actual living needs double or triple the average income, and therefore workers simply leave their jobs or take sick-days if the company sticks to ensuring only average income for them. This happens even in cities with high rates of unemployment, which is again quite difficult for

Japanese managers to understand.

Another typical mistake made by Japanese companies is that they choose Central Europe simply because they see it as a low wage zone, which is only partly true. However, as long as Japanese companies evaluate Central Europe only on the value of physical workers, they will not fully utilize the potential work power of Central Europe. As shown by Nokia and Ericcson in Hungary who established large-scale research institutes in Hungary, European companies are well aware of the high level of brainpower in this region. It is a universal problem and a task for Japanese companies to utilize foreign brainpower for fulfillment of their international strategies.

As for Central European countries, the so-called “brain drain” is a big loss for the countries. Therefore, it is an important task for governments to retain IT engineers as R & D manpower in home countries, irrespective of domestic or foreign ownership. One option is to encourage R & D activities within joint-venture companies with preferable policy measures for both the country and companies.