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# Japanese Foreign Direct Investment in the Czech Republic: A Motivational Analysis

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## Abstract

This paper examines the recent history and current status of Japanese foreign direct investment (FDI) in the Czech Republic, which represents about US\$ 1.8 billion in investments and employment of more than 31,000 local workers. By contrast, Japanese FDI in other countries in the region is insignificant. Data describing the historical development of Japanese investment are analyzed, showing that the automotive and electronics sector dominate. The paper discusses reasons for Japanese FDI in the Czech Republic and presents findings from a small exploratory survey of Japanese expatriate managers in the firms' Czech operations. Distinguishing aspects of Japanese investment in this country appear to be related more to cultural similarity factors and availability of skilled labour than to the typical attributions of investment incentives, low-cost labour, supply-chain linkages, and relative political stability.

**Key words:** foreign direct investment (FDI), Japanese companies, Czech Republic, Central and Eastern Europe.

## Introduction

Economic and political rejuvenation in Central and Eastern Europe (CEE) has attracted significant amounts of foreign direct investment (FDI) – some of it from neighbors, but in one key instance from an unexpected source: Japan nearly ties Germany as the leading foreign investor in the Czech Republic. Since 1993, the Czech Republic has rated high on an FDI overall attractiveness scale prepared by the United Nations; the country is expected to continue gaining significant foreign investments between 2004 and 2007 (UNCTAD, 2004a). In the 2004 A.T. Kearney/Foreign Policy Globalization Index, it ranked fourth in FDI proportional to GDP, and 14th most globalized overall, with Slovenia (at 19th) being the only other CEE country among the top 20.

The “familiarity theory” of foreign direct investment would lead us to expect that multinationals from neighbouring countries, rather than distant ones, would be more active in exploiting opportunities presented by labour cost differentials and investment incentives (Chang, 1995; Erdal & Tatoglu, 2002; Ramirez, 2002). However, this is not completely true in today's Czech Republic, where the leading foreign investors (Germans) were for a short period in 2003 replaced by Japanese multinationals (CzechInvest, 2003b), which for several years have ranked second. According to the Czech government agency responsible for attracting foreign investment, from January 1992 to April 2004 German firms invested more than 26% of the Czech Republic's cumulative direct investment, with Japanese MNCs following at 21% (CzechInvest, 2004). This anomalous finding is a key motivator of the present research. It is therefore not surprising that the CzechInvest website “speaks” not only Czech and English, but also Japanese.

After exploring the local market in the early 1990s through their trading arms, Japanese firms have established important manufacturing and even R&D facilities in the country. The Japanese presence in the Czech Republic is more intensive than in Poland, Hungary, the Slovak Republic, or Slovenia (see Table 1), all countries in Central Europe, emerging from former Soviet dominance and facing similar transition processes. For this report, we have studied the approaches used by Japanese companies to enter the Czech market, and examined the opinions held by their expatriate managers about this new investment environment and the consequences of the major cultural differences with their home country.

Table 1

Comparison of Japanese investment share in cumulative foreign direct investment among Central European countries

	Country				
	Czech Republic	Hungary	Poland	Slovakia	Slovenia
Japanese investment share in the country FDI	23%	5%	< 1%	< 1%	< 1%
Largest investor	Germany 26%	USA 29%	France 20%	Germany 24%	Austria 32%
Data source	CzechInvest	ITDH	PAIZ	Sario	TIPO
Period	Jan. 1992 - April 2004	Jan. 1990 - Dec. 2002	Jan. 1990 - Dec. 2003	Jan. 1993 - Mar. 2004	Jan. 1994 - Dec. 2002

Note: Figures do not include local and other than direct investments. Authors' calculations from raw data.

The presentation of our findings occurs in three parts. First, we report on the number and structure of Japanese business activities in the Czech Republic; next, we consider the reasons for Japanese FDI in the country; and finally we present the outcomes of a brief survey of top managers of Japanese companies in the Czech Republic. We intend for this study to promote further discussion about the presence of Japanese businesses in Central Europe, particularly about the reasons for massive Japanese investments in the Czech Republic.

### **Bilateral Relationships between the Czech Republic and Japan**

First reports about Japan were published in the Czech lands in the 16th century; direct contacts with Japan began in the 19th. The Meiji revolution brought Japanese travellers to Czech territory, seeking new technologies and standards for its rapidly developing industries. By the end of the 19th century, many Czech travellers (e.g., Josef Kořenský, Alois Svojsík, Barbora Eliášová) had visited Japan and their interesting reports were even designated as a special genre of literature, called Japonery (e.g., writers Joe Hloucha and Jan Havlasa).

Czech manufacturers built a long-lasting reputation for quality in Japan due to their exports of weapons during the Russian-Japanese war (1904-1905). This path was pioneered by Škoda Plzeň, which manufactured the rudder for the Japanese battle ship Mikasa in 1900. In 1907, the Czech Laurin & Klement automobile appeared in the fleet of the Japanese emperor, the Showa. The first diplomatic relationships between Czechoslovakia and Japan were established on September 9, 1918, when the Japanese government confirmed the National Committee of Czechoslovakia as the official government of the country in its struggle for independence from Austria, which was not finalized until the following month (October 28th). Starting in October, there was a Czech commissioner in Japan, upgraded to full ambassadorial status in 1920. Diplomatic relationships were interrupted between 15 March 1939 and 13 February 1957. Official economic relationships were re-established by the Agreement on Trade and Navigation, signed in 1959.

Bilateral relationships have since then developed in many ways. Japanese are familiar with Czech classical music and its performers; the Japanese language is taught as a major subject at two Czech universities as well as being offered at several others. On the political level, the imperial couple visited Prague in August 2002, and Prime Minister Junichiro Koizumi came in September 2003.

### **Japanese Businesses in the Czech Republic**

The history of Japanese business interests in the Czech Republic commenced at the end of the 1960s, when several young Japanese researchers and businessmen came to inspect new oppor-

tunities arising with the opening regime, and to learn new process methods, especially in the textile industry. Probably the first company with a permanent “pseudo-office” in Prague was the large trading company (sogo shosha) Mitsui & Co., Ltd., whose representative established a base for the firm’s activities in a luxury hotel in 1968.

25 years passed before JETRO (Japan External Trade Organization) established its office in Prague, in 1993. The pioneers in establishing Japanese production bases followed, with Matsushita (1996, televisions, in Plzeň) and Toray (1997, polyester fabric, in Prostějov) leading the way. Prior to that point, Japanese companies were represented by trading arms rather than manufacturing facilities. Table 2 summarizes the development of Japanese investment in the Czech Republic.

Table 2

Japanese Companies in the Czech Republic (1993-2004)

Year	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Firms	7	9	14	21	31	41	53	66	79	102	123	150
Announced investment (cumulative in million US\$)						430	730	1,038	1,312	1,470	1,536	1,783

Source: JETRO Prague annual reports (1997, 1998, 1999, 2000, 2001, 2002, 2003, 2004) – earlier figures not available.

Over time, Japanese investment became highly significant in the Czech Republic, along with investment from Benelux and Germany (CzechInvest, 2003a).

During each of 1999, 2000, and 2001, total Japanese investment in the Czech Republic increased by about US\$ 300 million; by the end of 2001, Japanese companies employed more than 18,000 people (as shown in Table 3). The most recent key FDI announcement (in 2001) was a joint venture between Toyota Motor Corporation and PSA Peugeot Citroën to produce 300,000 compact passenger cars for the European market starting in 2005. Each partner owns 50% of the investment, expected to total 1.5 billion euros. About 3,000 direct new jobs will be created, and (based on CzechInvest’s estimate) we can expect a major increase in indirect jobs among suppliers and related services, so altogether at least 10,000 new job opportunities will be created.

Table 3

Japanese Investment in the Czech Republic (2001)

	Companies	Cumulative Announced Investment (million US\$)	Employees
Manufacturing	26	1,305	17,933
Strategic services	3	7	96
Sales, trading and others	50	-	562
Total	79	1,312	18,591

Source: JETRO Prague (27 November 2001).

During 2002, the anticipated announcements of linked investments by Toyota/Peugeot suppliers followed, with Tokai Rika Co. announcing plans to invest more than US\$ 80 million for a new security components plant. Other announcements included (all in US\$ millions) Aoyama Seisakusho Co., Ltd. (25, fasteners); Fujikoji Corporation (10, thermostatic expansion valves); Takada (5, various components); Shimizu (12, plastic components); Denso Airs (7, aluminium tubes for air-conditioning systems); Aisin Seiki (13, engine components), Futaba Industrial Co., Ltd. (48, components), Sumitomo Light Metal Industries, Ltd. (15, extruded aluminium tubes for air-conditioning systems), and Toyoda Gosei (additional investment 15-20, rubber sealing products). A summary for 2002 is provided in Table 4.

Table 4

## Japanese Investment in the Czech Republic (2002)

	Companies	Cumulative Announced Investment (million US\$)	Employees
Manufacturing	42	1,457	21,290
Strategic services	4	13	141
Sales, trading and others	56	-	658
Total	102	1,470	22,089

Source: JETRO Prague (31 November 2002).

2003 was similarly fruitful concerning new investment plans of Japanese MNCs in the Czech Republic. Furukawa Electric Co., Ltd. laid the foundation stone of their new plant (US\$ 13 million, electronic components for automotive industry). Matsushita added another US\$ 9 million to expand a technology centre for televisions. Other announcements included Daikin Industries, Ltd. (US\$ 11 million, commercial-use air conditioners); Toyoda Machine Works (30, transmission and drive-train parts); Oiles Corporation (originally announced for Poland, 7, self-lubricated bearings); Nachi-Fujikoshi (10, bearings); and Olympus (3.35, high-tech repair centre for camera equipment). During 2003, it became evident that Japanese investors were locating their new sites in specific regions, especially in Plzeň and Louny. A summary for 2003 is provided in Table 5.

Table 5

## Japanese Investment in the Czech Republic (2003)

	Companies	Cumulative Announced Investment (million US\$)	Employees
Manufacturing	52	1,518	25,220
Strategic services	7	18	332
Sales, trading and others	64	-	1,113
Total	123	1,537	26,665

Source: JETRO Prague (1 December 2003).

In 2004, Asmo commenced construction of a new factory (18, servomotors for automobiles). This year also saw announcement of a Koito plant expansion (50, automobile headlamps), the festive opening of Denso Manufacturing Czech's site (255, automobile air-conditioning units), and another expansion of Panasonic AVC Networks (46, plasma televisions). At the end of August 2004, Kyocera revealed another investment plan (7, solar panels). Based on the success of its two major projects in Plzeň, Daikin decided to construct an additional factory for the production of compressors for air-conditioners in Brno in September 2004 (46 million USD). A summary for 2004 is provided in Table 6.

Table 6

## Japanese Investment in the Czech Republic (2004)

	Companies	Cumulative Announced Investment (million US\$)	Employees
Manufacturing	63	1,765	30,023
R&D, strategic services and others	7	18	338
Sales, trading and others	80	-	1,349
Total	150	1,783	31,711

Source: JETRO Prague (1 February 2005).

## Theory of foreign direct investment and its implications

Japan is among the world's leading sources of foreign direct investment flows (Crow & Chadee, 1996). Japanese overseas investment has focused on industries which are in decline in Japan (i.e., "sunset industries"), leaving exports to develop in domestic sunrise sectors. Japan has deliberately focused on penetrating foreign markets for high value-added, advanced products via exporting rather than through overseas investment. Consequently, Japanese companies, when compared with American and European multinationals, are relatively new players in the international arena, especially in the field of highly skilled and sophisticated production and R&D (Belderbos, 2003). Over time, Japan has shifted from being a significant exporter of goods to a major exporter of manufacturing capital (McMillan, 1996). However, some of Japanese firms have been recognized as internationally oriented from the very beginning in all their functions, e.g., Sony (Morita et al., 1986).

Dunning's ownership-location-internalization (OLI) "eclectic paradigm" is a useful tool for assessing FDI in general (e.g., Dunning, 1988). The variables related to the paradigm are reflected in managerial perceptions of asset power, market attractiveness, and costs of integration (Brouthers et al., 1999). Implications of Dunning's paradigm for Japanese FDI in the Czech Republic might be a topic for future research as the paradigm considers a variety of issues. This paper delineates only some of the key OLI attributes, focusing on the potential advantages of the Czech Republic over the other central European countries.

Cost advantage is frequently held to be a key criterion in deciding FDI locations (He & Long, 2003). Holland et al. (2000) conducted a comprehensive study of FDI in CEE. They found that in the Czech Republic, labor cost advantage was considered to be more important than asset power or market attractiveness. However, this finding is contradictory to other authors such as Moline (2004), who points out that an average salary for low-skilled worker in the Czech Republic is approximately US\$554 a month, while a comparable Polish figure is US\$ 487 and in Hungary only US\$ 424. As a result of their accession to the European Union on 1 May 2004, several central European countries (the Czech Republic, Hungary, Poland, Slovakia, and Slovenia) will sooner or later face increases in labor costs and diminishing cost advantages.

Overall, there is evidence that FDI in Central and Eastern Europe has been affected mainly by the degree of political and economic stability in the various countries, influenced by the relative market size and growth potential (Holland et al., 2000). Although there are differences among central European countries, political and economic stability should no longer be regarded as a dominant decision factor for FDI planning. If these countries were not regarded as sufficiently stable, they would not have been permitted to join the European Union. Relative market size and growth potential would probably favor Poland over other countries in the region (see Table 7). However, each country in the region (and, indeed, throughout the European Union) offers interesting and valuable opportunities for manufacturing and marketing of products and provision of services.

Table 7

Relative market size of selected central European countries

Country	Population (million, 2003)	GDP per capita (PPP, USD, 2003)	Projected GDP per capita (PPP, USD, 2015)*
Czech Republic	10.2	15,700	28,726
Hungary	10.0	13,900	24,499
Poland	38.6	11,000	17,749
Slovakia	5.4	13,300	23,936
Slovenia	2.0	18,300	33,445

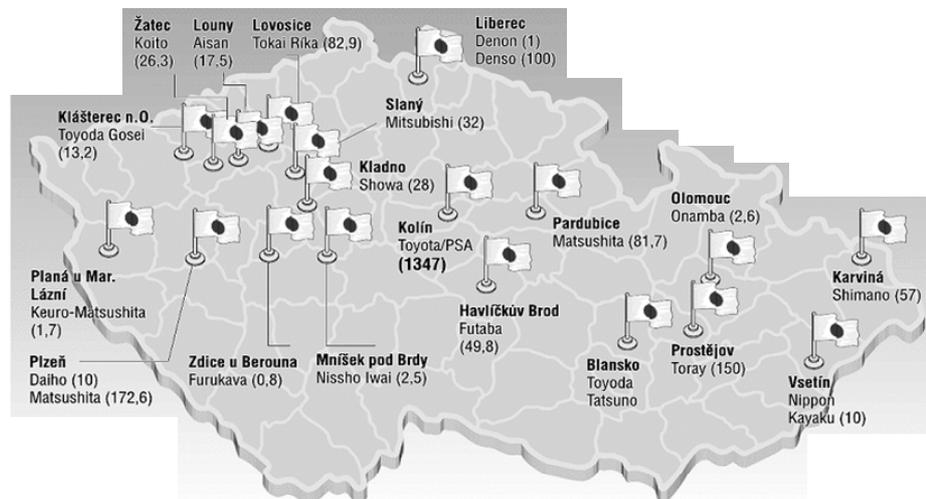
Data: CIA (2004); \* data from Havlik (2002) - projection assuming 4% p.a. GDP growth and zero population growth, converted at 1euro = 1.2 USD.

Large Japanese manufacturing companies are reported in the literature as intentionally spatially distributed. Arita and McCann (2002) examined spatial clusters of Japanese semiconduc-

tor manufacturers and concluded that much of their location behaviour could be explained by the multi-plant approach and supplier-buyer relationships. Spatial behavior considerations may also explain the concentration of Japanese companies in the Czech Republic.

Group behavior of large Japanese companies and the bandwagon effect were surveyed and repeatedly confirmed by several scholars (Kojima, 1978; Kim & Lyn, 1990; Ford & Strange, 1999; Arita & McCann, 2002). Japanese firms tend to locate in the same region as previous Japanese investments, and show similar patterns in their activities in the Czech Republic.

This spatial preference can be verified not only for the Czech Republic as a country, but for partial sub-regions within the country as well. For instance, the Plzeň industrial zone is heavily populated by Japanese investors (Matsushita, Daiho, Daikin, Koyo, Fuji Koyo, and others). A similar pattern is emerging north west from Prague around the towns of Louny, Lovosice, Slaný, Klášterec and Žatec (e.g., Koito, Tokai Rika, Mitsubishi Electric, Aisan, Fujikoki, Toyoda Gosei, Oiles, Kyocera, and others). A concentration of Japanese investors has recently begun to emerge in the industrial zone in Liberec (beginning with Denon and Denso). The situation in the end of 2003 is demonstrated in Figure 1.



Key: first line: town; second line: company; brackets: investment in million US\$.

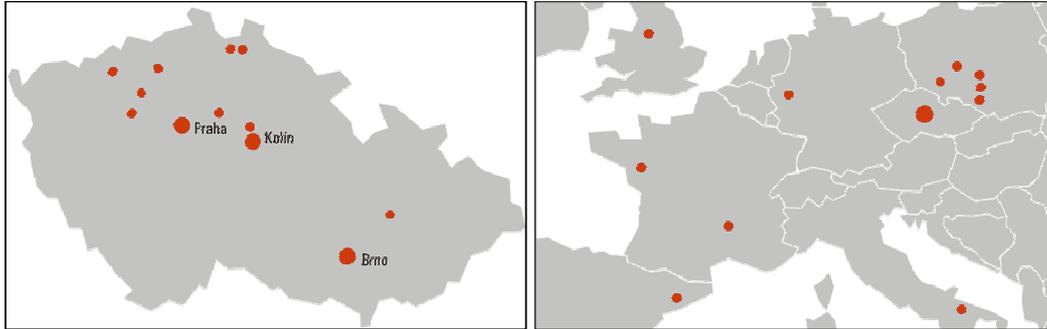
Source: ČTK, the Czech Press Agency (September 2003).

Fig. 1. Diffusion of Japanese companies in the Czech Republic

Considering the nature of the largest Japanese investment (Toyota joint venture with PSA) and the history of the automotive industry in the Czech Republic, a number of related companies have entered or will enter the Czech Republic, including Tokkai Rika, Fujikoji, Furukawa, and Toyoda Gosei. In this joint venture, Toyota is responsible for production, while PSA is in charge of purchasing and marketing. However, it seems that the majority of the suppliers will come from Japan (see Figure 2). The impact of this single large project on the overall number of Japanese companies in the Czech Republic cannot be underestimated and will require further analysis once production commences in 2005.

One theory of Japanese FDI patterns distinguishes high densities of related industrial activities, an educated and skilled workforce, minimal power of labor unions, and weak local competition as major investment decision factors (Ford & Strange, 1999). This corresponds with the Czech realities, with Japanese companies choosing this destination while referring to the success of their predecessors. An educated and skilled workforce together with a strong industrial tradition is also believed to be among key Czech FDI attractors (CzechInvest, 2003a). Table 8 shows that level of unionization and power of labor unions are not significantly lower than in other countries

in Central Europe, implying that the difference in labor unionization cannot be used as an explanatory variable. Exploring the level of local competition across industries (the last of Ford and Strange's criteria) would require an analysis beyond the scope of this study.



Source: TPCA (2005) Síť dodavatelů. Retrieved on 25 February 2005 from [http://www.tpca-cz.cz/cz/factory\\_supplier.php](http://www.tpca-cz.cz/cz/factory_supplier.php)

Fig. 2. Arranged suppliers of Toyota Peugeot Citroën Automobile Czech in the Czech Republic and in Europe

Table 8

#### Indicators of labor union power in Central Europe

Country	Unionization rate	Dominant level of wage bargaining	Collective bargaining coverage	Number of strikes and lockouts (1994-2003)*
Czech Republic	30%	Company level	25-30%	7
Hungary	20%	Company level	31%	58
Poland	15%	Company level	40%	1,564
Slovakia	35%	Sectoral level	48%	8
Slovenia	41%	Intersectoral level	100%	N.A.

Source: Carley (2004); \*International Labor Organization Statistics (2004).

The concept of FDI absorptive capacity considers a maximum FDI volume that a given host economy may absorb in a meaningful way (Kalotay, 2000). The latest data available show that the absorptive capacity of the Czech Republic is underutilized, and thus offers numerous further opportunities for foreign investors (UNCTAD, 1998). Manea and Pearce (2004) propose that FDI in CEE is currently primarily market-seeking, i.e. oriented toward production of goods for local/regional markets, rather than efficiency- or knowledge-seeking. However, this contrasts with the presence of Japanese MNCs in the Czech Republic, where FDI-based production is heavily exported outside CEE to Western European markets (Hoekman & Djankov, 1996).

Data for the end of 2003 show that Hungary lead the Central European region in number of Japanese expatriates, with 800, followed by the Czech Republic with 450 and Poland with 350 (Morita, 2003). Japanese FDI in Hungary and the Czech Republic was roughly equal at that time, with about half that total in Poland, in terms of value and number of companies, yet the ratio of expatriates to investments differed sharply. The Czech Republic featured approximately half as many Japanese expatriates per production site as did Hungary or Poland. Among the major Japanese production bases in Central Europe, those situated in the Czech Republic employ the lowest percentage of Japanese expatriates (Štrach, 2001), significantly reducing total branch labor costs. There are several possible reasons for this; it may be due to the good mutual understanding between Czech and Japanese managers, or, as Morita has proposed, due to Japanese investment in the Czech Republic being routed through German subsidiaries rather than directly from Japan, thereby necessitating fewer expatriates. It has been suggested to the authors during informal dis-

cussions with Japanese expatriates in the Czech Republic, that cultural proximity and long-standing cultural relationships between the two countries may be a significant driver for Japanese firms when considering new central European operations.

### **Survey among Japanese Managers in the Czech Republic**

In early 2001 a questionnaire was sent to 33 Japanese companies in the Czech Republic, all members of the Japanese Commerce and Industry Club. These companies are managed by a Japanese top manager, who was asked to complete the questionnaire; twelve reacted positively and sent their answers. Although such a sample is too small for general conclusions, the findings are interesting.

Due to the recognized importance of time to top managers, we minimized the time requirements for completing the form by adopting a format of selection from a set of offered responses. The goal was to confirm or contradict general assumptions about the Japanese style of management, about the role of Czech employees and women, about the circulation of Japanese managers, and about their opinions of Czech staff. Respondents could select more than one of the offered answers.

It was expected that all the respondents would speak English in the workplace and this hypothesis was confirmed. All managers communicated with subordinates in English; additionally, two utilized Japanese and one Czech. On the other side, they communicated with their superiors in Japanese (83%) or in English (17%). This supports the idea that in Japanese MNCs language barriers may imply communication problems or misunderstandings (Deresky, 2003).

An often mentioned issue in relation to Japanese management style is distinctive or otherwise disturbed relationships with non-Japanese employees and women in particular (e.g. Peterson, 1993; Kopp, 1994). This attitude can be objectively observed with regard to the relative importance of positions given to non-Japanese and women. Seven managers wrote that non-Japanese were in middle management in their organizations, and that their own positions were of national importance. Three managers thought that non-Japanese managers were occupying places in top management. One respondent answered that the highest rank of a foreigner was in low management. Women were regarded as being in positions of national importance in five cases, in middle management in six, in lower management in three, and in top management in one. (All of the respondents were male.)

Japanese businessmen are dispatched to foreign affiliates for a limited time period – usually for 3 or 5 years. Eight respondents planned to stay in the Czech Republic for five years, four for three years. This circulation of Japanese top managers may imply some instability of organizational systems, as each of the CEOs would have a different style of leading, different requirements, different motivation approaches, different promotional policies, etc. (see Šimková, 2000). This issue deserves further investigation, since Japanese MNCs must offer a time period acceptable to potential expatriates and their families while simultaneously achieving their own goal of managerial continuity. Japanese expatriates in the Czech Republic usually have broad experience gained at various overseas affiliates, but are at diverse stages in their careers.

The questionnaire also asked the opinion of the Japanese managers about various attributes of their Czech workers. They take Czech employees for flexible (7), clever (5), and active (4). Three respondents selected educated, polite, helpful, and open. No respondents indicated that they thought that Czechs were closed, business-like, realistic, or optimistic. The typical Czech worker employed by a Japanese company is a man between 25 and 35 years old with a high school education. The low average age may be connected to a common requirement for knowledge of English.

### **Conclusions**

Major firms from the land of the rising sun have already marked the Czech Republic on their maps, e.g., Toyota launched full production at its 300,000-vehicle joint venture with Peugeot Citroën in February 2005, while Matsushita operates a television manufacturing plant and software centre for the entire European market.

The Japanese business community is a comparatively closed society and companies are constantly afraid of leaking information. The intention of this paper is to stimulate discussion about an important and under-researched aspect of a major current economic issue. At present, Japan is the second largest source of foreign direct investment in the Czech Republic, a ranking it appears likely to retain for some time (OECD, 2003). This study discussed and conceptualized the arguments for high FDI inflow from Japan. Although the Czech Republic does not provide a large market, lower factor costs, or markedly higher levels of political and economic stability within the region, it does offer skilled labor, high FDI absorptive capacity, a strong industrial tradition, and an increasing number of Japanese companies and expatriates – all factors believed to be substantial attractors for incoming Japanese investments.

This discussion and exploration enhance the understanding of FDI theories and their applications adapted to specific local (Czech) and corporate (Japanese) settings, and links to previous work concerning Japanese FDI (e.g., Ford & Strange, 1999; Delios & Henisz, 2000). Similar patterns and group behavior among Japanese companies may be observed in the Czech Republic as in other locations (e.g., Arita & McCann, 2002; Iokibe, 2003),

Further research about the reasons for the high volume of Japanese investment in the Czech Republic in comparison with other Central European countries such as Poland, Hungary, Slovakia, and Slovenia is in order. Personal communications with Japanese managers indicate that greater cultural proximity between Czechs and Japanese may be a more significant factor than economic or supply-chain linkage criteria. Other sources cite an emerging high concentration of Korean companies in Slovakia (Đurianová, 2004; UNCTAD, 2004b), suggesting that bandwagon and crowding-in effects may play a major role in FDI attraction. Further research should apply both quantitative and qualitative analyses to examine FDI clusters in order to better understand the motivations of the investors.

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