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JAPANESE BUSINESS IN RUSSIA: LOCAL CHALLENGES AND ADAPTATION

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The improvement of the Russian investment climate encouraging an inflow of foreign direct investment (FDI) into the country's economy is being declared at the highest levels of the Russian government as an important objective for the further economic development of the country. However, one of the best ways to develop a comprehensive roadmap covering all the spheres which investors are interested in is to consider their opinions and ideas and react to the most urgent and critical issues which serve as obstacles to their investment activities in Russia.

This paper considers the case of Japanese investors in Russia and is based on a survey of Japanese companies doing business in Russia and several interviews with the representatives of the Japanese business community. We try to identify which factors attract Japanese capital to Russia and which hinder investment activities.

JEL classification: F21

Key words: Russian business climate, Japanese business, foreign investment in Russia, business culture, Japanese management

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Introduction

In recent years investment relations between Russia and Japan have experienced significant development. According to the Japan External Trade Organization (JETRO)³ data, in 2005–2014 Japan's FDI stock in Russia increased 29-fold⁴ but also experienced major shifts in terms of structure and technology. The share of FDI inflow into manufacturing industries of higher technological complexity and capital intensity increased significantly⁵. The regional distribution of Japanese FDI has become more diversified; in addition to the traditionally attractive regions of Moscow, St. Petersburg and the Far East, investment cooperation with the Central, Volga and Ural Federal districts has developed intensively.⁶

Despite recent progress in the development of investment relations and the complementary economic interests of the two countries, the level of cooperation is much below its potential. The share of the two countries in the structure of mutual trade and investment relations is modest: Russia accounts for 2,26% of Japan's foreign trade turnover and 0,24% of Japanese FDI outflow in 2014 (JETRO)⁷, while the Japanese share in Russian foreign trade turnover was almost 4% in 2014, (Federal Customs Service⁸), 1,54% of the inflow of all types of foreign investment and 3,93% of the FDI inflow (in 2013 according to the United Interagency Information and Statistics System⁹). Japan is the 10th ranked investor in the Russian economy in terms of investment stock of all types and 16th in terms of FDI stock in 2013¹⁰.

Studying Japanese investment in Russia reveals the particular challenges and obstacles that make Japanese companies reluctant to engage in business activities in Russia. Revealing those obstacles and finding ways to neutralize them may give additional impetus to the development of investment cooperation between Japan and Russia.

This paper analyses the factors attracting Japanese capital and the challenges which Japanese businesses face adapting to the Russian business environment. The research reveals and systemizes

³ JETRO Reports and Statistics, Japan's Outward and Inward Foreign Direct Investment, FDI stock (Based on International Investment Position, net), Outward <http://www.jetro.go.jp/en/reports/statistics/>

⁴ From 87 mln USD in the beginning of 2005 up to 2,5 bln USD in the beginning of 2014 (JETRO).

⁵ The share of manufacturing industries in the Japanese capital stock in Russia increased from 13,6% to 51% in 2005-2013 (United Interagency Information and Statistics System, Foreign Investment Stock <http://fedstat.ru/indicator/data.do?id=31231&referrerType=0&referrerId=1292884>

⁶ See details in N.V. Ershova The Development of Japanese-Russian Cooperation in Investment Sphere // Rosyiskij Yaponovedchesky Journal (Russian Journal of Japanese Studies). 2012. № 3. P. 13-28 (in Russian)

⁷ JETRO Reports and Statistics, Japan's International Trade in Goods; Japan's Outward and Inward Foreign Direct Investment, FDI stock (Based on International Investment Position, net) <http://www.jetro.go.jp/en/reports/statistics/>

⁸ Russian Federation Federal Customs Service, Foreign Trade Statistics <http://stat.customs.ru/apex/f?p=201:7:34916493764136::NO>

⁹ United Interagency Information and Statistics System, Foreign Investment Inflow <http://www.fedstat.ru/indicator/data.do?id=31335&referrerType=0&referrerId=1292884>

¹⁰ Ibid.

the factors restricting the development of investment cooperation and their roots, and identifies possible ways of overcoming these challenges.

Data and Methodology

The research is based on the results of a survey of Japanese companies who are members of the Japan Business Club Moscow (JBC). The survey was conducted in April-June, 2015 as part of the research project “Russia’s Business Climate through the Eyes of Foreign Firms” in the Institute for Industrial and Market Studies (IIMS, HSE). The target of the survey was to see how members of foreign business associations in Russia evaluate the business climate in Russian regions and how the current political and economic events, i.e. international sanctions and economic crisis, affect their activities. Another objective of the study was to identify the main problems foreign firms are facing in Russia; to gather ideas how these problems can be addressed by Russian regional and federal administrations; and to find out what regional administrations in Russia can do to make their regions more attractive for foreign investors. However, this paper is limited to the attractiveness of Russia as an investment destination and the problems and challenges that Japanese companies face. The survey was administered online via a website. Member companies of the JBC Moscow received an internet link (URL) to the online questionnaire, which was available in Japanese, Russian and English. Below is the short description of companies participating in the survey.

More than half the companies (55%) started doing business in Russia after 2005, and about a quarter had been in Russia before 1991. For 71%, the number of employees of the Russian branches or subsidiaries does not exceed 50; 86% of survey participant’s firms are under foreign ownership. 62% are engaged in importing to Russia with following sales on the domestic Russian market. however, 19% produce goods and services in Russia to sell them on the domestic Russian market; and 12% – on both domestic and foreign markets. Over 82% do not invest in R&D in Russia. 53% are working in manufacturing, 20% in business and investment consulting, 13% in trade and 7% each in transport, and financial services. 55% are represented in 1 or 2 regions only; the distribution between other groups is quite flat: 22% work in 3–10 regions and 22% in more than 10 regions (even more than 20 regions of Russia). Although the companies may be engaged in business activities in a number of regions, for 65% Moscow is the most important region for their business. Only 4 other regions were marked as the most important: Kaluga region, Kursk Region, Moscow region (not including Moscow city) and Saint Petersburg.

To sum it up, most of companies in the sample are registered in Moscow and engaged in importing and selling manufacturing goods or providing consulting services in different regions of

Russia. However, there are several limitations to the dataset. The major limitation is the small sample due to the low response rate. The survey link was sent to about 187 companies; the maximum number of responses for some questions was 32, which gives us a response rate of approximately 17%. However the number of unanswered questions grew toward the end of the questionnaire leaving some gaps in the dataset. The low response rate presumably biases the sample by the type of companies and their business activity.

In addition to the survey we used content analysis of several interviews with Japanese business, academic and NGO representatives to illustrate the main findings. The interviews were partially conducted by the author and partially available in open internet sources. In the interview analysis we investigated the challenges, problems and obstacles that were mentioned by the interviewees and categorized them depending on the frequency of mention. The interviews used in this research were partially carried out during a Japan Foundation Japan Studies and Intellectual Exchange Fellowship Program (2011–2012) at the Kyoto Institute of Economic Research (Kyoto University, Japan).

The interviews were given by the representatives of the business community (70%), NGOs (20%) and academics (10%) and took place between 2008 and 2015. The business representatives were mostly from companies producing machinery and electronics or involved in manufacturing industries (62%), the rest were companies from banking sphere, IT, construction, pharmaceuticals and trade. 90% of the firms of the interviewed representatives have offices or branches in Russia.

The limitations to the interview sample include the small number (20 interviews) and some possible gaps from open-source interviews that were not conducted as part of the research topic. Due to the informal nature of some interviews and at the request of some interviewees not all names are available in this paper.

Next we compared the findings of the HSE survey to the results of the survey conducted by JETRO, Europe, Russia and CIS Division “2014 Survey on Business Conditions of Japanese-Affiliated Firms in Russia”. The interview results also provided additional examples of the challenges for Japanese business in Russia. These relate to the business culture and management practices rather than to the business climate. Therefore on the basis of the interview content analysis we suggest a general classification of challenges for Japanese business in Russia. It is assumed that each problem or challenge can be classified depending on the origin of the problem. Addressing these challenges depends on their origin. A consideration of these different aspects will allow more comprehensive and systematic recommendations to further development investment cooperation between Japan and Russia.

Results

Attracting factors

In order to reveal the main factors attracting Japanese investors to Russia we posed a question about the main reasons for starting business in Russia. The distribution of answers to this question is presented in Table 1. The most popular reason was gaining access to the Russian market (81%). Within this the respondents pointed out the high potential for the development of the market, and the growth of personal consumption underlying the expansion of demand. A quarter of companies said the high profitability of investment in Russian economy was their main reason for investing.

Tab. 1. “What do you think was the main reason for your firm to start investing in Russia?”

(in percentage points)

Access to the Russian market	80,8
High profitability of investments in Russia	26,9
Availability of natural resources	11,5
Availability of qualified labour	3,8
Flexible education and retraining policies	3,8
Less rigid environmental regulations than elsewhere	0,0
Less rigid labour regulations than elsewhere	0,0
Low labour costs	0,0

Source: HSE Survey

Notes: the sum doesn't equal 100% as multiple choice was available for this question (up to 3 answers)

More detailed results were obtained for the question on investment incentives in the particular regions most important for the company's investment activity in Russia. Although proximity to consumer markets and the high profitability of potential investment are still the main factors (78% and 33% respectively), the quality of the infrastructure and the availability of a qualified labour force also plays an important role for investment decision (see Table 2). However, these results can be applied only to a narrow range of regions: Moscow, Kaluga region, Kursk Region, Moscow region and Saint Petersburg.

Tab. 2. “Why did your firm decide to invest in the region chosen above?”

(in percentage points)

Proximity to consumer markets	77,8
High profitability of potential investments	33,3
Quality of infrastructure	22,2
Pre-existing highly qualified labour force	16,7
Political stability	11,1
Pro-investment incentives provided by the regional government	11,1
Production cluster proximity	5,6
Low labour costs	5,6
Flexible education and retraining policies	0,0
Natural resources	0,0
Low regulatory burden	0,0

Source: HSE Survey

Notes: the sum doesn't equal 100% as multiple choice was available for this question (up to 3 answers)

The interview results correspond to the survey findings. The interviewees noted a developing and promising Russian market as the most important (sometimes the only) factor attracting Japanese investors. Almost 70% of interviewees mentioned that “the Russian market is the biggest and most promising market in CIS region and is growing continuously”¹¹, moreover, “within the market the demand for high-quality goods is increasing due to better solvency and that attracts Japanese firms as the segment of high-quality and expensive goods is the target for Japanese producers”¹².

The availability of infrastructure in particular regions and the presence and support of business partners were mentioned as important factors by some interviewees. The availability of resources was not a significant factor, few respondents mentioned it.

Recent tensions in Russian international relations and the economic crisis have inevitably affected the activity of Japanese companies in Russia. However, they remain optimistic about their prospects: according to Fumitaka Kawashima, Vice-President of Toyota Motor Russia “although the Russian market is shrinking due to the crisis, the company’s market share is increasing steadily[.... W]e understand that current market instability is temporary and [...] we are expecting the market to recover and grow”.¹³

¹¹ From the interview with Junichi Okishima, Director of Yokohama company, 2012. Analytical Agency AUTOSTAT <http://www.autostat.ru/news/view/9434/>

¹² From the interview with representatives of the Japan Association for Trade with Russia and NIS (ROTOBO), 2012

¹³ From the interview with Fumitaka Kawashima, Vice President of Toyota Motor RUS, 2014. Analytical Agency AUTOSTAT <http://www.autostat.ru/news/view/17784/>

According to the HSE survey 67% of respondents admit that despite the crisis and the shrinking market, Russia remains an attractive investment destination. 24% of respondents state that doing business in Russia is somewhat less attractive than a year ago.

Challenges

To the question about the main difficulties and obstacles faced by Japanese companies during the first year of operation in Russia, the respondents mentioned various factors. The results are shown in Table 3. About half the companies had difficulties associated with the language barrier, while a third said regulation and customs clearance were significant difficulties for their business (up to 3 answers were available). Concerning regulation many companies specified labour regulation, company establishment procedures and GOST (technical standards) as the most serious regulatory obstacles.

Tab. 3. “What do you think were the main difficulties faced by your firm during the first year that you operated in Russia?”

(in percentage points)

The language	52,0
Regulation	36,0
Custom clearance	36,0
Taxes	24,0
Competition by other firms within the sector	20,0
Access to infrastructure (electricity, water...)	12,0
Access to finance	12,0
Hiring skilled labour	8,0
Corruption	4,0
Security	4,0
Access to land	0,0

Source: HSE Survey

Notes: the sum doesn't equal to 100% as multiple choice was available for this question (up to 3 answers)

20% of companies suppose that the situation with corruption has improved over the last 3 years, while 4% think that it has become worse. On the other hand about a third of survey participants said that nothing had changed and corruption problems remained at the same level. A quarter of interview respondents confirmed that doing business in Russia is usually associated with corruption.

63% of companies do not have a problem with skilled personnel recruitment and retention. However, 25% sometimes face these problems and for 13% it is a considerable problem. Respondents specified that there might be difficulties with recruiting specialized engineering staff with good English and with recruitment in the Far Eastern region of Russia. However, interview respondents claimed that labour turnover is quite a problem. Yuichi Tsujimoto, the Hitachi Construction Machinery President says: “Personnel training is an important area, we recruited Russian employees, sent them to study in Japan, organized programs in professional colleges led by Japanese specialists”¹⁴. This practice of personnel training is typical for Japanese companies. Therefore labour turnover causes significant losses of investment in human capital and staff development.

The most serious obstacles mentioned by the interviewees are associated with additional expenses and lead to a decrease in profitability, for example, changes in laws and regulation cause increased spending on lawyers and specialists. Many problems are caused by infrastructure problems. During plant construction Japanese companies face delays due to the additional time and capital expenses needed to get access to infrastructure. Registration processes usually take longer than expected, however, recently the procedure-related obstacles seem to have declined¹⁵.

In general there is no consensus on the change in the Russian investment climate during the last 3 years: 36% think it has become slightly or significantly better while 48% believe it has worsened.

The investment attracting activities of regional governments have had some success, half the respondents think that some or most regional administrations are actively trying to attract foreign investors. The other half supposes that only a few or no regional governments are involved in such activities. These results correspond to whether the regional administration is a help or a hindrance for foreign investors: 20% said they helped, 20% said they hindered. 30% said regional governments neither helped, nor hindered. This shows that regional administrations in Russia have very different policies towards supporting foreign investors, and each case is unique. This result may also reflect foreign investment ‘saturation’ in a particular region, or simply the competence of the regional administration.

Matching results

1. External factors

¹⁴ From the interview with Yuichi Tsujimoto, President of Hitachi Construction Machinery, 2014. Vedomosti <http://www.vedomosti.ru/newspaper/articles/2014/08/19/pozicii-ssha-i-yaponii-nevovsem-absolyutno-sovpadayut-yuiti>

¹⁵ According to interviewees perception.

Due to differences in methodologies the results cannot be matched completely, however, we can see that the most important factors repeat under any method of analysis. In Table 4 we include the results of the JETRO survey and matched them to more or less corresponding factors in the HSE survey and interviews.

Tab. 4. Matching results of Interviews, HSE Survey and JETRO Survey on attractiveness factors of investment in Russia

(in percentage points)		(in percentage points)		
Attractiveness factors (HSE)	Interview	HSE Survey	JETRO Survey	Attractiveness factors (JETRO)
			83,9	Market size/growth potential
Market, demand, perspective	72,2	80,8	12,9	Accumulation of potential clients
Resources	5,6	11,5	2,2	Abundant land/office space, inexpensive prices
Logistics, infrastructure	11,1	-	3,2	Developed infrastructure
Partners	22,2	-	1,1	Accumulation of supporting industries
Availability of qualified labour	-	3,8	12,9	High quality of employees
Flexible education and retraining policies	-	3,8	4,3	High employee retention rate
High profitability of investments in Russia	-	26,9	-	

Source: HSE Survey, Interviews with Japanese business representatives, 2014 Survey on Business Conditions of Japanese-Affiliated Firms in Russia, March 2015, JETRO

Notes: the sum doesn't equal 100% as multiple answers are possible

The results differ significantly, except for market and demand as a factor of investment attraction. In the JETRO survey there are two separate but related advantages: market size/growth potential and the accumulation of potential clients.¹⁶ Another factor mentioned in all 3 data sources is the availability of resources, the JETRO report only considered land and office space.

Some additional comments provided in the interviews are worth mentioning. The most important factor attracting Japanese investment is the fast-growing and promising Russian market (despite a period of crisis, Japanese investors see Russia as an attractive investment direction in the long-term). Many representatives of the Japanese business community agree that while the Russian market is expanding fast, it is very dynamic and is characterized by rapid changes in consumer

¹⁶ 2014 Survey on Business Conditions of Japanese-Affiliated Firms in Russia, March 2015, Japan External Trade Organization (JETRO), Europe Russia and CIS Division, Overseas Research Department, p. 35.

preferences which are difficult to predict especially in the long-term. The problem is that the Japanese management style focuses on long term strategic planning, therefore the low predictability of the Russian market is regarded as a significant challenge.

Another factor often mentioned is the availability of resources. However if most Japanese investment projects in Russia used to be associated with the development of natural resources, nowadays with the growth of the share of manufacturing projects human resources and their quality are becoming increasingly important. Japanese investors note the high level of educational of Russian employees, but labour costs in practice often turn out to be much higher than expected. In many cases this is caused by the cost of the hiring process and staff turnover. The Japanese management system is based on the principles of loyalty, motivation and commitment to the corporate culture. Trying to adapt this model to Russia, Japanese companies face high staff turnover because of the differences in business cultures and management practices. This factor will be further analysed below.

As far as the risks and challenges are concerned there is a range of factors mentioned in the interviews and surveys.

Tab. 4. Matching results of Interviews, HSE Survey and JETRO Survey on problems and challenges of investment in Russia

(in percentage points)		(in percentage points)		
Obstacles and problems (HSE)	Interview	HSE Survey	JETRO Survey	Obstacles and problems (JETRO)
Immigration and labour law	15			
Business registration	10	-	67,7	Complexity of administrative procedures
Custom clearance	-	36,0		
Corruption, bureaucracy	25	4	49,5	Unclear policy operation by the government
Infrastructure	20	12	24,7	Underdeveloped infrastructure
			54,8	Soaring labour costs
Labour resources management	35	8	24,7	Insufficient workforce, difficulties in hiring human resources
Language	10	52	-	
Taxes	-	24,0	59,1	Complexity of tax system and procedures

Access to finance	-	12,0	-	-
Security	-	4,0	-	-
Partners	20	-	11,8	Immature or underdeveloped accumulations of related industries
Localization	10	-	-	
Competition by other firms within the sector	-	20,0	-	
	-	-	78,5	Volatility of exchange rates
	-	-	74,2	Unstable political and social climate
	-	-	31,2	Lack of land/office space, raising land prices/ rent

Source: HSE Survey, Interviews with Japanese business representatives, 2014 Survey on Business Conditions of Japanese-Affiliated Firms in Russia, March 2015, JETRO

Notes: the sum doesn't equal 100% as multiple answers are possible

According to Table 4 there are a number of important factors mentioned in all three data sources. They are corruption, bureaucracy, different types of regulatory procedures (especially labour and immigration law and the complexity of company establishment procedures), law and regulation in general, the lack of infrastructure, and problems with labour resources, especially labour costs and availability, and hiring problems.

Among main problems and obstacles for investment projects, the respondents often mentioned the difficulty and the complexity of the registration process and the establishment of the company. The construction sector seems to be the most problematic. Greenfield investments (especially in the manufacturing sector) involve major facilities and construction investment, while Russian procedures for obtaining building permits are a serious barrier to the project: the process takes an average of 540 days and requires over 50 documents. As a result the cost of obtaining a permit turns out to be several times higher than in other BRICS countries, for instance¹⁷.

Another major problem is balancing local production and imports. A lack of reliable partners force companies to import parts and materials while a government memorandum and economic sense requires an increase in production localization. Production localization at Japanese factories in Russia in general does not exceed 15–20%¹⁸. “We have to admit that Japanese manufacturers do not trust the quality of the components and materials produced by Russian suppliers; therefore they are quite reluctant to localize although they have to follow the terms and conditions of the governmental agreements on industrial assembly. They prefer to purchase materials and components from their subsidiaries or suppliers with whom they work in the Japanese

¹⁷ Industrial investment in Eurasia (report), ROTOBO (The Japan Association for Trade with Russia & NIS) 2011, p.79

¹⁸ From interviews with Japanese companies representatives from factories in Yaroslavl' and St. Petersburg.

market; move their own component production facilities closer to the assembly plant or to work with the subsidiaries of European or American companies. Japanese companies also try to persuade their suppliers from Japan to enter Russian market, however, partner companies and suppliers of the Japanese manufacturers are reluctant to enter the Russian market because, given the existing output of Japanese enterprises in Russia (in particular automotive), the transfer of production facilities is considered unprofitable for them¹⁹. Furthermore, potential Japanese suppliers also face the problem of high-quality material supply in their part of the production chain.

Thirty of 100 biggest world automotive component suppliers are Japanese companies, however, only 3 of them have production facilities in Russia. These are Asahi Glass in Nizhny Novgorod, Toyota Boshoku in St. Petersburg, and Takata in Ulyanovsk region. One of the leading global suppliers of automotive components—Denso—has signed an Industrial Assembly Memorandum with the Russian Ministry of Economic Development.²⁰

Finally, red tape, corruption, opaque bureaucratic procedures and competitive tendering practices damage the country's investment image. Japanese investors are also concerned about the inconsistencies and shortcomings of Russian legislation, which increases costs for legal services, burdening the budget of investment projects.

The issues of property rights, especially intellectual property right protection, and contractual obligation enforcement mechanisms are also mentioned as important issues by Japanese interviewees.

Infrastructure and logistics also add problems to foreign investment projects in Russia. Weak infrastructure in some regions does not allow the effective matching of raw material markets and consumer markets, and increases transportation and logistics costs. However for Japanese companies the problems of logistics and transport infrastructure are not the most serious.

All these major risks emerge from the weaknesses and drawbacks of the Russian investment climate therefore each of them should be addressed directly, facilitating procedures and regulations and making the climate more foreign-business friendly. There are also challenges that originate not only in the external business climate but that are much affected by the internal specifics of Japanese companies and their production and management systems.

2. *Internal factors*

¹⁹ From the interview with representatives of the Japan Association for Trade with Russia and NIS (ROTOBO), 2012.

²⁰ Forum "Avtoevolutsiya". Vedomosti annex 08.02.2012

Whatever the local investment climate characteristics, an investor has to adapt not only to its institutional and economic situation, but also to the peculiarities of the local business environment, and business and management practices. These issues are relevant not only for Japanese firms, but for all companies involved in foreign operations. Japanese companies often try to implement on overseas plants a production and management model which was developed in the specific framework of Japanese economic, social, psychological, cultural conditions. However, in a different business and cultural environment Japanese management and production practices may not only be ineffective, but even inapplicable.

In the analysis of adaptation of Japanese production and management systems to Russian conditions we used the framework described in research on hybrid factory performance carried out by Tetsuo Abo et al. [2007] (Japanese Multinational Enterprise Study Group)²¹. Companies representing primarily the manufacturing sector were regarded in the discussion of the application of Japanese production and management practices since the tertiary sector represents a limited range of the distinctive features of Japanese production and management systems. Eventually we can identify which practices in business organization and management can be useful and effective for Japanese companies operating in Russia and which cannot be adopted. The analysis was based on Japanese automotive production plants in Russia.²²

The issue of product diversification and production line flexibility seems to be an important part of the production organization process in Japanese plants in Russia, given the rapid changes in the preferences of the market. For example, the Nissan factory in Kamenka (St. Petersburg) has only one production line, but unlike the Japanese plants process automation is extremely low—about 10%. All welding and painting are done manually, even the transportation of parts is not automated and is done manually using special trolleys²³. As a result this does not allow any expansion of an employee's functionality, limits the speed of the production line, and hence the output.

Japanese equipment and mainly Japan-produced imported parts help to ensure the quality of products, for example, there have been almost no cases of defects in the Toyota plant in Russia. The

²¹ Tetsuo Abo, 2007 *Hybrid Factories: A worldwide Comparison of Global Production Strategies*, New York: Palgrave-Macmillan. The approach deals with the analysis of transferability (applicability and adaptability) of Japanese-style management and production systems across different regions abroad. and assesses 23 aspects of these systems. According to the author's methodology 23 elements characterizing the Japanese system of management and production are assessed using a 5-point scale by representatives of the Japanese TNC's affiliates abroad for their compliance with the typical Japanese practices applied on national enterprises. The study allows to compare those elements and see to what extent Japanese common practices can be applied on the overseas branches in particular countries or groups of countries. Research is conducted primarily among manufacturing companies (transportation machinery, electronic and electrical engineering), especially because the production process includes the maximum number of common practices and elements to be considered.

²² See in details in N.V. Ershova, S.N. Lavrov, A.Y. Plotnikov. *Russia-Japan: From Political Confrontation to Economic Cooperation*. Moscow. TEIS, 2013.

²³ Nissan's factory in Kamenka from inside <http://www.autopeople.ru/article/nissan/producer/25297.html>

system of stopping the production line for quality control works at every stage of production, because the level of automation in the plant is very low. The admissible share of defects at the Nissan factory is 2%. Most of defects are eliminated in 5 minutes on the production line.²⁴

Regarding the applicability of "just in time" production systems, it is almost impossible to implement it in Russian factories given the low localization of component production and the fact that the delivery period for imported parts from Japan is up to 2 months. Therefore logistics or local supply channels seems problematic and time-consuming while the organization of cluster production in collaboration with Japanese sub-contractors in Russia would be possible only with a rapid growth of the output from the partner's assembly plants and guaranteed sales stability. Unfortunately the problems of the implementation of the Japanese production model in many cases do not allow an increase in the output to potential, or even planned levels.

As far as personnel management is concerned some companies localize management because they admit that the Japanese management system is too specific to be used unchanged in most business cultures. In particular, Sony uses management localization widely to develop local human resources, provide opportunity for professional growth and development.²⁵ Training programs are an important part of the personnel management strategy for all Japanese companies. Many firms organize training and practice in factories in Japan and Europe, however, unlike in Japanese companies, opportunities for interdepartmental staff rotation are limited due to the narrow specialization of employees.

Although, as in most countries, the Japanese principle of lifetime employment cannot be applied unchanged, the focus on long-term cooperation and clear criteria for promotion corresponds to the preferences of Russian employees. The main hiring criteria are qualifications and motivation, and competition is high. However, staff turnover, especially at the beginning (for those reluctant or unable to adjust to the Japanese management system) is also high.

In general, according to the hybrid factories approach developed by the Japanese Multinational Enterprise Study Group, the overall level of the Japanese management and production system application is low. Systemic, interrelated elements of the model were the least applicable in a foreign business environment because they are originally based on the specifics of the organization of the company's external relations as well as on the economic and social environment in Japan. These elements include primarily the "just-in-time" supply and production system, participation in the "quality circles", a system of recruitment, remuneration and promotion.

²⁴ Ibid.

²⁵ From the interview with S. Arai, Director general of Sony CIS, 2005 <http://www.jpclub.ru>

Among the most applicable elements of the Japanese management and production system are those related to the maintenance of harmonious teamwork, and the coordination of work processes. Indicators related to production technical support, the equipment and characteristics of the production line which are the most "autonomous" and not fundamental elements of the Japanese management model are also applicable.

In general, the model of adaption of Japanese companies in Russia is similar to CEE countries, which have a higher degree of practice localization and low applicability of Japanese methods with strong control from the parent company. On the other hand, such a strategy is typical for the initial stage of Japanese business development; over time we can expect a more intense implementation of the Japanese system elements and the growth of branch autonomy.

3. Other/non-economic factors

The interview analysis distinguished some factors that cannot be classified either as emerging from the investment environment drawbacks (external) or from Japanese production system applicability (internal). These concern the informational issues and compatibility of business cultures.

One of the major factors hindering the development of investment cooperation between Russia and Japan is the perception of the Russian investment climate in Japan and the underlying lack of information about the Russian market and the business climate. Insufficient experience of doing business in Russia and a lack of research on business opportunities has a negative impact on the decisions of potential Japanese investors trying to avoid the risks associated with uncertainty. Therefore it is necessary to promote a favourable image of the Russian business environment and investment climate, to provide potential investors with information about the conditions for doing business.

The impact of the compatibility of business cultures of Japan and Russia is realised at the stage of business collaboration development. Internal factors which restrict compatibility emerge largely from the differences between host and home business cultures. Despite these differences we managed to identify certain characteristics that can serve as a basis for mutual understanding in business relations.

The value and motivation systems of Russian and Japanese employees, and as a result the approach to the working processes, differ radically. Due to an unfamiliar corporate culture and values Russian workers lack the moral incentives which are an extremely important tool for human resource management in the Japanese model. In addition, there are fundamental differences in approaches to the development of projects and assignments: the Japanese pay great attention to the details of a project which may seem minor to the Russian side. Whilst the conceptual approach of

the Russians and the lack of planning accuracy can cause tension and delays in negotiations with the Japanese.

On the other hand both cultures share the principles of collectivism and high context.²⁶ Business relationships in Russia and Japan are largely based on interpersonal relations and informal methods for resolving problematic issues. These common features can serve as a basis and a starting point for the development of mutually acceptable ways of organizing productive business cooperation.

Conclusions

The Russian economy is attractive for Japanese investors as it provides a range of opportunities and advantages that Japanese companies usually look for in their foreign expansion strategies. However, almost every advantage entails some kind of a challenge caused either by factors in the business environment and institutional framework, or by conflicts with the Japanese approach towards organization and management.

The analysis shows the constraining factors can be divided into 3 groups by the origin—external, internal and other (non-economic) factors. *External factors* include the weaknesses and drawbacks of the Russian business environment and investment climate. In other words, these are the factors faced by all investors doing business in Russia. The perception of the Russian investment climate by Japanese investors is also inaccurate. *Internal factors* are more specific and concern the adaptation of Japanese companies and their business and production models to the Russian business environment. For Japanese investors these issues might be common for overseas branches of Japanese companies, in other words based on Japanese business model distinctive features. *Other or non-economic factors* are associated with the aspect of the compatibility of business cultures and information issues.

In order to overcome the challenges for investment projects on the basis of our analysis we offer the following recommendations for both sides.

For the Russian side:

- 1) Infrastructural development: the modernization of railways and ports to raise their capacity (especially in the Far East), and the construction of roads with possible participation of foreign investors;

²⁶ Hall, E. The Silent Language. Garden City, N. Y.: Doubly. 1959

- 2) Constructing gas, electricity and water supply systems (with possible participation of foreign investors);
- 3) The development of social and educational facilities for the regions attracting FDI in order to provide labour supply and retraining program support;
- 4) Loosening immigration policy and regulation, the simplification of work permit related procedures;
- 5) Informational support for foreigners working in Russia, language courses;
- 6) The simplification and optimization of business registration and customs clearance procedures, a reduction of paperwork;
- 7) Active interaction with foreign business via such mechanisms as the International Council for Cooperation and Investment (an advisory body of the Russian Union of Industrialists and Entrepreneurs) in order to react to business needs and receive feedback.

For the Japanese side:

- 1) Apply a more aggressive and active strategy for entering Russian market. Timely responses to changing market conditions are essential;
- 2) Use the opportunities of innovative and technology-intensive industries. Many interviewees stressed the low level of innovation and technology in the market and the prospects for IT development;
- 3) Implementing Japanese know-how and expertise in production management can be effective, while the labour management should be localized as much as possible (as in the case of Sony);
- 4) Localize the management of facilities in Russia;
- 5) The difference in Japanese and Russian business culture should be taken into account. A friendly, positive work climate seems to be received positively, but differences in motivation and value systems should be addressed as if neglected these can lead to increased staff turnover;
- 6) Actively address the position of the business community to Russian governmental bodies via a collective voice such as provided by the JBC Moscow.

The solution to the problem of improving Russian-Japanese investment relations and the promotion of cooperation has several layers. In terms of economic factors the improvement of the investment climate is a priority. We need not only provide comfortable conditions for doing business in Russia but also clearly inform potential investors of new opportunities. The adaptation

of the Japanese production and management system to Russian conditions seem resolvable and the compatibility of business cultures also seem possible. A much more difficult task is to overcome the information barriers and improve the perception of Russian business environment among potential Japanese investors.

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