

MACROECONOMIC VERSUS INTERNATIONAL BUSINESS
APPROACH TO DIRECT FOREIGN INVESTMENT:
A COMMENT ON PROFESSOR KOJIMA'S
INTERPRETATION

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This short article attempts to criticise the explanation of "Japanese type" direct foreign investment put forward by Kiyoshi Kojima (1973, 1975, 1978, 1982) and to put his criticisms of the "international business approach" into context.

I. *Outward Investment by Japanese Firms*

Japanese foreign investment is felt to require a special approach because it exhibits several characteristics which differ from US outward investment. These may be characterised as follows [Ozawa (1979b)].

- (1) A later take off of outward investment, dating from the mid 1960s in the case of Japan.
- (2) A clustering of Japanese direct investment in Asia and Latin America rather than in advanced economies.
- (3) The different industrial structure of Japanese investment which is concentrated in relatively labour intensive or technologically standardised products such as textiles, metal products, unsophisticated electrical goods and chemicals.
- (4) The type of investment characterised in (3) and (2) above is carried out by small and medium sized manufacturers, who account for a high proportion of Japanese DFI.
- (5) The proportion of Japanese investment in extractive ventures is higher than any other industrialised country.
- (6) Japanese firms are deemed to be more responsive to the formation of joint ventures with host country firms than are US and other source country firms.
- (7) Group investment, where a number of Japanese firms, usually trading companies, often with help from Government agencies, participate jointly as a common form of foreign investment. As a result external sources of funds are called upon to finance DFI [See also Ozawa (1979a)].

These characteristics have led Japanese analysts to propose alternative explanations specifically related to Japanese conditions. One of the most ingenious is the theoretical framework developed by Kiyoshi Kojima.

Kojima's approach is variously called "a macro economic approach," "a factor endowments approach" and "a model of trade oriented (Japanese-type) foreign investment" to distinguish it from "anti-trade oriented (American type) DFI." Kojima's aim is to integrate trade theory with direct investment theory and to contrast "Japanese type" investment with "American type."

Kojima (1978) begins with the standard two country, two factor, two product Heckscher-Ohlin model of trade. He then introduces Mundell's demonstration that under rigorous Heckscher-Ohlin assumptions "the substitution for commodity of factor movements will be complete." The process for achieving this is that capital [Homogeneous (money) capital] flows from the capital rich to the capital poor country, perhaps in response to the imposition of a prohibitive tariff on capital intensive exportables, so the recipient country becomes more capital abundant and reallocates its resources such that production of the capital intensive good expands and the labour intensive good declines until equilibrium is reached at a point exactly corresponding to the post-trade situation in the absence of the capital movement. This pattern of output change—that the recipient country's comparatively disadvantaged industry expands and its comparatively advantaged (in terms of its *original* factor endowment) contracts is posited in the Rybczynski theorem. Kojima views American DFI in this light, arguing that the basis for trade is eliminated by outflows of capital from the capital exporting country's advantaged industry so DFI is a substitute for trade.

In the Japanese case, however, Kojima's argument is that the host country's production frontier expands in such a direction that the (preinvestment) comparatively advantaged industry expands and the comparatively disadvantaged industry contracts, thus enhancing the basis for trade.

This "complements" case is achieved by the Rybczynski line sloping in an opposite direction (i.e. the line linking the original production point and the post-capital inflow production point moves 'upward'). This effect cannot occur if homogeneous "money capital," perfectly re-allocable to any industry, is the norm. Therefore Kojima suggests at this point that direct investment capital is a package involving technical knowledge and human skill components (including management skills); it is therefore to some extent industry specific. This capital moves to the host country because of 'comparative advantages in improving productivity' in the host country and the resultant increase in profitability gives the motivation. Here Kojima introduces a crucial assumption: that productivity in the host country is increased *more* through direct investments in the labour intensive industry than in the capital intensive industry "due to the smaller technological gap and a greater spillover of technology to local firms" (1978, p. 126). The same amount of output is produced with proportionately smaller inputs of labour and capital, i.e. Hicks-neutral technological change is deemed to have taken place.

The critical factor in this model is the disproportionate effect on productivity, when sector specific capital moves into the host's comparatively advantaged industry. The implicit assumption is that industry-specific public goods have been transferred—the proof of this is Kojima's (1978, p.127) statement that the production frontier in the source country remains unchanged "since the technology and managerial skills do not decrease even when they are applied abroad and since labour and capital are assumed unchanged" in the source country, for Kojima includes the assumption that Direct Foreign Investment involves a negligible transfer of "money capital."

The "comparative advantage in improving productivity" can thus be seen as the result of the combination of internationally mobile inputs transferred by the investing (Japanese) firm, viz. managerial and organisational skills, with the vital addition of guaranteed access to (Japanese) markets and distribution networks, together with locationally immobile inputs, notably cheap labour. Kojima suggests that because of the sector specific nature of these productivity improving resources, it is easier for firms which possess such attributes to relocate abroad (outside Japan) rather than to diversify into other domestic industries. Consequently, there is no presumption (unlike product cycle type US DFI) that the outward investors are the "leading" firms. Indeed it is suggested that weaker firms, most exposed to exogenous shifts in comparative advantage, will be most likely to relocate in LDCs.

This approach is sharpened and contrasted with what Kojima calls "the international business approach" in his most recent article [Kojima (1982)], in which "the work of John Dunning and his school...are...essentially variants of the international business approach" (1982, p.1). It was noted above that Kojima resorts to industry specific advantages in achieving his results, which he acknowledges ("on this point, I admit, we must borrow ideas from the business-administration approach" 1982, p.5). Despite this, there remains a gulf between Kojima's approach to Japanese outward investment and ours.

The normative element in Kojima's approach is evident. He switches at will between what is and what should be (e.g. 1982, p.1 "Direct foreign investment should originate in the investing country's comparatively disadvantaged industry" etc.). The purpose seems to be to contrast the virtues of "Japanese-type" direct investment with the disadvantages of the "American type."

It is not clear if Kojima believes that all Japanese investment is "Japanese type" or whether his explanation is a partial one. We would not deny that most source countries have a "Japanese type" or "offshore production" component in their total direct investment, nor that this proportion is higher for Japan than the typical North American or European source country. Such investment are explicable by a combination of location cost differences and transferable assets within the firm. [Buckley and Casson (1976), Dunning (1981)] Kojima's explanation must exclude direct investment flows between advanced countries. It cannot begin to tackle cross investment between two countries within an industry.

Kojima's approach cannot explain the form of doing business abroad. Why should a Japanese firm choose to own an investment in a cheap labour country? Why not instead simply enter into a long term purchasing contract or other arm's length arrangement? Why not license Japanese technology to host country firms? Kojima's approach cannot deal with these issues because of the cavalier fashion in which he dismisses the costs and benefits of internalisation which make the choice of mode of conducting business abroad central to the explanation of foreign investment. These benefits and costs are well known and we do not repeat them here [see Buckley and Casson (1976, pp.37-45)] but Kojima's characterisation of them as "pseudo-economies of scale" is inaccurate (1982, p.13). Kojima fails to distinguish firm level economies of scale from plant level economies. Economies of scale at the level of the firm include the internal utilisation of assets embodied in human skills, technology, management and marketing ability etc. The minimisation of Governmental interference by such devices as transfer pricing is a reaction to one type of external market imperfection and is not intended to bear the brunt of explaining the growth of multinational firms. And to explain is not to condone. Casson (1979) points out that social costs of

internalisation may be heavier than private costs but rational economic decision making by the actors concerned (multinational firms) leads to this suboptimal result. Transactions costs, and their minimisation are ignored by Kojima and this leads to blanket condemnation of attempts by firms to design arrangements which attempt to reduce such costs.

Kojima's approach as enunciated in his 1982 article begs many questions. The cost based approach fails to explain why costs fall in the host country after (Japanese) foreign takeover. Transfer of ownership from the submarginal industries in the source country to the host country must involve an infusion of technology and management (p.2). These are *within* industry factors, not macroeconomic at all. The so called "correspondence principle" is, as Geroski points out, at variance with the atomistic assumptions of Kojima's model. The "macroeconomic" framework of the model disintegrates under careful inspection.

Application 1 of the model (p.5) again begs the contract versus ownership issue and leads to the empirical issue of matching these choices to reality.

Application 2 reveals Kojima's "orderly transfer" development model. Such "orderly development" condemns less developed countries to be constantly catching up. It may also stifle rather than develop the latent competitive advantages of their industries. This issue has recently been forcibly re-opened by Emmanuel (1982) who argues that this type of labour intensive non-technology intensive operation condemns LDCs to continuing poverty.

Application 3 argues normatively that Japanese firms should not attempt to enter advanced markets in defensive moves designed to overcome tariff barriers. This second best type of investment does not increase world welfare on the narrow assumptions of the Heckscher-Ohlin model, but it has been found virtually impossible except in a narrow range of industries (textiles) and activities (e.g. electronics assembly) to penetrate protected, advanced markets by any other means.

Application 4 confuses "pseudo economies" with real firm-level economies of scale, such as spreading research and development costs and it ignores the careful treatment of the costs and benefits of internalisation extant in the literature. It further ignores a corollary of the internalisation rubric, that under many circumstances internal markets are more easily perfectible than external ones [Buckley (1983)].

Kojima ignores the view that technology transfer is more efficiently achieved via a wholly owned subsidiary than by a market solution such as licensing. The evidence on this is at least mixed, for instance Balasubramanyam (1973) found that the full range of technology was not available to host country firms except by internal transfer.

The approach we favour does not exclude comparative cost formulations. Indeed, we explicitly include location costs in our theoretical framework. However, as well as the location of economic activity, we must also explain the mode of conduct of that activity. What is of interest is not only that textiles are manufactured in North Africa but also that they are made under German ownership. In addition, we must not only assume technological leadership amongst some (source) countries in particular industries, but attempt to show why this occurs. Kojima's formulation leaves out the creation and exploitation of technological advances and his failure to analyse the market for information leads to a straightforward cost based location theory which ignores the interaction between location and ownership.

II. *Conclusion*

We have seen that the crucial element in Kojima's explanation of Japanese foreign direct investment is the improvement in productivity in the host country brought about by the infusion of the "package of resources" involved in Japanese investment. Of key importance are the market access which the link with a Japanese distribution network brings, and the organisational skills of Japanese management when working with relatively unskilled or semi-skilled labour. The host country unit, when taken over or set up by Japanese DFI, becomes integrated with a marketing network guaranteeing market access. The addition of a Japanese imprint enhances the quality image of the product. Japanese ownership therefore confers immediate benefit.

The specialist skills infused include the skills developed by Japanese enterprises in response to the particular stimuli which they have faced in Japan; notably a cooperative rather than competitive environment, a docile and relatively cheap workforce and skills in organising high quality, mass production systems. The range of industries over which these skills are crucial is very different from those where US (and European) firms have developed intra industry specialisms and consequently the industrial structure of Japanese DFI is very different to "Western" DFI. It has however been differentiated by Kojima more starkly than our version sees it by his concentration on a product cycle interpretation of "American type" DFI.

Japanese DFI represents a search for location specific inputs (stable environment, low transport costs, but chiefly cheap labour) to complement the skills developed by Japanese enterprise. It corresponds to Western, chiefly US firms, 'offshore production' and exhibits a similar industry structure [Moxon (1974), Finger (1975, 1976)].

Japanese outward investment must indeed be explained by reference to locational criteria, notably the relative labour costs in 'nearby' LDCs as compared with Japan. The firm specific skills—access to a (worldwide) distribution network, organisation ability and managerial skills—of Japanese firms differ significantly from the typical US or European MNEs' strengths and consequently the industrial distribution of Japanese DFI differs from these other industrialised countries. Differentiation of Japanese DFI has been exaggerated by its comparison with Product Cycle type US DFI, which is at most only a subset of that country's outward investment—an explanation which has been outdated by events [Giddy (1978)].

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