

Japanese Businesses in New Phase As East Asian Economy Heads to Integrated Whole

By Akashi Toshio

Introduction

The emergence of China, ASEAN and other economies in the East Asian region has been remarkable in recent years. Their combined real gross domestic product (GDP) accounted for 27.6% of the world's GDP in 2005, up from 21.5% in 1980. The region, sometimes dubbed "the growth center of the world," is having an increasing influence on the global economy. Real economic activities are said to have spearheaded the effective integration of the East Asian economy. A recent spate of economic partnership agreements (EPAs) and free trade agreements

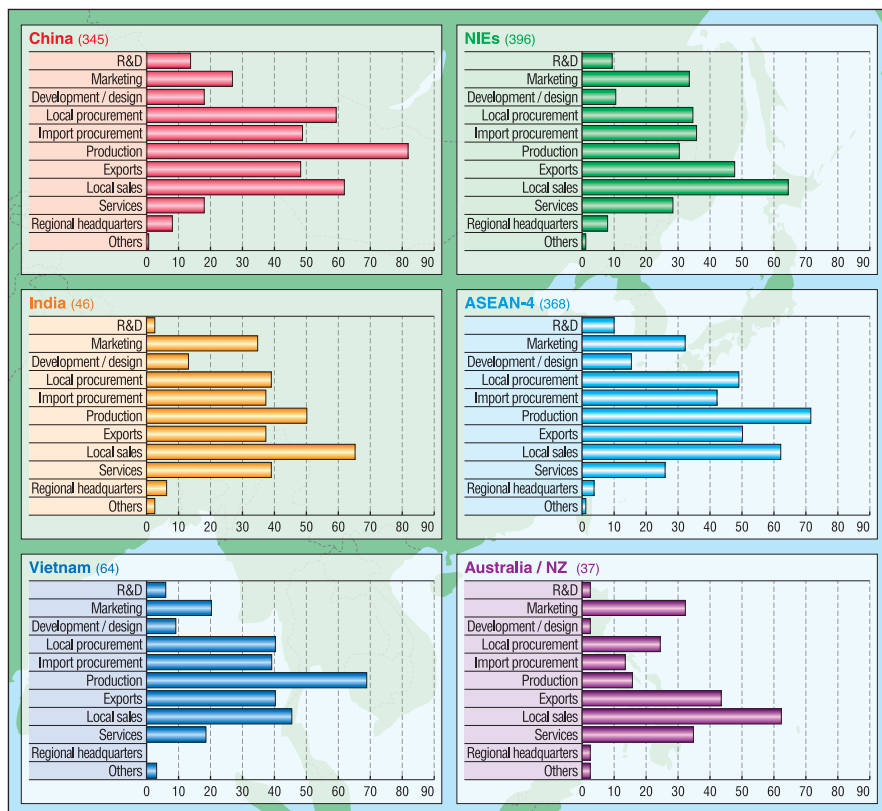
(FTAs) has brought about institutional integration as well, embracing even India, Australia and New Zealand. Progressing economic liberalization within the region is making business environments in East Asia borderless and seamless. Business networks in East Asia, led by Japanese companies, are becoming sophisticated and deepening ties with the regional economy. In this article I would like to focus on new changes in the region from the perspective of production and shed light on how progress is being made in economic realities that now require EPAs / FTAs covering the entire region in institutional and policy terms.

1. Expanding Japanese Business Networks in East Asia

The expansion of EPAs / FTAs in East Asia has lowered trade barriers, making the regional economy seamless, unfettered by national borders. In addition, such factors as regulatory and system reforms in regional countries are giving companies more freedom in their business activities. Under such circumstances, Japanese companies' business networks are believed to be expanding and deepening further. (Chart 1)

According to a recent survey, Japanese business networks have undergone changes in the last three years. Many respondents to the survey cited as such changes increased concentration of production by products / parts and increased numbers of East Asian countries in which they procure parts and sell goods. Also high in the percentage of replies was expanding division of labor in the manufacturing process not only between Japan and other East Asian countries but among East Asian countries other than Japan. Those survey results show that Japanese companies are increasingly adopting systems for division of labor in several countries and regions, whether within a single company or among several companies. The survey indicates at the same time that Japanese companies are moving to consolidate production and supply functions scattered in various countries and regions – a move pursuing economies of scale – and to take other measures. Such moves are based on the perspective that East Asia is becoming a single market as a whole. (Chart 2 on the next page)

Chart 1 Business functions held in East Asia by Japanese manufacturers
(No. of companies in parentheses)

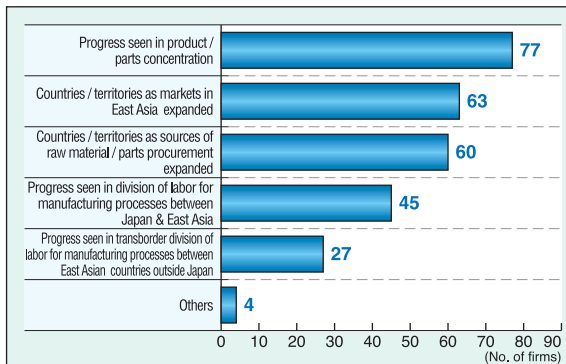


Source : Japan Industrial Policy Research Institute

(1) Progress in Division of Labor for Manufacturing Processes in Many Countries

Asked about changes in the last three years with regard to procurement of parts and materials by Japanese companies from their East Asian bases, the largest percentage of respondents said the value

Chart 2 Changes in East Asian production / sales networks of Japanese manufacturers in past 3 years
(173 respondents, each picking more than 2 replies)



Source : Japan Industrial Policy Research Institute

of their local procurements has increased. Notably, a high percentage of Japanese companies said they have increased parts procurement not only from their own bases in the region but from other places, namely China and ASEAN. In the survey, about 30% of companies with operational bases in China and about 40% of those with footholds in the ASEAN region said they are procuring from places other than their own bases.

Of the companies that said the amount of procurement from Japan has decreased, many replied that in contrast, they have boosted procurement from their local bases or from China and ASEAN where they do not have footholds. The replies show that the market for procurement, such as parts supply, is growing in the East Asian region. Among factors behind such a trend is, in the first place, the growing capability of China and ASEAN to supply parts thanks to direct investment from Japan, newly industrializing economies (NIEs), Europe and the United States. Another factor is that EPAs / FTAs such as the ASEAN Free Trade Area (AFTA) have lowered tariff barriers within the East Asian region.

(2) Consolidation of Production / Supply amid Regional Market Integration

Characteristic of recent moves is progress in the consolidation of production and supply functions by companies pursuing economies of scale in East Asia, particularly in the ASEAN region.

A network of agreements in East Asia is continuing to grow. It includes AFTA, the Closer Economic Partnership

Agreement (CEPA) between China and Hong Kong, the ASEAN-China Free Trade Agreement (ACFTA) and the FTA between Thailand and India. Before the formation of such agreements, these markets were protected by high import duties. In order to enter these markets, it was necessary to build a separate production base in each country. However, with the EPAs / FTAs bringing down tariff barriers and opening up markets, it has become easier to treat the region as one unified market and to set up a production and supply system accordingly. In other words, it has become easier to pursue economies of scale such as cost cuts through mass production and improved product lineups based on the philosophy of “selection and concentration.” Encouraged by such changes in the business environment, Japanese companies are pushing forward with efforts to restructure and enhance the efficiency of their East Asian business networks according to their own management strategies.

A look at specific trends shows that from the 1990s to the beginning of the 2000s, Japanese companies tended to shrink their manufacturing operations in Japan, which had considerably lost their edge in terms of price competition, and to relocate production to East Asia. In recent years, however, Japanese businesses are sometimes reshaping their East Asian production and supply bases regardless of their footholds in Japan. They now regard the East Asia region as one market, seeking to set up the most efficient manufacturing systems in the region mainly for local market supply. They are thus pursuing economies of scale by cutting costs and improving product lineups.

2. Increasingly Unified East Asian Market & Flexible Plant Locations

Tariffs between China and ASEAN will be gradually brought down by the FTA, and Vietnam is expected to deep-

en ties with other regional economies. The East Asian region is likely to become more seamless or unified in the future as a result.

Amid these changes, Japanese companies will likely have more opportunities to improve the efficiency and optimization of their production and sales systems through consolidation and realignment of their local manufacturing functions and other business operations. In fact, Japanese companies are moving to dissolve, withdraw or transfer their local subsidiaries in line with reorganization of corporate structures and review of management resources. A high percentage of companies cite these moves as reasons for closing some footholds and merging others in the region. It is hoped that further improvements will be made in the business environment in the future so that such moves may take place more flexibly and quickly.

For East Asian countries, the lifting of barriers in the regional market means greater chances to lure direct foreign investment. Regardless of the size of demand in the East Asian region, foreign investors will be interested in setting up manufacturing and supply bases if a location is deemed to have enough investment appeal. Each country is therefore expected to boost efforts to create an attractive business environment, contributing to further development of the region.

Conclusion

As the East Asian economy heads toward a seamless, integrated whole, Japanese companies are working to enhance productivity taking advantage of the trend. They now look at the region as one unified manufacturing base, dividing production processes in several countries. They also see the region as an integrated market, consolidating manufacturing and supply functions, and expanding and deepening their business networks. JS

Akashi Toshio is Research Officer, Policy Planning Research Division, Trade Policy Bureau, Ministry of Economy, Trade & Industry.