Risk Management & Direct Investment — Cases from Japan & Uzbekistan

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Introduction

The 21st century has seen globalization increasing with the widespread application and integration of cutting-edge technologies and international business. Moreover, the development of innovative technologies has been transformational, with international trade, cross-border movements and global financial transactions now resulting in a deeply interconnected world. As a consequence, economic instability or political turbulence in one country can affect the rest of world and create vulnerability in markets. Globalization and technological advancement have also become the driving engines of foreign direct investments, with many iconic conglomerates rapidly expanding their business around the globe by this means.

In recent years, numerous Japanese enterprises have been outsourcing their production outside Japan and actively conducting activities internationally to expand their business. For instance, Indonesia, China, Mexico, Vietnam and even Myanmar are popular destinations for Japanese direct investment. However, countries in Central Asia, including Uzbekistan, have not been as popular in this regard as many other nations. Nevertheless, in my view, many Japanese enterprises are not doing enough to pursue the potential opportunities in other emerging economies and markets. Why is it that Uzbekistan cannot attract foreign direct investment, or to put it another way, why do Japanese companies not have plans to invest in Uzbekistan? What could be the potential barriers? In the following, I would like to examine these concerns by looking at the micro and macro environment.

Micro Environment Analysis: Risk Management

It is widely known that enterprises face certain risks which can cause serious losses in profit or damage to their reputation. In order to avoid such threats, many conglomerates have been establishing "risk management" departments within their organizational structure. Managing risk effectively has always been a concern for most enterprises, but controlling reputational risk has now become more difficult than before because of technological innovations such as social media, the Internet and other mass-media publications which can quickly damage a company's name. Additionally, companies can also face backlashes from activist groups as well as negative media coverage that could affect their stock prices. Phil Maxwell, a director of risk management at The Coca-Cola Company, argues that "the speed of risks is so much greater now, and as a result you have to be more prepared — faster to respond than in the past." In my view, many large Japanese companies consider expanding into overseas market but are afraid of compliance issues, such as inadequate service or product quality.

Cultural Challenges: Risk Takers or Risk Avoiders

In order to get a better understanding of this issue, I decided to investigate the cultural attitudes of Japanese and Uzbek managers with regard to risk management and their perceptions of business, as the cultural component is paramount in doing business internationally. Theoretically, it is obvious that in individualistic cultures people behave differently from people in collective cultures. A well-known scholar and cross-cultural researcher, Edward T. Hall, identifies that in terms of communication Japanese people are rarely "outspoken" and refers to their "high-context culture" where "messages are indirect and unspoken" compared to West Asia and some nations in Europe. Furthermore, he says that unclear responses or "unspoken words", "expressions and body language" can play a crucial role in conveying messages, noting that the simple word "Yes" in Japanese does not necessarily mean agreement on every occasion, but can imply "No" or "Maybe" in verbal communication.

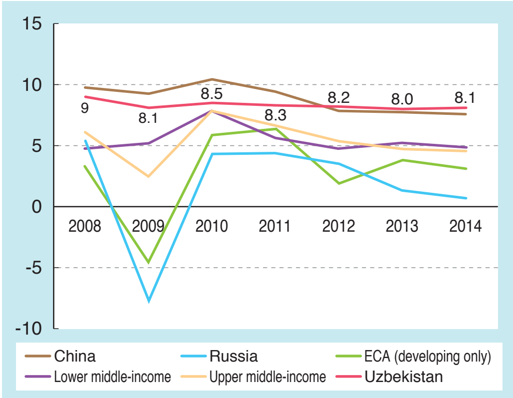
Whilst living and studying in Japan for three years, I have observed that many Japanese usually do not express their opinion straightforwardly. By contrast, people in Uzbekistan are overwhelmingly interactive in critical discussions and express their ideas explicitly. However, Uzbeks are more likely to be considered multi-active, tending to take risks and handle several tasks in a more relaxed and flexible way, whereas Japanese are more concentrated on time management and expend great efforts on planning in order to avoid unpredictable risks. Japanese managers plan carefully and discuss in detail before starting any task, a somewhat time-consuming process, while Uzbek managers start the task with draft plans and change the plan based on the process, fixing problems along the way.

From Japanese managers' perspective, risk management aims to analyze potential risks based on past events or historical data, and then to design and complete the task based on analyses that tend to focus on the prevention of serious failures. But from the standpoint of Uzbek managers, risk management is to examine potential risks, which may then be taken while completing the task. Uzbek managers are quite ambitious to achieve their ultimate goals through mitigating risks and obstacles.

One of the interesting points of the Japanese method is that when Japanese managers face trouble or problems in the process of accomplishing a task, they analyze the causes and try to find out what was wrong with their plans or what went wrong in their process, which takes up time and is a little bit inefficient. In contrast, when Uzbek managers have trouble or issues during a task, they try to solve that problem quickly and move forward to the next process in order to accomplish the project. The causes of the problem may be analyzed later on or outsourced to third parties. It is pretty hard to identify which method is the more efficient or better way to adopt in terms of risk management.

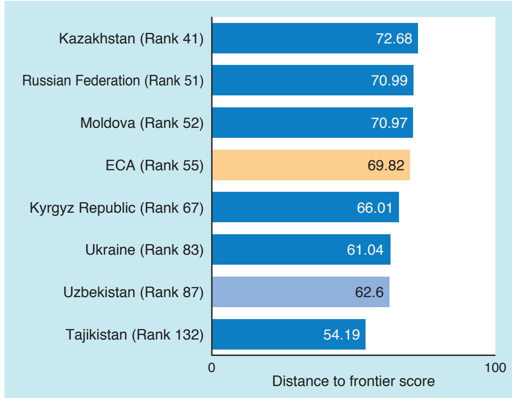
These kinds of cultural and also linguistic differences (Russian is more widely used in Uzbekistan than English) could be one of the barriers for Japanese investors in Uzbekistan, while Uzbek entrepreneurs also may struggle to understand Japanese business models and strategies that include avoiding high uncertainty when it comes to direct investment.

CHART 1
GDP growth in Uzbekistan, its key trade partners, ECA, lower & upper middle-income countries, 2008-14 (in %)



Source: Uzbek authorities and World Bank and IMF database

CHART 2
How Uzbekistan & comparator economies rank on ease of doing business (2015)



Source: Doing Business *database (2016)*

Macro Environment Analysis: Investment Environment in Uzbekistan

After the breakup of the Soviet Union, Uzbekistan started a new era in terms of shifting from a socialistic to a capitalistic market, against the backdrop of the geopolitical dilemma between East and West. On top of that, during the early years of independence — as Lionel Beehner, a political analyst at the Council on Foreign Relations, notes — Uzbekistan was threatened by terrorist attacks that were supported by Islamic extremist groups like the Islamic Movement of Uzbekistan and Hizb ut-Tahrir. The Uzbek government then started to implement belt-tightening policies for foreign companies, and it strictly controls security in all sectors, sometimes excessively in order to maintain peace and security in the region. To foreign investors, this may look like a closed and corrupt system. Indeed, several decades ago government officials turned a blind eye when it came to corruption and it remained a key obstacle for businesses, but things have changed dramatically and in recent years the government has been taking drastic action to eliminate corruption. Uzbekistan has adopted anti-corruption action plans and established an anti-corruption coordination commission.

I have learned that in terms of investment decisions, many Japanese companies used to obtain information about Uzbekistan's business environment from analytical reports by third parties, which may not necessarily have provided enough substantial information. I think that one of the best tools for acquiring reliable investment information is for Japanese investors to go to Uzbekistan and conduct their own research in order to acquire a full understanding of business opportunities in Uzbekistan.

Moreover, in terms of macroeconomic performance, Uzbekistan has been able to maintain high growth and sustainable GDP of around 8% over the last seven years *(Chart 1)* with GDP growth averaging 8.3% per annum between 2008 and 2014. This makes Uzbekistan one of the fastest-growing economies among the Europe and Central Asia nations.

Mining is one of the important economic drivers of Uzbekistan, including gold, silver, platinum and copper which are the second most significant export commodities. However, lots of domestic enterprises are struggling with old-fashioned technologies and do not have much production capacity. If Japanese companies bring their state-of-the-art innovative and efficient technologies in these fields, production and exports could be boosted in the future. Value-added production is paramount for Uzbekistan and an automobile assembly plant in Andijan (GM Uzbekistan), an automobile power plant in Tashkent (GMPT), and a bus production plant in Samarkand (Isuzu) are good examples of successful foreign businesses in the country. But even though these automobile companies have established production lines in the country, they mainly import all parts and components from outside the country. So I think it would be better if the Japanese automobile parts companies bring their own production lines close to the giant factories and boost production in the region.

Uzbekistan is gradually revamping its image and reputation in the global business community, and in 2015 the nation was ranked 87 out of 189 nations in terms of doing business and investment opportunities *(Chart 2)*. In point of fact, there are plenty of advantages in Uzbekistan for foreign investors, such as a low corporate tax rate and inexpensive labor costs. Particularly, the overall corporate tax rate in 2015 was 7.5% while financial institutions like banks were subject to double that rate at 15%, reasonably low compared to other emerging countries. In addition, certain entities will have a chance to receive exceptional benefits like a 50% profit tax reduction if the company generates more than 30% of its revenue from overseas markets by exporting its products or services. I believe this kind of advantage will open the doors to better business opportunities if Japanese companies consider bringing their investment projects to Uzbekistan.

Possible Solutions

I would like to suggest some possible solutions for in-depth development and business integration. Firstly, Japanese and Uzbek managers should implement competitive global management tactics in which a certain degree of risk is taken and controlled for better business integration. Secondly, since Uzbekistan is a largely unknown market for many Japanese companies, Uzbek officials should organize plenty of seminars and promotional materials and reports in various languages in order to attract foreign investors, particularly Japanese, and in the meantime a specialized support team should be established for investors from Japanese companies. And thirdly, Japanese companies should conduct their own research and analysis in Uzbekistan and observe the reality and opportunities, rather than relying heavily on third party reports.

Finally, I believe that there are massive investment opportunities in Uzbekistan, particularly for Japanese companies and especially in the natural resources and automobile sectors, among others. The Uzbek government is preparing a healthy investment environment to make it easier for foreign investors to do business. I passionately believe that Uzbekistan will become a popular destination for Japanese investors in the future, irrespective of cultural or linguistic barriers. JS

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