Special Topic

Localization of Management in Japanese-related Firms in Indonesia

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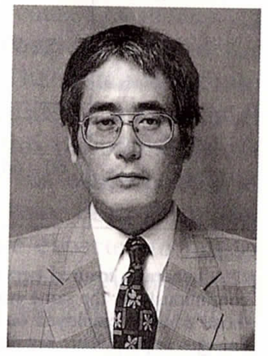

1. Hypothesis and Data

Japanese overseas firms have an international reputation for being slow to localize management arrangements. Slow localization itself is not necessarily to be condemned or criticized, as a firm's goal lies not in localization but in exploiting local circumstances to maximize profits. However, reluctance to localize may result in the management of Japanese-related firms being disadvantaged: they may be unable to attract capable people, or their most capable employees may leave. This difficulty in retaining capable employees further delays localization, and sets up a vicious cycle. To promote localization, host country governments may impose regulatory measures on foreign firms that would limit the free behavior of firms and may result in the loss of good business opportunities.

In addition to these potential disadvantages, slow localization increases labor costs, especially for Japanese expatriates, as many would be forced to extend their time in overseas subsidiaries.

As Japanese-related firms are probably aware of the disadvantages of slow localization, the question is "Why do they seem reluctant to localize their management?"

Before considering the background to slow localization, we should examine the assumption that Japanese-related firms have a localization policy. The policy depends largely on the Japanese share of stock in the firm, and despite any disadvantages, Japanese-related firms might actually be reluctant to become localized. If this is correct, the next obvious question is: "Despite the negative impression given by their reluctance and the obvious disadvantages suffered, what makes these companies so reluctant to localize?" Further, if they do in fact want to be localized as soon as possible, but cannot do so, what factors are preventing this?

While the causes of slow localization by Japanese firms have been discussed from various viewpoints, our hypothesis, at least as far as manufacturing firms are concerned, is that the slowness is partly related to their adherence to their efficient production systems. Japanese manufacturing firms in the automobile, electric, and steel industries are known for their management efficiency and assurance of high quality, despite continuing to suffer the effects of insufficient and delayed measures against the collapse of the bubble economy.

Characteristics of the Japanese production system in the manufacturing sector include: efficient, flexible, and high quality production; an intimate relationship between design divisions and production divisions; strict shop floor monitoring by supervisors; and well-trained workers. It would seem logical that Japanese firms adhere to transplanting such a production system to their overseas subsidiaries, as it is the only system they know, and it seems to promise good performance. However, this system requires well-trained managers, engineers, supervisors, and workers. Transferring the production system and training highly-skilled employees takes time. Thus, adherence to transplanting a production system could slow down the process of localization.

If the rate of localization is a result of this adherence, then the speed of localization depends on the rate at which the production system is transferred and highly-skilled employees are trained.

To sum up, our hypothesis is that Japanese firms may be slow to localize because of their localization policy. Further, this slowness may be due in part to their adherence to maintaining their own efficient production system. In other words, for these firms, localization is commensurate with the successful transfer of their production system.

In examining the hypothesis, we used data from 100 Japanese-related firms operating in Indonesia*.

2. Japanese Expatriate Ratio

First, we examined the average Japanese expatriate ratio. The ratio of Japanese expatriates to total employees is 1.8 percent. The ratio of Japanese division managers to total division managers is 34.3 percent. Two out of three, or 66.6 percent, of division managers are Indonesian nationals. The ratio of Japanese directors to total directors is 70.5 percent. The ratio of Japanese division managers and directors to total division managers and directors is 46.2 percent. It is difficult to judge whether these ratios are comparatively high or low, but one obvious feature is the much higher ratio of Japanese directors compared to the ratio of Japanese division managers.

3. Localization Policy

Let us then look at the localization policies of Japanese-related firms and consider whether they want to be localized.

The proportion of firms that do not plan to localize top management is 45.0 percent. It is understandable for Japanese-related firms to keep the ultimate management responsibility in the hands of Japanese expatriates. In fact, in firms with no policy for localization of top management, there is a very high tendency for the ownership of stocks to be concentrated in Japanese hands. For example, in firms where Japanese people hold less than 50 percent of the stock, only 17.4 percent have no localization policy, whereas in firms where Japanese people hold 50 percent to 75 percent of the stock, the ratio is 44.4 percent. In firms where Japanese people hold between 75 percent and 100 percent of the stock, it is 44.8 percent. In firms that are 100 percent Japanese owned, 76.2 percent have no policy for localization of top management.

Although many firms do not have a policy for localization of top management, few firms have no policy to localize divisions. In other words, they are willing to advance localization in the divisions. In fact, Indonesians have already taken responsibility for divisions in 50 percent to 70 percent of Japanese-related firms. Even firms with Japanese holding a higher share or 100 percent of the stock have a localization policy for divisions other than top management.

Japanese-related firms seem to be willing to advance localization in all divisions except top management. However, why is the percentage of firms practicing localization not higher than 50 percent to 70 percent?

4. Analysis

To determine what affects the speed of localization, we use regression analysis on data collected from 100 Japanese-related firms. The dependent variable is the ratio of Japanese directors to total directors. Independent variables and their expected causal relations are as follows:

1) Length of operation

The longer the firm has been established, the lower the ratio of Japanese directors.

2) Number of employees

The larger the size, the lower the ratio of Japanese directors. This is because larger firms attract capable local workers more easily and have more director positions available.

3) Japanese share of stock

The greater the share, the higher the Japanese director ratio.

4) Top management localization policy

The less positive the company is in localizing top management, the higher the Japanese director ratio. For the analysis, we substituted the category variable for a numerical variable, that is, four for "no top management localization policy," three for "localization will take a long time," two for top management will be localized soon," one for "top management is already localized."

5) Difficulties with production

The variable is a proxy variable that indicates the degree to which the production system has been transferred. The fewer the number of difficulties, the lower the Japanese director ratio. The variable ranges from zero (no difficulty) to seven (difficulties with all seven items, such as, for example, prompt trouble shooting).

6) Well-trained engineers

This variable is also a proxy variable. The more highly trained the engineers are, the lower the Japanese director ratio. The variable ranges from seven (unable to perform all seven tasks, such as production planning) to 28 (able to perform all tasks independently).

The results of the analysis, shown in Table 1, reveal very interesting facts.

First, neither duration of the operation nor company size have any significant effects on localization of

Table 1. Result of Regression Analysis

	(1)	(2)
Constant	26.616 (2) (2.597)	61.756 (1) (3.851)
Length of operation	-0.051 (-0.458)	-0.031 (-0.287)
Number of employees	0.03 (0.289)	0.072 (0.721)
Japanese share of stocks	0.359 (1) (3.602)	0.365 (1) (3.750)
Top management localization policy	0.309 (1) (3.115)	0.255 (1) (2.652)
Difficulties with production	0.162 (3) (1.736)	
Well-trained engineers		-0.227 (2) (-2.443)
Adjusted R squares	0.293	0.330
Dubin Watson ratio	1.939	2.015
Number	88	88

Notes:
(1) significant at one percent level, (2) significant at five percent level, and (3) significant at 10 percent level.

director positions. It is often observed that Japanese expatriates decrease in number as time goes by. However, this does not necessarily mean that localization of management positions advances with the duration of operation. It should be noted here that the change in the number of Japanese expatriates is different from localization.

Second, the Japanese share of stock has a significant, positive impact on the Japanese director ratio. The higher the Japanese share, the higher the Japanese director ratio.

Third, the top management localization policy also has a significant, positive impact on the ratio. If a company has no localization policy concerning top management, the ratio of Japanese directors to total directors remains low. In other words, the localization policy for top management affects localization in the other divisions.

The fourth finding, and that of most interest, is that the variables that are expected to indicate the degree of production system transfer have a significant, positive effect on localization of director positions. The more difficulties with production there are, the higher the Japanese director ratio. In other words, the fewer the difficulties, the lower the Japanese director ratio and the higher the Indonesian director ratio. Moreover, the more highly the engineers are trained, the lower the Japanese director ratio and the higher the Indonesian director ratio.

To sum up, the more successfully the production system is transferred, the further localization is advanced.

5. Conclusion

The share of stock held by Japanese, the localization policy for top management, and the degree of the production system transfer are the main factors significantly affecting localization of directors in Japanese-related firms in Indonesia.

Of the three factors, the degree to which the production system has been transferred is a convincing factor. When production does not go well, the firm needs more Japanese expatriates. As Indonesian production engineers become better trained and the difficulties with production are reduced, localization of management is further advanced.

The influence of the other two factors does not seem to be as convincing as that of the degree of the production system transfer. Why is it that the higher the proportion of shares held by Japanese, the lower the Indonesian director ratio? Why is it that the more reluctant the company is to localize top management, the lower the Indonesian director ratio? Japanese-related firms might be cautious about localization without any pressure from Indonesians. For some reason, the policy for top management localization extends its influence to localization in other divisions.

If localization is to be advanced further in order to take advantage of good business opportunities and avoid government regulation, these two factors have to be considered. Length of operation does not automatically advance localization of management. It is not unexpected for host country governments to put pressure on Japanese-related firms to further localize, or to limit the positions that Japanese expatriates are allowed to take.

Note:
* For further details see Nakamura, Keisuke, ed. *Management Comparison and Localization: Indonesia and Japan*. Center for Japanese Studies, University of Indonesia, Jakarta: 2000. In addition to the localization of management at Japanese-related firms, this study compares the management practices and performance of 200 Indonesian firms and 100 Japanese-related firms.

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EU-JAPAN SYMPOSIUM

New Employment Strategies in the EU and Japan: Adaptability and Entrepreneurship

Since 1991 the Japan Institute of Labour (JIL), in cooperation with the Ministry of Labour and the European Commission, has held a series of symposia dealing with labor issues common to Japan and the European Union. The aim has been to promote mutual understanding and to explore solutions to commonly shared problems. On March 6, 2000, the eighth such symposium was held in Tokyo. At present, the maintenance and expansion of employment is one of the most crucial labor policy issues both in Japan and in the EU. The Japanese government, together with labor and management, has joined in a concerted effort to put forward new policies aimed at creating job opportunities and establishing an environment in which people can work in various ways. The member nations of the EU are seeking through their shared employment strategy arrangements which will allow labor to be reallocated flexibly, facilitate the establishment of new businesses and foster the entrepreneurial spirit. The symposium revolved around the maintenance and expansion of employment as the main theme. It consisted of two sessions – one on "adaptability" and the other on "entrepreneurship." Throughout the symposium some 150 participants from government, labor, and management in Japan and the EU countries, including people from foreign embassies in Japan, engaged in lively discussions.

The first session on "adaptability" opened with keynote addresses by Japanese and EU experts.

Takashi Araki, Associate Professor of Law at Tokyo University, described the idea of "adaptability" as an approach to increasing productivity and competitiveness whereby labor and management use flexible employment patterns such as part-time work and flexible workplace practices to adjust to social and economic change. He stressed the importance of balancing work flexibility with job security. Prof. Araki analyzed the diversity of approaches in Japan, the EU countries and the U.S. While American companies simply seek their own flexibility and leave employment issues to the labor market, in the EU such flexibility is developed through labor-management negotiations. In Japan, too, large companies seek to balance flexibility and employment security through negotiations with labor unions. However, such negotiations generally occur between the two parties within the same company and this method of achieving a balance in the large-scale sector does not work properly for small- and medium-sized firms where unions have not been organized. Thus, it is left to governmental policies and legislation to lay down the principles governing Japanese workplaces as a whole, and the function of labor-management negotiations is limited compared to the EU.

Dominique Anxo, Associate Professor at Göteborg University in Sweden, described the situation in the EU. He indicated that a growing number of European enterprises are introducing new methods of organizing production in accordance with structural changes in society and the economy resulting from economic globalization and the introduction of new technologies. He said they need to reconsider ways of regulating working hours in response to the shift away from traditional approaches to work organization and production systems, to new and more flexible ones. This was seen as involving a greater commitment on the part of workers, a reorganization of hierarchical structures, and a shift