

STRATEGIC LOCALIZATION OF JAPANESE ENTERPRISES IN CHINA—AN EMPIRICAL APPROACH

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Abstract

This paper presents a new framework with the aim to deliver a solid basis for further analysis and discussion about the various forms of localization strategies towards the Chinese market. The localization of Japanese companies in China is still at a low level, although it did progress to some degree. As for “goods”, the proportion of sales within local markets or regional markets is still low. As to “manager”, local staff is rarely promoted to managerial positions. As to “capital”, funds are still procured from Japan. The success of Japanese companies depends on deciding on the right localization strategy or the right localization strategy mix bearing in mind the particular circumstances of the Chinese markets. Different factors influence the decision-making process of the strategic Japanese management style, such as new competitors, strong suppliers, and new technologies etc. Based on this theoretical understanding the main objective of Japanese companies should be to strengthen their capability building that aims for better technology and quality. To reduce costs and to enhance access to local markets and the regional market in China, R&D and the development of products intended for Chinese local markets should be strengthened. At the same time, it will be essential to nominate local staff who is familiar with domestic conditions to the ranks of top management in Japanese enterprises more frequently than now. At the same time, the Japanese companies should develop their strategic management in order to make the most out of the long term capability building. However, the most important question for a successful localization strategy of Japanese companies in the Chinese market is still if and how China's economy will continue to develop against the background of the difficulties in the political and social system.

Key Words: *localization; anti-Japan moods; Local Business Know-how; Local Crisis Management Organization; Japanese Brand Image*

Introduction

The People's Republic of China has gained increasing importance as a market and production base for the internationally active Japanese industry. At the same time Japanese companies represent one of the most important backers of China's economical and technological development. Simultaneously, complicated political issues that are difficult to deal with exist between Japan and China, such as historical issues, issues related to Taiwan and so on. Those issues are not ones that can be settled if one party compromises, and cannot be settled easily. In other words, the concern of anti-Japan moods consequent from these problems as a background situation will persist for some time.

Therefore, what sort of localization strategies should Japanese companies pursue in China; a country that is undergoing drastic economic development and with a physically powerful anti-Japanese mood? In this paper, the analysis starts from the question of why Japanese companies are attracted to China and focuses on discussing how these new developments and changes in the Chinese market will impact on Japanese companies' localization process based on the analysis from my research and the filed survey of Japanese companies in China, which was done during April 2006 through September 2007.

Literature Review

Basic theoretical understanding tells us that a company must manufacture a product that is valued by consumers in order to make a profit. Thus, we say that companies should engage in the activity of value creation. A firm's business strategy is defined as the actions that managers take to attain the objectives of the company (Porter 1986), that are actions to reducing costs of value creation (low-cost strategy) or to differentiating its product (differentiation strategy) (Porter 1980, 1985).

For a theoretical approach to the complex subject of localization strategies towards the Chinese market, it is useful to think of the company as a value chain composed of a series of distinct value creation activities including production, marketing, materials management, research & development (R&D), human resources management, information systems, and the firm's infrastructure. We can categorize these value-creation activities as primary activities and support activities (Porter 1985). Both the primary and the support activities are important to improve a firm's profitability: business strategy is the key. It is the most important consideration that the company and its employees have to bear in mind, in order to attain the fundamental objective of any business, to make profit.

If we are following Porter's theoretical understanding, expanding to international markets (in our case to China) allows companies (in our case Japanese companies) to increase their profitability in ways not available to purely domestic enterprises. Therefore Japanese firms are able to earn a greater return from their distinctive skills, or core competencies, and realize a greater experience curve economies, which reduces the cost of value creation. Also, Japanese companies can realize local economies by dispersing particular value creation activities to those locations in China where they can perform the value creation most efficiently, for example labor-intensive industries in western China with a huge supply of unskilled and inexpensive labor. The term 'core competence' refers to skills within the firm that the competitor cannot easily match or imitate (Hamel and Prahalad 1989). These skills may exist in any of the firm's value creation activities, that is R&D, production, human resource management, marketing, general management, information system and technology, and so on. Such skills are typically embodied in products that other firms find difficult to match or imitate: it is difficult, for example, for Chinese companies to imitate products, production technology or the management know-how from Japanese companies operating in the Chinese market. Once again, according to the theoretical view of Porter (1985), the core competencies are the bedrock of a firm's competitive advantage. They enable a firm to reduce the costs of value creation and/or to create value in such a way that premium pricing is possible.

What does all this mean for the internationally operating Japanese Company that is trying to be successful in China? In brief, it means, that the Japanese firm will benefit by shifting each value-creating activity it performs to the location in China where economic, political, and cultural conditions, including relative factor costs, are most conducive to the performance of that particular activity.

Theoretical Background

We can classify the motives for Japanese companies to develop and implement business strategies towards China as resource-seeking and market seeking. These two basic motives of Japanese companies towards China stand behind the fundamental purpose of any business firm to make a profit. We had a theoretical approach on the two basic business strategies to attain the main objective of any firm: reducing costs of value creation (low-cost strategy) or differentiating the products (differentiation strategy).

Many Japanese companies have moved into China as the Chinese economy has grown. Before the 1990's¹ the so-called "taking-back type business" constituted the mainstream in which products assembled in China are exported to Japan and third countries. However, when two-digit growth was achieved for four consecutive years, from 1992 to 1995, companies emerged that moved into China by regarding China as a market for sales.

At the beginning of 2000, China joined the WTO² which means that the Chinese market was totally opened. This has led to a consumption boom chiefly in the coastal areas. Recently, most Japanese companies moving into China intend to promote sales activities with the Chinese market as their target. However, sales activities for the changed Chinese market are significantly different from the "take-back type" business style. To promote sales activities in the Chinese market, business localization must be resolutely implemented. With respect to the personnel management as well, a transition from the labor management type to the human resource development type is also necessary.

There are many cases that the delays in becoming aware of the necessity of localization³ exist among Japanese companies nowadays. Obviously, the reason is because the successful experience in the "take-back type" management is too strong. The construction of factories in China in a "take back type" business style essentially means the operations of factories in China, even though such operations are part of the management of a company moving into China.

While this is not the only issue, many Japanese companies are facing tough challenges in the business of selling products in Chinese market. In other words, although China's attractiveness as a market is increasing as the result of a growing economy, many Japanese companies are not benefiting from such growth. They should lose no time in drastically changing their management style.

Current Status of Japanese companies in China

1 A Contradiction Feeling about Japan

As we all know, anti-Japanese demonstrations occurred in Beijing on April 9, 2005. It then spread to Shanghai, Tianjin and Hangzhou on April 16, and to Shenyang, Xiamen, Guangzhou, and Shenzhen on April 17, causing great bewilderment among Japanese people. Following these affairs, there remains some influence such as sporadic labor-management disputes and the avoidance of order placement for, especially, public goods made by Japanese companies.

The problem is that such anti-Japan feelings may emerge and become a major crisis to the management of Japanese companies in China. The most important features of this issue are that the people who took the lead in the anti-Japan protests were members of the younger generation in their twenties and thirties. Via the interview at Chinese universities, we also observed the keywords "contradiction" may easily express Chinese students' feelings about Japan⁴. In fact, many Chinese people have studied in Japan such as, myself, and their experience in Japan was used as a model in numerous fields such as politics, economy, diplomacy, and science and technology in the modernization process in China. In addition, some Chinese students have favorable images about the Japan due to the result of the survey, such as that Japanese people are diligent, keep their promises, create excellent products, and

¹ The Tiananmen Square protests of 1989 were a series of demonstrations led by students, intellectuals and labour activists in the People's Republic of China between April 15, 1989 and June 4, 1989.

² World Trade Organization.

³ Creating mechanisms for the development of local human resources.

⁴ In China's history education, Japan is referred to as a nation that invaded China during wartime and, at the same time, as a model of success in the modernization of Asia during the postwar restoration.

cultural items such as movies and music.

Conversely, news and articles about Japan's political leaders reported by the Chinese media regarding political issues are contrary to such favorable images, making it difficult for young people to understand the contradictions posed by these aspects. Many young Chinese are not anti-Japanese as far as every particular aspect is concerned. They joined the anti-Japanese demonstrations with mixed feelings. The slogan of "do not buy Japanese products" used in the anti-Japan demonstrations was to express criticism of the Japanese government and, particularly, the issue concerning the visits to Yasukuni Shrine by political leaders. Overall, young Chinese people discriminate between political activities and daily activities. It is not the case that the majority of young people are influenced by anti-Japanese education and practice blind nationalism.

In Japan, some people tend to attribute all of the feelings about Japan to a patriotic education provided by the former Chinese government. However, the "contradiction" may be further expanded if this phenomenon is too greatly simplified in dealing with the issue. In considering future Japan-China relationships and business activities of Japanese companies in China, it is necessary to expand the understanding of the feelings about Japan further among Chinese people⁵ as described in this section.

2 Impacts on Japanese Companies

The issue of feelings regarding Japan has emerged as a new business risk. Because this issue has a complicated background, it is expected that this problem will persist for some time. Until now, no cases have been reported in which the issue of feelings about Japan exerted a major impact on the business activities of Japanese companies in China. However, in assuming that this issue will continue for a long time, attention should be paid to it by Japanese companies.

In April, when the anti-Japanese demonstrations took place, sales representatives of a Japanese manufacturer who I interviewed⁶, went the rounds of its stores in the response to information that its products were being withdrawn from stores. They found that other competing foreign companies and domestic companies were strongly urging storeowners to "withdraw Japanese products from their shelves" and passing out leaflets.

In the case of tenders for some public works projects to which high political attention is paid, Japanese companies sometimes received disadvantageous treatment. Even if these issues do not cause severe damage, it is important to prepare remedial measures and manuals during ordinary times by assuming that these problems might occur again. It is also important to build social trust and confidence in a company in its daily activities as a measure for avoiding risk.

During an interview, a Chinese professor noted that, "We hope for the realization of a superior Japanese management model in China. A model in which labor and management are united to conduct business operations can serve as an important direction that Chinese companies should pursue in the future. This is because we have major concerns over labor-management problems in China. If a Japanese company can achieve pioneering management techniques in terms of these aspects and can provide a model, such a company will be highly regarded." The most effective preparatory measure for avoiding potential risks is that individual Japanese company generously exercise the expertise and skills they can be proud of in China and earn respect in China.

Because many Chinese people have confidence based on the economic development they have achieved in the past ten years or more, attention should also be given to such confidence. In Shanghai alone, more than 30,000 Japanese people live there if long-term

⁵ Especially, the younger generation.

⁶ Please make a reference at the filed survey abstract.

assignments are included. On a daily basis, they are required to behave in a manner that will earn the respect of the local society.

Localized Strategic Action Required for Japanese Enterprises

1 Strengthening Local Business Know-how to Respond to Changes

In order to improve the ability to respond to business risks in China, what is first needed is to equip an organization with the ability to flexibly respond to sudden environmental changes. For example, measures to deal with the shortening of a product life cycle include the diversification of production methods. Specifically, these include increasing the operating rate of production facilities to recover investment as quickly as possible, reducing plant investment as much as possible, and utilizing outside companies by use of OEM⁷ components if appropriate.

Moreover, in order to strengthen the ability to respond to changes in distribution channels such as a shift from existing channels to major volume retailer channels, measures required include strengthening a company's commitment to distribution channels and increasing the control of the information flowing in distribution channels.

Moreover, while this has become common, Japanese companies in particular face a major problem of hiring and retaining skilled personnel. Although some reports indicate that difficulties have been encountered in hiring workers, there is a more than abundant simple work force even in the coastal areas as represented by workers from the rural areas. Rather, the serious problem is how to secure human resources having the necessary expertise and high level of technical background. The struggle among companies to obtain skilled personnel will become increasingly intense.

To improve the ability to respond to such changes, it is necessary to strengthen local business know-how enabling quick decision-making according to situations based on information collected at the local site. This requires the provision of integrated management functions covering development, manufacturing and sales to the local site and localizing the planning functions by developing Chinese managers. For business operations in China, strengthening local business know-how is the best way for Japanese company's to respond to changes in the future.

2 Establishing a Local Crisis Management Organization to Control Risk

In light of the response to the feelings about Japan as discussed in the preceding chapter and the past SARS⁸ outbreak as well, it is important to "establish a crisis management structure for unexpected situations" as a method of helping to deal with risks in doing business in China. The fundamental factor of crisis management is to instantly collect accurate information at the local site and to make a quick decision at the local site. This calls for the localization of an organization. Moreover, an instruction manual should be prepared that indicates the actions to be taken by each organization if a problem, unfortunately, occurs. This manual should be systematically disseminated throughout the company by means of internal company communications.

In addition, the need to increase organizational sensitivity with respect to the possible occurrence of a problem, the degree to which advance studies were made on a series of remedial measures demonstrated basic differences between these two companies. These differences included measures to deal with distribution channels, consumers, and the mass media.

⁷ Original Equipment Manufacture.

⁸ Severe Acute Respiratory Syndrome.

Currently, some Japanese companies are studying remedial measures within such organizations as crisis management committees consisting of local and head-office members established for business in China by detecting indications of risks on a routine basis rather than when a problem occurs. The involvement of top management in risk issues has brought about the effect of increasing overall organizational sensitivity to risks in those companies. This is one of the good examples to explain the importance of establishing a local crisis management organization to control risk.

3 Accelerating Strategic Localization to Create Japanese Brand Image

In addition, to a structure for crisis management, it is also important to work through the media to obtain a correct understanding of business activities by consumers and other relations in China.

The media environment in China is extremely complicated with many TV stations, newspapers and internet portal sites. There are about 300 TV stations (about 3,000 channels), about 2,000 newspapers, and about 9,000 magazines. While circulation of official organs as represented by the People's Daily is decreasing, the circulation of evening papers, tabloids and amusement papers carrying TV programs and entertainment and sports information is increasing.

With the number of users exceeding 100 million people, the Internet has come to have a vital role in forming public opinion. While past use was limited mostly to some younger people and people in the higher income brackets, the Internet is now being used by people at numerous age segments. The number of users is increasing not only in the coastal areas but also in the provincial areas. At the same time, the number of female users is also increasing. If negative information about a company is posted, the article is transmitted through the Internet and copies are instantly made available. Consequently, information⁹ is disseminated in an instant. Recently, there have been many cases where a consumer's complaint about a company spread through the Internet from one area to all of China.

The organs carry the official views of the government, and the tabloids surprisingly have only limited sources of information, and are under the management of the government. However, countless pieces of information flow through the Internet because of the advantage of anonymity. Recently, a bribery case was prosecuted with an indication through the Internet serving as the initial reason for such prosecution.

While keeping daily relationships with the media is costly, any widespread damage caused by the dissemination of negative information may be enlarged to several dozens of times the public relations cost of telling the company's side of the story. Accordingly, it is important that a company establish relationships with the media on a daily basis at least to ensure that the articles are written based on accurate information.

In particular, strong Internet contact should be a part of any company's public relations activities. First of all, information should actively be disseminated in China concerning the company's management policy, business activities and contributions to the local community. This can be done through a company's website to promote an understanding of the appropriate company image.

The representative measures through assuming increased business risks are discussed above. However, while measures to deal with risks must be carefully prepared, they have no meaning if the mindset of dealing with business in China becomes passive. Recently, conversations have emerged that critical feelings and/or opinions about China have started to appear among management executives at head offices in Japan, and this atmosphere is propagated to their local organizations in China. However, the total amount of trade between

⁹ This is most often negative.

Japan and China has already surpassed that between Japan and the United States. The relationships between Japan and China have developed into one that can be called a community. The development of China under international rules such as WTO will benefit many Japanese companies.

With the growing scale of risks, many of the measures against risks cannot be implemented without commitment of the head office in Japan. I hope that the head offices are united with their local offices to re-establish a strategy for China that is appropriate for the new competitive era. I believe that most Japanese companies should accelerate strategic localization to create Japanese brand image in Chinese market as soon as possible. Otherwise, the chance will lost and never come back.

Conclusions

When considering entering the Chinese marketplace, Japanese companies can never do too much planning. On one side of the coin, China is a market ripe with opportunities due in part to its strong labor force and low cost of doing business. But the other side of the same coin shows that it is important not to take Chinese culture lightly.

It is not by happen stance that China has grown to be an emerging economic giant. The Chinese have a long history and are a very proud people. To underestimate them by not appreciating the degree of sensitivity that goes into their society is a dangerous proposition. In fact, if no action is taken to improve the current situation, these problems may become even more serious in the future. Fundamental solutions to these problems will come from a deepening mutual understanding from each other. Learning from history is the work of learning from the past and, at the same time, is the work of burying past evils.

This is what I have mainly gained from the filed survey both in Japan and China. Through this article, I want to share it with those Japanese companies who are trying to enter the Chinese market.

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