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The Link between Exports and Foreign Direct Investments (FDI) on a Firm-Level

By

Bjorn Thunstrom*

Abstract

This article aims at giving the theoretical reasoning and empirical evidence so as to connect Japanese foreign direct investment (FDI) to Serbia with Serbian market entry via exports to Japan. It is shown that there exists a Link between exports and FDI¹ on a micro-level or firm-level. The study analyzes the firm-level vehicles for competency transfer (spillover) as a part of the Link between FDI and exports. The firm-level Link dynamics between FDI and exports are supported by empirical evidence and extensive case study interviews with the main Japanese manufacturers that have invested in Eastern Europe, as well as with trading houses and governmental institutions.

Key Words

Corporate strategy, market entry, exports, FDI, investments, Japan, Serbia, Eastern Europe, firm-level spillovers, competency transfer, network theory, risk averseness, competitive advantage

1. Introduction

With the democratic revolution in Serbia in the year 2000, the Japanese government has become more involved diplomatically in bilaterally assisting Serbia with economic development in order to create fundamentals for strengthening of the economic ties between the two countries and to restore pre-war commerce levels. As a result of this shift in the Japanese government's strategy towards Serbia, business links between Japan and Serbia are recently strongly supported by Japanese institutions. Japan has become Serbia's main donor country with \$80 million in allocated aid² with plans for further increased technical assistance in the next few years³. In April 2004,

*The author would like to express his deep gratitude and acknowledge the comments and advice from Professor Hirokuni Sogawa, Keio University. The author may be contacted via email: bjorn_thunstrom@hotmail.com

¹Definition of Foreign Direct Investments (FDI): FDI is defined as "an equity investment which is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's role being to have an effective voice in the management of the enterprise (IMF, 1977)

²Ministry of Foreign Affairs (MOFA), Interview with senior official for South Eastern Europe, Tokyo, May 10, 2005

³JICA, Interview with country officer for Serbia, Europe Team, Tokyo, May 20, 2005

for the first time after the start of transition, a substantial Japanese investor delegation headed by the Japan Bank for International Cooperation (JBIC) visited Serbia. Regarding the opportunities for *inward Japanese FDI to Serbia*, it is noted that Japanese production facilities have been set up across Central & Eastern Europe (CEE), and re-location of production facilities to low-cost countries for export to third countries is a trend that is expected to continue⁴. Serbia offers a set of attractive factors for inward FDI, such as a tradition in industrial production, availability of cheap and skilled labor as well as the lowest taxes in the CEE⁵, and good skills in English communication⁶. The Serbian government is actively promoting Serbia for FDI in manufacturing for foreign firms aiming to export to the 450-million people EU market⁷, where one of the crucial steps has been to enter an exceptional *autonomous agreement with the EU*; almost all products originating from Serbia can be exported without customs and tariffs to the EU⁸. Also, another measure the Serbian government has taken in order to improve Serbia's position for manufacturing FDI targeting Eastern markets is to as the only country in CEE (outside the CIS⁹) enter a Free Trade Agreement with Russia¹⁰, making it possible for foreign investors in Serbia to reach an additional market of 150 million people¹¹. Certainly, these export-promotion measures are not exclusive created for foreign exporters in Serbia, but also benefit local Serbian companies. Japanese companies show a growing interest for FDI in Serbia, and JBIC has from this year received several requests for finance from Japanese manufacturing firms¹². In addition, Serbian corporate culture is compared to other South East European nations more collective in spirit, which enables a relative fit to the collective spirit in Japanese corporate culture, and is supposed to facilitate communication and interaction between Japanese and Serbian business counterparts and colleagues¹³. There are therefore fundamental *business* reasons for trade and FDI between Serbia and Japan, assisted by the *diplomatic* efforts taken by the Japanese government to reestablish business ties with Serbia, as well as the fact that Japan is Serbia's main donor country.

This is a *unique* analysis in the sense that most studies done until now on the connection between FDI and exports have been performed on a macro-level within one industry with aggregate data (cf. Kokko, 1994; Aitken et al., 1997; Kaminski, 1998; Zhang, 2001; Djankov, 2000; Konings, 2001; Mankovska, 2003;). As opposed to those previous macro-studies, the study in this article analyzes how the link dynamics work on a micro-level, or *firm-level*, through in-depth business case studies. The analysis is supported by interview answers from Japanese manufacturers' FDI experience in

⁴"Trends of Japanese FDI by Industries", *JOI Bulletin*, September, 2003

⁵"Investment Guide CEE", *Dresdner Bank*, May, 2002

⁶*Gallup International*, 2002

⁷*Government of Serbia*, Interview with Ms. Gordana Lazarevic, Deputy Minister for International Economic Relations, Belgrade, July 11, 2005

⁸"Serbia & Montenegro-Stabilization and Association Report 2004," *European Commission*, March 30, 2004, p.33

⁹*Comment*: CIS=Commonwealth of Independent States (ex-Soviet republics)

¹⁰*Government of Serbia*, Interview with Ms. Jasmina Habziabdic, Assistant Minister for International Economic Relations, Belgrade, July 13, 2005

¹¹"Why Invest in Serbia", *Serbian Investment and Export Promotion Agency: www.siepa.gov.yu*, 2004

¹²*JBIC*, Interview with Senior official, Tokyo, June 10, 2005

¹³*Sapporo University*, Interview with Dr. Shosaku Tokunaga, Emeritus Professor, President Japan-Serbia Association, Tokyo, April 19, 2005

Eastern Europe, as well as from Japanese trading houses with business there. The empirical evidence from Japanese FDI and trade in Eastern Europe is then applied on the case of Serbian firms' expected exports to Japan, and Japanese firms' expected FDI in Serbia.

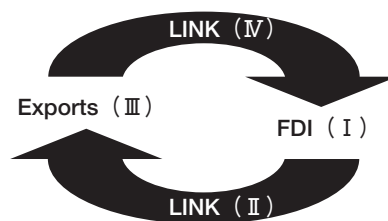
Previous research is scarce on firm-level spillovers, with the exceptions of limited analysis on individual components in firm-level spillovers (cf. Fosfuri, 2001; Gunther, 2001; Javorcik, 2004). A unique feature in this article is that the *vehicles for competency transfer* of Japanese management techniques, marketing and technology have been studied on a *micro-level* as a set of components propelling firm-level competency spillovers, creating a new academic contribution on the business links between exports and FDI. Specific aspects of the Japanese business context has been taken into consideration, such as the influence of the *keiretsu dynamics* and *trading houses* on the export-FDI link, and the argumentation has been creatively based on *network theory*.

2. Hypothesis

The base hypothesis for this chapter is that there exists a link between Serbian firms' market entry via exports to Japan with FDI from Japanese firms to Serbia, where exports and FDI positively influence each other.

It is assumed that Japanese firms undertaking FDI in Serbia ("I" in figure 1) transfer know-how, skills and techniques that enable local export firms in Serbia to become more competitive when exporting to Japan. This transfer of know-how includes the understanding of Japanese management techniques, marketing, technology, distribution channels and market dynamics in Japan (shown as "LINK II" in figure 1). It is therefore assumed that FDI encourages exports. The transfer of these Japan-specific competencies are supposed to create improved opportunities for local exporters in Serbia to start exporting to Japan ("III" in figure 1).

Figure 1: Link between Exports and FDI (Schematic)



When exporting, the understanding about the market dynamics and investment opportunities on the Serbian market will slowly diffuse through business contacts that are created between the two countries. A "spillover" in terms of understanding about the market opportunities in the exporting firm's home country, Serbia, have an impact on investors in the FDI home country, Japan. While uncertainty has been shown to be one of the main obstacles for undertaking Japanese FDI (Marinova, 2003; Morita, 1995; Hutchings, 1999), the risk averseness is assumed to decrease with more market knowledge, making Japanese investors more comfortable investing in Serbia; exports would

therefore encourage FDI (shown as IV in figure 1). It is therefore assumed that there exists a connection between exports and FDI, visualized in the figure above.

3. Methodology

Literature desk research was done to gain an understanding for the theoretical background of Japanese FDI strategies, market entry strategies via exports to Japan, as well as the limited publications that exist on the link between FDI and exports. Furthermore, presentations, press releases and other documents were consulted. In order to validate the theory assumptions, a number of deep case study interviews were conducted with senior management in Japanese corporations with FDI in Hungary (representing the vast majority of Japanese investments in electronics and automotive), as well as with a Japanese trading house with considerable experience in the region: Sony, TDK, Company S (large electronics manufacturer, name is not allowed to be revealed), Suzuki and Itochu Corporation. Also, interviews were conducted with Daido Metal, the only Japanese firm with manufacturing in Serbia-Montenegro.

In addition to the literature desk research and corporate interviews, interviews were conducted with Japanese and foreign organizations in Japan that contributed with insightful and relevant comments: JETRO, JICA, JBIC, JOI, Keidanren (ROTOBO), Ministry of Foreign Affairs, East European embassies' commercial sections, East European trade- and investment agencies, and the European Commission Delegation in Japan¹⁴. All relevant comments from the above mentioned interviews have been included in this article as support for theory findings; however, not all interviewees have been able to answer all questions, hence a best-effort basis based on qualitative analysis.

Benchmarking with Hungary was chosen since Hungary has been one of the most successful countries in Eastern Europe to attract Japanese FDI, and also structurally has similar traits to Serbia; it is a neighbor country, it has the same size of market (population of 10 million), as well as a socialist legacy. Some references have also been made to the Czech Republic for the same reasons.

4. Theory Background to the Link between Japanese FDI and Serbian Exports

In the following sections in this chapter, the Theory background will be discussed regarding the theory constituents that contribute and influence the linkage between Serbian exports to Japan and Japanese FDI to Serbia. The constituents that influence the linkage are supposed to be primarily on a firm level, and will one-by-one be covered; *spillover effects, network theory, the implications on competence transfer from keiretsu dynamics facilitated by trading houses, insights into Japanese investors' risk averseness as well as flying geese- and fish behavior theory.*

¹⁴Comment: JOI=Japan Institute for Overseas Investment
JETRO=Japan External Trade Organization
JICA=Japan International Cooperation Agency
ROTOBO=Keidanren (Japan Business Federation) CEE research institute

4.1 Firm-Level Spillover Effects Based on Network Linkages

Frequently mentioned benefits associated with Japanese multinational firm activity include expansion of the production base, with the creation of new employment¹⁵. In line with these findings, the European Commission's research in South Eastern Europe acknowledges that there are many positive effects associated with the presence of foreign investors; these spillover effects range from transfer of new management skills, know-how, and technologies, with beneficial effects on productivity, as well as improvement of the international market-access (increased contacts with foreign businessmen) of local companies¹⁶. Spillover effects on a firm-level (or micro-level) in management skills, marketing competencies, technology and processes such as quality standards are assumed to transfer to a certain degree across industries within a country, enabled by *network linkages*. Various local firms that are *linked in a business network* through business deals with the firm subject for Japanese FDI, i.e. suppliers of material or equipment, advertisers, consultants etc, may learn new techniques from the Japanese firm, for example in Japanese quality standards. As a subset within such network linkages, specific for Japanese FDI is the relationships of Japanese FDI firms to Japanese trading houses, as well as relations with firms within keiretsus. Network linkages are in detail analyzed in section 4.4.1, and based on the reasoning of network theory, covered in the subsequent section.

4.2 Network theory

The network theory (Cook & Emerson, 1978; Johanson & Mattson, 1987; Hakanson & Johanson, 1993), focuses on the relational aspects of FDI. Japanese investors' behaviour in the CEE, regarding their emphasis on creating networks in the countries where they are undertaking FDI, can according to Marinova & Morita be explained using the network theory¹⁷. Business networks can be regarded as sets of connected relationships between firms¹⁸. Johanson and Mattsons "Industrial Network" model argue that to get established in a new market, the firm has to build relationships that are new to it and to its counterparts¹⁹ in order to get access to important resources. In particular, "*the relationships may promote development of knowledge*", and "*the relationships may be used as bridges to other firms*"²⁰. In addition, the researchers have found that representatives of firms that network with each other, "are aware of each others' interests, and are prepared to pay some attention to them". The relationships arise through *exchange processes* (= "networking"), and it is understood that this is indeed the case for investors and business partners when engaging into *business exchange* situations (e.g. business meetings, business seminars) as well as in *social exchange* (e.g. dinners, informal networking events), in which also *information exchange*²¹, visualized in Figure 2 below:

¹⁵Cieslik, A., Ryan, M., "Characterising Japanese Direct Investment in Central and Eastern Europe", *Post-Communist Economies*, Vol. 14, No. 4, 2002, p. 514

¹⁶"The Western Balkans in transition", *European Commission*, January, 2004

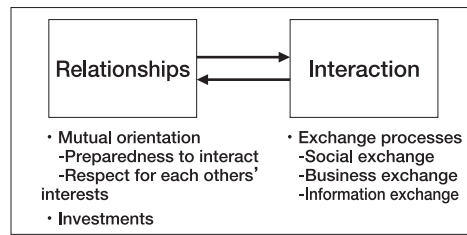
¹⁷Marinova, S., Morita, K., Marinov, M., "Characteristics of Japanese Foreign Direct Investment in Central and Eastern Europe" in Marinova, S., Marinov, M., *Foreign Direct Investments to Central and Eastern Europe*, Ashgate Publishing Ltd., Aldershot, 2003, p. 155

¹⁸Anderson, J., Hakansson, H., Johanson, J., "Dyadic Business Relationships within a business network context", *Journal of Marketing*, vol. 58, 1994, p. 1

¹⁹Johanson, J., Mattson, L.-G., "Interorganizational Relations in Industrial Systems", *International Studies in Management and Organization*, vol. 17, no. 1, 1987, p. 36

²⁰ibid., 1987, p. 37

²¹ibid., 1987, p. 37-38

Figure 2: Relationships and Interaction in Industrial Markets

Source: Johanson, J., Mattson, L.-G., 1987, p. 37

Johanson and Mattson have developed their research primarily from a social point of view since inter-firm interaction processes are carried out by individuals. They have also found that “*through relationships with customers, distributors, suppliers, etc, a firm can reach out to a quite extensive network; the firms in the network get indirect access to assets (knowledge and resources) in firms with which they do not have a direct relationship*”²². Anderson, Hakansson, and Johanson, have made similar findings, arguing that two connected relationships can be both directly and indirectly connected with other relationships that have some bearing on them, as part of a larger business network²³. Holm, Johansson and Thilenius build on this theory base, with findings that the counterparts in the relationship are in turn engaged in other relationships, implying that the interaction and transfer of e.g. competency *extends outside the industry*²⁴.

Resources (e.g. competencies, knowledge), developed in a relationship not only are important to those in the relationship, but also may have implications for resources (e. g. knowledge) of parties engaged in indirectly connected relationships²⁵. A firm may hence transfer competence not only to its partners, but also to its partners’ partners. The supplier may utilize the knowledge about that process when supplying other customers, and transferring this quality process competency to both the customer and the customers’ customers. Therefore, networks are an excellent vehicle for spillover in terms of the transfer of skills, understanding, and knowledge between firms.

A special type of network involving most Japanese trading houses is the keiretsu. Since Serbian exporters as well as Japanese investors will most likely have connections with one or several keiretsus, the next section analyzes how the keiretsu network can contribute to the transfer of knowledge and information about the Serbian market to Japanese investors across industries.

4.2.1 Keiretsu dynamics and trading house influence

The Japanese keiretsu system is very unique, and can be seen as a special case of the network linkages as analyzed in the previous section. The keiretsu system is represented by close business network linkages; these business network linkages are cross-industrial in a tightly knit cross-shareholding relationship²⁶. Keiretsus often

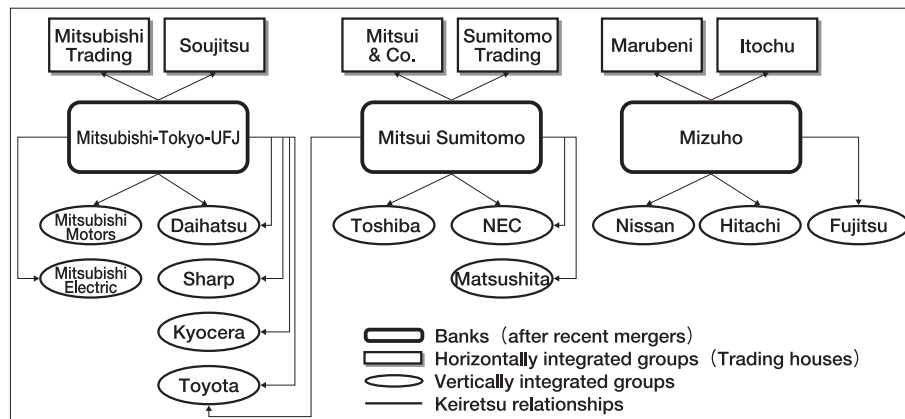
²²Johanson, J., Mattson, L.-G., *ibid.*, 1987, p. 46

²³Anderson, J., Hakansson, H., Johanson, J., *ibid.*, 1994, p. 2

²⁴Holm, U., Johanson, J., Thilenius, P., “Headquarter Knowledge of Subsidiary Network Contexts in the Multinational Corporation”, *International Studies of Management & Organization*, vol. 25, 1995, p. 101

²⁵Anderson, J., Hakansson, H., Johanson, J., *ibid.*, 1994, p. 1

²⁶Czinkota, M., Kotabe, M., *Japanese distribution strategy*, Business Press Thomson Learning, London, 2000, p. 9

Figure 3: Relations between Parts of Keiretsu Industrial Groups in Japan

Source: Lincoln, J., Gerlach, M., 2004, p.22; eurotechnology.com/doing-business-in-japan

consist of a network of companies in diverse industries, ranging from manufacturers to retail²⁷, engaging in “exceptionally varied and extensive activities”²⁸.

While the number of keiretsu groupings is modest, each group can have many members; just the top horizontal groupings (close capital ties), such as Mitsui, Mitsubishi and Sumitomo, are estimated to have over a thousand corporate members, giving them a tremendous power over business activities in Japan²⁹. These keiretsus are deeply involved in transport and trading among others. The trading within the keiretsus is organized by *trading houses*, which imports and exports a wide variety of products, including electronics and agricultural products. The trading houses would be the first instance of Japanese business that gets in contact with Serbian exporters. The horizontal keiretsus with large trading houses also have relationships with vertical keiretsus that focus on manufacturing in e.g. electronics³⁰, via a bank as shown in Figure 3.

Japanese investors across industry affiliation in CEE countries are also closely connected to Japanese trading houses i.e. Mitsui and Sumitomo. Thomsen & Nicolaides conclude that FDI from Japanese trading houses into a host country is likely to expand bilateral trade flows, including exports from the host country to Japan³¹. The trading house establishes natural business and distribution links between the host country and Japan, and creates increased opportunities for meetings between Japanese businessmen and host country exporters.

As can be derived from the analysis in this section, Japanese companies, due to the unique keiretsu dynamics, are used to build relationships across industries, and also realize the benefits of competence transfer between industries. Additionally, trading houses would be catalysts to help disseminate knowledge about the Serbian market to member companies of the keiretsu (as well as to related companies to the keiretsu).

²⁷Czinkota, M., Woronoff, J., *Unlocking Japan's Markets*, Charles E. Tuttle, Tokyo, 1993, p. 36

²⁸ibid., 1993, p. 32

²⁹ibid., 1993, p. 33

³⁰Lincoln, J., Gerlach, M., *Japan's Network Economy*, Cambridge Univ. Press, Cambridge, 2004, p.22

³¹Thomsen, S., Nicolaides, P., *The evolution of Japanese direct investment in Europe*, Harvester Wheatsheaf, Hemel Hempstead, 1991, p. 80

As will be seen in the next section, about risk averseness, business across industries via networks (where keiretsus are a special Japanese case), enables creation of understanding about a market, which will contribute to decrease hesitation to investments.

4.2.2 Risk Averseness

Japanese investors seem to have some different traits compared to Western investors. There is a cultural phenomenon involved in the investment pattern of Japanese multinational corporations (MNC) in Eastern Europe. Primarily, Japanese MNCs have been more *risk-averse* than Western European and North American corporations, and there may have been a mental barrier for Japanese corporations at that time in the 1990's to invest in CEE due to political and other uncertainties³², as well as a lack of information and understanding about the East European markets. Both trade and investment levels have traditionally been very low between Japan and Eastern Europe. That explains the limited knowledge and understanding among Japanese investors for business dynamics and investment opportunities in Eastern Europe, hence the hesitation to invest there. Including the previous discussions on network theory, it is understood that with expanded, increased business dealings between networks of Japanese and Serbian businessmen, information and knowledge about investment opportunities and dynamics will be easily transferred to Japanese investors. Hence, with more frequent contacts, information, knowledge and understanding, Japanese investors may be less hesitant to invest in Serbia.

An other aspect of the Japanese risk averseness, Japanese investors are to a higher degree than others eager to see a cooperation between Japanese institutions such as the JBIC, JICA, JOI and Jetro with the country receiving the investment, both for reasons of legacy of relationships³³, for chances to have increased availability of information³⁴ about the market environment in general in the host country and about the possible acquisition target company in particular. Another reason is the chance to increase prospects for risk sharing either with a government body in the country of investment or with a Japanese organization³⁵.

Additionally, joint-investment seminars by Jetro, JICA, and the Hungarian Investment and Trade Development agency (ITD) have also been instrumental in building understanding for FDI in Hungary among Japanese firms and decreasing risk averseness³⁶. The successful Hungarian approach to Japanese institutions, with subsequent reduction in risk averseness among Japanese investors should be seen as a precedent for Japanese FDI in Serbia.

As can be derived from the analysis in this section, knowledge and information about a market reduces the risk-averseness and uncertainty among Japanese firms in their decision process to undertake FDI. Further understanding of how Japanese investors influence each other, is covered in the next section.

³²Morita, K., *Japan's Foreign Direct Investment in East European Countries*, Praeger Publishers, Westport, 1995, p. 194

³³Hutchings, R., *Japan's economic involvement in Eastern Europe and Euroasia*, Macmillan Press Ltd., London, 1999

³⁴Morita, K., *ibid.*, 1995

³⁵Morita, K., *ibid.*, 1995

³⁶ITD (The Hungarian Investment and Trade Development Agency), Interview with Economic Counsellor, Tokyo, February 25, 2005

4.2.3 Flying Geese and Fish Behavior

Japanese firms like to follow in well-trodden footsteps³⁷. Hence in CEE countries where Japanese companies have a lack of accumulated managerial experience, Japanese investors are more risk averse in undertaking FDI in such a country³⁸. The importance of successful FDI show cases is characterized by Meyer³⁹ as well as Ozawa⁴⁰, in the so called “*flying geese pattern*”, based on analysis of Japanese investments in South East Asia⁴¹. The idea of the theory is that a first investor or small group of investors lead the way, and if successful, other Japanese investors will soon also undertake FDI in the host country. Furthermore, the “flying geese” theory implies that Japanese FDI firms spread competence to local firms in the FDI host market. The firms directly benefiting from Japanese competence transfer will in their turn transfer the knowledge to other companies in the FDI host country, resulting in competitive strengths for a range of industries in the host country. Meyer concludes that the model could also apply to Eastern Europe⁴², which can be exemplified in the case of Hungary where Suzuki invested in auto production and created “Magyar Suzuki”, with a considerable number of suppliers following.

The behaviour that Japanese investors follow each other has been characterized as “*fish behaviour*”, referring to when a school of fish changes direction⁴³, and illustrated in research by Urata⁴⁴. In particular, Japanese electronics firms followed the same investment pattern like schools of fish in Malaysia and Thailand⁴⁵. The “fish behaviour” could also be valid for Eastern Europe, with the Japanese electronics firms, Sanyo, Sony, and TDK following a similar behaviour when doing FDI in Hungary.

Kinoshita adds that in the early phases of investing in a new country, the actions of competitors are dominating, leading to a follow-each-other behaviour⁴⁶.

This behavioural characteristic of Japanese investors, in terms of following each others’ behaviour, shows the importance in giving one or a few Japanese firms information and knowledge about the Serbian market. Once these firms reduce their hesitation to invest, other Japanese firms may follow.

4.2.4 Conclusion of Network Theory Section

From the analysis above, it can be concluded that on the firm level, there are expected *spillovers* in terms of management know-how and technology skills that could be transferred from a Japanese investor to Serbian exporting companies, enabled through networks theory dynamics. The special Japanese business network with keiretsus implies that Japanese businessmen have a tradition in exchanging informa-

³⁷Hutchings, R., *ibid.*, 1999

³⁸Morita, K., *ibid.*, 1995

³⁹Meyer, K., *Direct Investment in South-East Asia and Eastern Europe: A Comparative Analysis*, Palgrave, Basingstoke, 2001, p. 109

⁴⁰Ozawa, T., “Foreign Direct Investments and Economic Development”, *Transnational Corporations*, February, 1992

⁴¹Meyer, K., *ibid.*, 2001, p. 109

⁴²Meyer, K., *ibid.*, 2001, p. 108

⁴³Moran, T., *Foreign Direct Investment and Development*, Institute for International Economics, Washington DC, 1998, p. 73

⁴⁴Urata, S., *Emerging Patterns of Production and Foreign Trade in Electronics Products in East Asia*, The Asia Foundation, San Francisco, CA, 1995

⁴⁵Moran, T., *ibid.*, 1998, p. 87

⁴⁶Kinoshita, Y., “Private Information for Foreign Investment in Emerging Economies”, *The Canadian Journal of Economics*, Vol. 34, No. 2, May, 2001, p. 462–463

tion and building relationships across industries, facilitated also by the existence of trading houses in the keiretsu. The keiretsu connection with Serbian exporters and Japanese investors is an additional corner stone vehicle for the creation of an understanding about the Serbian market among Japanese investor firms, which reduces the hesitation for investments. Japanese investors show a certain risk aversion to undertake investments, however with increased market knowledge about unknown markets, the hesitation to undertake FDI decreases. Once one Japanese investor has successfully entered a foreign market, other Japanese investors may be ready to enter (*flying geese pattern theory*), which further increases the chances to higher FDI in a market. The Japanese investors also show a pattern of similar behavior once investments have been done (*fish behavior theory*), enabling an increase in FDI among Japanese firms that already have a presence in a foreign market.

4.3 The Theory Dynamics of Micro-Spillovers

This section is based on transposing the previous theory discussions with reasoning on the dynamics in the Export-FDI link between Japan and Serbia. As discussed in the previous theory discussions, there are benefits in terms of knowledge, know-how and competence transfer (called spillover) to local firms from FDI. There are a number of vehicles for spillover transfer between the FDI firm and local firms on a micro-level in Eastern Europe, as researched by Djankov & Hoekman (1999), Konings (2001), Gunther (2002), Fosfuri et al. (2001), and Cieslik & Ryan (2002). The vehicles supposed to contribute to firm-level spillovers are:

- *Training*: Japanese firms have a relatively strong emphasis on training of employees, which increases the general skill-level in the Japanese local affiliate, and also contributes to a unique understanding of Japanese management style, marketing, technology and distribution channels among local staff in the Japanese local affiliate. Training of suppliers is also common among Japanese manufacturing firms undertaking FDI.
- *Labor turnover*: Skills and competencies in for example Japanese marketing and technology may be transferred via people that switch jobs to other firms, which also happens across industries. Foreign firms, such as Japanese, train local employees who later join local firms or set up their own business, bringing with them all (or part of) the technological, marketing, and managerial knowledge that they have acquired⁴⁷. According to Fosfuri et al., spillovers occur more easily when the multinational company that is undertaking the FDI, and the local firm are *not* direct competitors⁴⁸. The reason is that by not being direct competitors, the MNC will be less hesitant to let the trained worker switch to a local firm since company-specific knowledge will be of less use to the local firm, hence not eroding the MNCs competitive situation. However, the trained worker will be able to bring non-company specific knowledge spillovers, such as Japanese technology, marketing, management concepts as well as understanding of the Japanese way of doing business to the local firm. It is therefore implied that knowledge spillover such as those mentioned in this paragraph, have a higher chance to proliferate when the local firm is operating in another sector

⁴⁷Fosfuri, A., Motta, M., Ronde, T., "Foreign direct investment and spillovers through workers' mobility", *Journal of International Economics*, 53, 2001, p. 206

⁴⁸ibid., p. 214-215

with different products than the MNC, yet to some extent related to the MNC⁴⁹.

- *Imitation*: Since interaction between firms actually is the result of business relationships between individuals according to Johanson & Mattson (1987), it can be expected that best-practice processes observed by businessmen when dealing with other businessmen would be transferred by imitation. The imitation can occur with “learning by watching”⁵⁰.

Local firms that learn such new techniques and skills through the above mentioned spillover components, may in their turn dynamically transfer these skills over to other local exporting firms, which will benefit from increased competitiveness when exporting to Japan, creating new opportunities for the exporting firms. When these spillovers are obtained by the local Serbian firms, these firms gain understanding about the Japanese market and best-practices to do business in Japan, as well as access to distribution channels to Japan. The increased understanding for Japanese marketing skills and techniques will help the exporting firms improving their “market-access” capability for entering the Japanese market, eventually leading to increase in exports to Japan from local firms. In that perspective, Japanese FDI in Serbia can positively contribute to transferring Japanese technology, management skills and know-how, creating competitive advantage to local Serbian firms for exporting to Japan.

Gaining such insights is especially important for local firms in a country like Serbia, where transition from a socialist to market economy has only started in 2000, about 10 years later than in the other East European countries. Gaining access and learning Japanese management- and marketing skills by local Serbian firms is not easily duplicated by firms without the linkage to the few Japanese FDI operations. Therefore, the firms that actively aim to acquire skills and competencies in Japanese management, marketing skills and know-how via spillover effects, will access scarce and inimitable capabilities, hence fulfilling the two conditions for creation of competitive advantage (Barney, 1991).

4.4 Reasoning on the Dynamics in the Export-FDI Link between Japan and Serbia

From the theory discussion, we have a base for the link between FDI and exports. In this section, the link dynamics will be reasoned upon from a firm-level or micro-perspective.

The impact of the spillovers from Japanese FDI on Serbian firms may be even stronger than in other East European countries, since the Japanese government is also strongly involved on a diplomatic level in Serbia with various aid and finance programs, through organizations such as JICA, Jetro and JBIC.

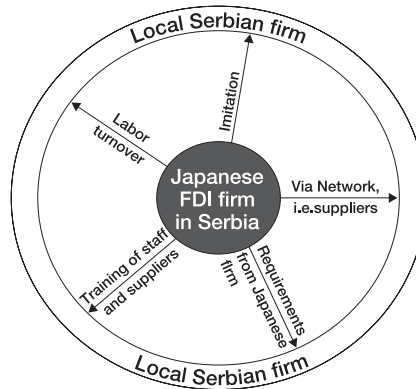
4.4.1 Mechanism for the Influence of Japanese FDI on Serbian Exports on a Micro-Level

As mentioned previously, there are supposedly a number of *vehicles* for the transfer of spillovers to local Serbian firms in the case of Japanese FDI, and will here be applied on the Serbian firm’s situation. The vehicles for spillover transfer are networks, requirements from Japanese firms, training of staff and suppliers, labor

⁴⁹ibid., p. 215

⁵⁰Gunther, J., *The significance of FDI for innovation activities within domestic firms*, Halle Institute for Economic Research, Discussion paper, May, 2001, p. 9

Figure 4: Vehicles for know-how and competency transfer from a Japanese FDI firm in Serbia to Serbian local firms



turnover, and imitation, visualized in Figure 4, which will be evaluated with empirical evidence in chapter 5.

Networks as spillover vehicle on a micro-level: From the network theory section we understand that relationships in networks promote development and transfer of knowledge. Networks are formed between Japanese FDI firms and their suppliers, customers, and other related firms (such as for example HR agencies and advertisement agencies). These firms have a direct relationship with the Japanese FDI firm, and get access to Japanese management style, techniques and other competencies. Suppliers and advertisers for example, that have learnt a Japanese competency or process by the direct interaction with the Japanese firm (for example quality processes), may in its turn use this gained knowledge and apply it in its relations with other Serbian customer firms among which may be firms involved in exporting activities to Japan. That competency is then transferred to the Serbian firm interested in exporting to Japan, and may assist that local firm when exporting to Japan. The local Serbian firm does not necessarily have to be operating in the same industry as the Japanese FDI firm. This is supported by network theory findings (see section 4.2) from Anderson et al (1994), Johanson et al (1987), and Holm et al (1995), where for example Holm et. al.⁵¹ has found that counterparts in a network relationship are in turn engaged in other relationships, implying that the interaction and transfer of competency can extend outside the industry.

The *keiretsu system dynamics* among Japanese firms further support the cooperation and exchange between firms in different industries. The Japanese keiretsu system is unique for the western world, where Japanese businessmen are used to network and build relationships with businessmen from a variety of industries, to a higher degree than Western businessmen. In both Prague and Budapest, Japanese managers and representatives from local companies have regular and frequent gatherings co-organized by Jetro, CzechInvest, and ITD (Investment and Trade Development, Hungary), where local businessmen have possibilities to network with Japanese managers from various industries. The keiretsu system, as well as the involvement of Japanese and

⁵¹Holm, U., Johanson, J., Thilenius, P., *ibid.*, 1995, p. 101

local trade promotion organizations, are a unique combination working as a catalyst for the creation of networks between Japanese and local firms across industries, with subsequent additional competence transfer (spillover) as result.

In this business network context, another unique feature of Japanese business is important, the *trading houses*. The Japanese trading houses were pioneers in entering the East European markets, and have had long presence there even before the start of major Japanese FDI. For example, also during the sanctions in Serbia in the 1990's, Mitsui had an office with Japanese staff operating in Belgrade. The trading houses are used to building networks across industries, and could also function as a catalyst for network relationship building between individuals in Japanese and Serbian firms. The presence of trading houses is unique for Japanese business, further enabling spillovers via networks. In interviews with representatives from both the ITD⁵² (Hungarian Investment and Trade Development agency) and CzechInvest⁵³, the importance of Japanese trading houses for relationship creation between Japanese FDI firms and local firms were confirmed. In Serbia, with much less Japanese FDI than in Hungary or in the Czech Republic, the importance of the networking between Japanese and Serbian businessmen facilitated via Jetro, JICA, keiretsu system dynamics, and the presence of trading houses, is expected to be even stronger. Hence, networks are vehicles for spillover between a Japanese FDI firm and a local Serbian exporting firm, linking FDI and exports between firms on a micro level.

Requirements as spillover vehicle on a micro-level: Japanese FDI firms often require local firms that want to enter a business relationship, to comply with a number of processes. One example of such a process is the quality process. According to CzechInvest, Czech companies that wish to be suppliers to Japanese firms, first have to comply on very strict quality requirements⁵⁴. In order to acquire this quality competency, some suppliers get training organized by Japanese firms, while others have to acquire the quality competencies on their own in other ways. The suppliers having been accredited by a Japanese firm to fulfil the quality requirements, will then be attractive partners for local firms due to the highly appreciated recognition of Japanese quality on the one hand, and in order to transfer the quality process competency to other local firms⁵⁵. Hence, local firms that aim at exporting to Japan can obtain know-how about Japanese quality processes indirectly via local firms that are in direct contact with the Japanese FDI firm, suggesting requirements to be a vehicle for spillover to local firms. This spillover vehicle is expected to have the same mechanisms in linking FDI to exports in Serbia on a micro-level as it has in for example the Czech Republic as described above.

Training of staff and suppliers as spillover vehicle on a micro-level: Training is an important aspect in Japanese companies, and Japanese corporations investing in Eastern Europe often have training programs in Japan where local staff is sent to participate in; as an example, when Suzuki made its investments of manufacturing

⁵²ITD (The Hungarian Investment and Trade Development Agency), Interview with Economic Counsellor, Tokyo, February 25, 2005

⁵³CzechInvest, Interview with Director, Yokohama, February 28, 2005

⁵⁴CzechInvest, Interview with Director, Yokohama, February 28, 2005

⁵⁵CzechInvest, Interview with Director, Yokohama, February 28, 2005

Suzuki cars in Hungary, Hungarian middle-managers in Magyar Suzuki as well as from local suppliers were brought over to Japan for a training crash-course in Japanese management style, techniques, distribution systems, and other aspects of Japanese business dynamics⁵⁶. In 2005, for the first time, a Serbian business representative will participate in a 2-month training seminar on Japanese business organized by JICA⁵⁷. In the same way as the mechanism for how requirements can be a vehicle for spillovers to local firms (as discussed in the previous section), training will also be that. Suppliers will also in this case, following the mechanism described in the previous section about requirements, contribute to developing competencies about Japanese processes in other local firms, reaching local firms aiming at exporting to Japan. Hence training is also a vehicle for creating a link between FDI and exports on a micro-level.

Labor turnover as spillover vehicle on a micro-level: Top management in Japanese FDI firms in Eastern Europe are almost exclusively of Japanese origin, however, the majority of the middle managers are of local origin⁵⁸. The local middle managers get trained in Japanese management techniques, Japanese technology and marketing, as well as in Japanese distribution systems. The local middle managers in Japanese corporations are highly operational and are given quite considerable responsibility, resulting in a good understanding in dealing with Japanese business dynamics. Naturally, the functional competencies of such managers would be of high value for local firms aiming to export to Japan even if industries would be different; their understanding of Japanese distribution channels, marketing, and business dynamics would help the local firm gaining competitive advantage in their export endeavours. This is supported by research by Fosfuri et al, finding that foreign firms, such as Japanese, train local employees who later join local firms or set up their own business, bringing with them all (or part of) the technological, marketing, and managerial knowledge that they have acquired⁵⁹. In particular, it has been found that spillovers via labor migration is more effective when the migration occurs to a local firm in another industry for reasons of competition; the trained local worker will be able to bring non-company specific knowledge spillovers, such as Japanese technology, marketing, management concepts as well as understanding of the Japanese way of doing business to the local firm⁶⁰. Therefore, with migration of trained middle-managers from Japanese FDI firms to local firms in different industries, local Serbian firms aiming to export to Japan would gain an advantage, hence a link between FDI and exports on a micro-level.

Imitation as spillover vehicle on a micro-level: As discussed in the theory section, imitation is the last identified vehicle for spillover from a Japanese FDI firm to a local firm. The imitation can occur through “learning by watching”, meaning that the Serbian local firm observe the Japanese investor’s entrepreneurial actions, e.g. in the field of marketing or logistics, and legally copy certain practices which are new to

⁵⁶*Embassy of Hungary*, Interview with Economic Counsellor, Tokyo, February 10, 2005

⁵⁷*Kobe University*, Professor Masahiko Yoshii, Graduate school of Economics, February, 2005 (email)

⁵⁸*CzechInvest*, Interview with Director, Yokohama, February 28, 2005

⁵⁹Fosfuri, A., Motta, M., Ronde, T., “Foreign direct investment and spillovers through workers’ mobility”, *Journal of International Economics*, 53, 2001, p. 206

⁶⁰*ibid.*, 2001, p. 214-215

them and result in innovation activities⁶¹, creating a competitive advantage when exporting to Japan. Hence, imitation can also be seen contributing to the link between FDI and exports on a micro-level.

4.4.2 Mechanism for the Influence of Serbian Exports on Japanese FDI on a Micro-Level

A combination of the above-mentioned vehicles for spillovers deriving from FDI creates possibilities for the Serbian exporter to gain knowledge, understanding and organizational capability for exporting to the Japanese market. The knowledge includes understanding for the market- and industry structure, management and marketing techniques, communication style, and cultural behavior in Japan, hence encouraging the start of exports, and creating a good base for the Serbian firm to create an entry strategy for the Japanese market.

Exporting gives opportunities for businessmen from Serbia to meet importers from Japan, initially primarily from Japanese trading houses. The keiretsu system, and that trading houses are well-networked with corporations in various industries, can according to network theory enable a spread of knowledge regarding investment opportunities on the Serbian market among Japanese investors. In addition to the ties with keiretsu firms and trading houses, Japanese investor corporations oriented towards countries with lower levels of Japanese investments tend to be well-networked and informed through the participation in formal gatherings organized by JETRO, JICA, JBIC, and JOI. When the Serbian exporters get in contact with these investor communities, the knowledge about the Serbian investment opportunities can spread further. As discussed in previous sections on risk averseness, increased information and understanding about the Serbian market may decrease the risk averseness among Japanese investors to do FDI in Serbia. Serbian exports to Japan could therefore serve as a catalyst for Japanese FDI into Serbia, hence a link back from exports to FDI.

Once a few Japanese investors have started to do FDI in Serbia, more may follow according to the analysis in section 4.2.3 on flying geese theory. Last, additional FDI in Serbia by one Japanese investor may stimulate other Japanese investors to undertake further FDI there according to the fish behaviour pattern among Japanese investors.

5. Empirical Evidence of the Link Dynamics Process

Based on the theory and analysis in previous sections in this article, the dynamics in the process of how Japanese FDI and Serbian exports can be linked on a micro-level, is in this section supported by empirical evidence from primarily Japanese electronics firms and trading houses with FDI and business in Eastern Europe, as well as from interviews with Japanese and East European institutions (empirical evidence is referred to with a “►” sign). This section is divided in to four phases of the Link dynamic process between Serbian exports and Japanese FDI; (a) Export initialization, (b) FDI initialization, (c) Export continuation, and (d) FDI continuation. Empirical evidence is supporting each of the four phases, as well as the connection between the phases.

⁶¹Gunther, J., “The significance of FDI for innovation activities within domestic firms”, *Halle Institute for Economic Research*, Discussion paper, May, 2001, p. 9

a) Export initialization

- The Serbian exporter starts exporting to Japan via a Japanese importer, initially primarily from Japanese trading houses.
 - ▶ According to CzechInvest⁶², the best option for an East European SME exporter in terms of risk reduction, financial support, and distribution network access on the Japanese market, is to partner with one of the large established trading houses for exports to Japan. Also the European Commission in Tokyo suggest East European exporters (including Serbian exporters) to initially export via a trading house⁶³.
 - ▶ The Hungarian Investment and Trade Agency in Tokyo (ITD), adds that it is difficult for an East European exporter to develop own distribution channels, and the best way in the beginning of business with Japanese firms is to go via a Japanese trading house. Japanese trading houses (primarily Itochu and Mitsui) have played key roles in assisting Hungarian SME (Small Medium Enterprise) exporters to succeed with exports to Japan in the food sector⁶⁴.

b) FDI initialization

- While importing Serbian products, it is assumed that Japanese firms build knowledge about the Serbian market, and that the Japanese firms pass that knowledge on to their business partners according to the Network theory, in formal and informal meetings between representatives of Japanese and Serbian firms.
 - ▶ According to Itochu, it is common to let foreign exporters network with a selection of the more than 700 affiliated companies of Itochu for example in receptions and seminars in Japan; furthermore, Hungarian export products are promoted to Itochu's affiliated companies as well as to affiliate's affiliates via a web-system called "I-Cross", enabling exposure to more than 1000 companies⁶⁵.
- According to knowledge diffusion to partners' partners in Network theory, knowledge about the Serbian market will be channelled through to the Japanese investor community with certain interests in the Serbian market. The network theory suggests such a connection in knowledge conveyance to business partners. Thereby, the Japanese investor will get increased understanding and knowledge about the Serbian market through Serbian exports to Japan.
 - ▶ According to Keidanren⁶⁶, such benefits via networking exist, i.e. Hungarian exporters invited by Itochu to present their products in Japan, occasionally inform representatives from affiliated companies to Itochu about investment opportunities on the Hungarian market. Since the Hungarian exporter was introduced by Itochu, a reputed trading house in Japan, potential

⁶²CzechInvest, Interview with Director, Yokohama, February 28, 2005

⁶³European Commission Delegation in Japan, Interview with Official in Trade section, Tokyo, June 17, 2005

⁶⁴ITD (The Hungarian Investment and Trade Development Agency), Interview with Economic Counsellor, Tokyo, February 25, 2005

⁶⁵Itochu, Interview with Ex-president Itochu Hungary, Tokyo, April 26, 2005

⁶⁶Keidanren (ROTOBO), Interview with Deputy Director, Department for Central-Eastern Europe, Tokyo, April 22, 2005

Japanese investors affiliated to Itochu would feel a certain confidence for the advice from the exporters.

- As the Japanese investors gain insights into and knowledge about the Serbian market, the propensity to undertake FDI increases:
 - ▶ Trading houses can play a favourable role for supporting diffusion of market knowledge about investment opportunities in East European markets, exemplified with Itochu having played a significant role in assisting Suzuki's FDI in Eastern Europe with information provision about the Hungarian market, and access to its network of contacts with suppliers and government institutions in Eastern Europe⁶⁷.
 - ▶ According to Morita⁶⁸, Japanese propensity to undertake FDI increases with the knowledge and information about the market to invest in. There will therefore supposedly be a link from the Serbian exporters' activities to Japanese investors undertaking of FDI in Serbia.
- With Japanese FDI into Serbia, *micro-level spillovers* will positively benefit Serbian firms in Serbia. These firm-level spillovers include transfer or competencies and knowledge in terms of Japanese market- and industry structure, Japanese management and marketing techniques, communication style, and cultural behavior in Japan, creating a good base for the Serbian firm to create an entry strategy for the Japanese market. The spillovers can according to theory in section 4.4.1 be realized through five vehicles components: networks, requirements, labor turnover, training of staff & suppliers, and imitation, and will in the following be supported by empirical evidence:
 - *Networks as spillover vehicle on a micro-level:*
 - ▶ Suzuki offers Hungarian firms in unrelated industries to transport products in Suzuki's containers to Japan, that otherwise would go empty back to Japan. Hungarian firms in industries such as wine, sausages and goose liver are via Suzuki's channels able to establish a product presence on the Japanese market, and spread further information about the investment situation in Hungary via export channels. These contacts between Japanese and Hungarian firms in unrelated industries have created increased understanding for undertaking FDI in Hungary by Japanese firms, reduced risk hesitation among Japanese investors, and encouraged Japanese FDI to Hungary⁶⁹.
 - *Requirements as spillover vehicle on a micro-level:*
 - ▶ According to Daido Metal, the only Japanese firm with manufacturing in the State Union Serbia-Montenegro, the strict requirements in terms of quality and cost-efficiency to its local suppliers has enabled several local suppliers in Serbia to start exporting components also to Daido Metal's production sites in Japan, which would have been impossible without Daido Metal's competency transfer via requirements to the local suppliers⁷⁰.

⁶⁷ Suzuki, Interview with Group leader European marketing, Hamamatsu City, March 25, 2005

⁶⁸ Morita, K., *ibid.*, 1995, p. 194

⁶⁹ Embassy of Hungary, Interview with Economic Counsellor, Tokyo, February 10, 2005

⁷⁰ Daido Metal, Interview with Ex-Managing Director of Daido Metal Kotor, June 30, 2005

- By clearly communicating supply requirements, local suppliers have raised their quality process standards, and out of a total of 200 suppliers to Sony in Hungary, 30 are local⁷¹.
- Company S has transferred some technology knowledge, which has enabled the local suppliers to improve their competency and abilities, and also partly transferred some of the new insights to partner companies (that occasionally operate in different industries)⁷², hence micro-spillover from requirements.

-Labor turnover as spillover vehicle on a micro-level:

- According to Keidanren, local middle managers that have been trained in Japanese management style and business practices, and switch jobs from a Japanese firm to a local firm, can assist local firms with their exports to Japan.
- This is confirmed by Sony⁷³, whose turnover of middle-managers is about 15% annually, among which some of the managers switching jobs actually go to local firms. As a specific example, a Sony manager switched to a local firm in a *different industry*, and is currently using his functional skills and insights about Japanese business in the local (non-electronics) firm's export activities to Japan. Managerial job switches to different industries is seen as less harmful for Sony compared to if a trained manager would switch to a direct competitor. According to Itochu, the average turnover among local middle-managers that have received training in Japan is about 25%, hence higher than middle-managers without Japan experience, which further indicates that labor turnover is a considerable vehicle of spillovers on a micro-level.
- Jetro agrees that local Serbian firms could gain competitive advantage with exporting to Japan from hiring local staff that previously worked in Japanese firms, even if the sectors are different, and add that knowing the product is less important than to understand the dynamics of the Japanese market⁷⁴.
- TDK has recognized turnover of trained managers as a problem for the business, and has encouraged certain incentives in terms of salary and responsibility benefits to trained managers so as to reduce cost of labor turnover. Although migration of trained managers from Japanese firms to local export industry is beneficial to those local firms in the short-term, it can actually impede Japanese FDI long-term if turnover rates get too high, hence a need to have a balanced turnover of trained managers.

-Training of staff and suppliers as spillover vehicle on a micro-level: Labor training in advanced Japanese know-how supposedly creates awareness among the staff in the Japanese firm as well as with suppliers and other related local firms for Japanese business, benefiting local Serbian exporting firms via labor migration over time.

⁷¹Sony, Interview with General Manager, Ex-president Sony Hungary, Tokyo, April 5, 2005

⁷²Company S (large Japanese electronics manufacturer), Interview with General Manager, Ex-president Hungary factory, Tokyo, April 4, 2005

⁷³Sony, Interview with General Manager, Ex-president Sony Hungary, Tokyo, April 5, 2005

⁷⁴JETRO, Interview with Deputy Director, European Division, Overseas research department, Tokyo, May 20, 2005

► According to the JBIC research, Japanese firms with FDI in Eastern Europe tend to educate their local suppliers⁷⁵.

► More than 500 Hungarian managers have been trained in Japan until 2004 (i.e. Sony, TDK, Suzuki and Ibiden send local middle-managers on 2-month Japan business training in Japan), and results are now shown after some of those managers switched jobs to join to local exporters in different industries, by increased exports to Japan in wine and goose-related products. Middle-managers that previously worked for Japanese firms join the Budapest alumni club, from which local Hungarian firms can hire export managers experienced with business with Japanese companies, offering those local firms competitive advantages in their export efforts to Japan⁷⁶.

► Managers from Sony Hungary have been invited by the Hungarian government to train local exporters in Japanese marketing and quality processes⁷⁷. Also, competency is transferred from Sony to local suppliers via training by Sony engineers through continuous visits to suppliers. The same is valid for Suzuki, where staff visit local Hungarian suppliers and provide suggestions, proposals as well as evaluations⁷⁸.

► Daido Metal trains and educates the local suppliers in Serbia-Montenegro by dispatching engineers to the supplier for some period, as well as by inviting the supplier to training in Daido Metal's production plant. The training of suppliers has in the matter of 2 years made it possible for the local suppliers to improve various quality processes to such an extent that several of the local suppliers in Serbia now are delivering components to Daido Metal's production of bearings in Japan⁷⁹. FDI from the Japanese firm has hence created possibilities for local suppliers to export to Japan, hence a direct link between Japanese FDI and local exports to Japan.

-Imitation as spillover vehicle on a micro-level: Imitation of Japanese methods, "learning by watching" also builds knowledge among local firms that makes them more prepared for exporting to Japan.

► According to TDK, local suppliers can learn some processes by imitating TDK processes, however such imitation is limited and does not have a considerable impact on competency transfer to local firms⁸⁰.

c) Export continuation

- The Serbian exporters, even in unrelated industries, are hence expected to with time gain access to Japanese management techniques, technical knowledge, and knowledge about the Japanese market thanks to the micro-spillovers from the Japanese investors.
- Serbian firms that started with exports to Japan gain further insights to the

⁷⁵ JBIC, Interview with Senior overseas investment research analyst, Tokyo, June 3, 2005

⁷⁶ ITD (The Hungarian Investment and Trade Development Agency), Interview with Economic Counsellor, Tokyo, February 25, 2005

⁷⁷ Sony, Interview with General Manager, Ex-president Sony Hungary, Tokyo, April 5, 2005

⁷⁸ Suzuki, Interview with Group leader European marketing, Hamamatsu City, March 25, 2005

⁷⁹ Daido Metal, Interview with Ex-Managing Director of Daido Metal Kotor, June 30, 2005

⁸⁰ TDK, Interview with Senior Vice President & Member of the Board, Ex-president TDK Hungary, Tokyo, April 1, 2005

Japanese market through the micro-level competence spillover from Japanese investors in Serbia, adding to Serbian firm's competitive advantage on the Japanese market.

- ▶ According to the Japanese Ministry of Foreign Affairs, the strengthening of local Serbian exporters' abilities to do business with firms in Japan thanks to learnings from Japanese FDI firms in Serbia is expected to be further facilitated by JICA specialists (ex-Jetro) that from this year (2005) are dispatched to work inside the Serbian investment and export promotion agency (SIEPA) in Serbia⁸¹.
- With additional FDI, the impact of the spillover from Japanese firms to local Serbian firms is assumed to transfer further competencies to local Serbian firms that facilitate their market entry to Japan (through the effects of the Japanese FDI in Serbia as discussed above), leading to more Serbian market entry via exports to Japan.
 - ▶ The Economic Counselor at the Embassy of Serbia in Japan, evaluates that Japanese FDI to Serbia could contribute to additional Serbian exporters to gain insights for exports to Japan⁸².
 - ▶ Serbian exporters are from 2004 increasingly supported to network with Japanese FDI firms and trading houses so as to augment the number of Serbian exporters to Japan via trade fairs organized by Jetro (in Dusseldorf, March 2005), and JBIC (in Serbia, April 2004)⁸³.

d) FDI continuation

- Additional Japanese firms may be expected to do FDI in Serbia, once a few have undertaken successful FDI.
 - ▶ The large Suzuki investment in a car production plant in Hungary has enabled an increase in contacts and information about the Hungarian market in Japan in several aspects, reducing risk-averseness for FDI among Japanese investors; Suzuki spreads information about the investment conditions on the Hungarian market to companies in Japan that are directly linked to Suzuki's operations⁸⁴.

As a final remark, the process described above can equally be initialized with Japanese FDI, stimulating Serbian exports to Japan. Hence the process can start with both exports and FDI.

6. Conclusion Analysis of the Link Dynamics Process between Serbian Exports and Japanese FDI

It can be comprehended that the link dynamics process between Serbian exports and Japanese FDI can be shown as an iterative process, where the process can be

⁸¹ *Ministry of Foreign Affairs (MOFA)*, Interview with senior official for South Eastern Europe, Tokyo, May 10, 2005

⁸² *Embassy of Serbia and Montenegro*, Interview with Economic Counsellor, Tokyo, May 13, 2005

⁸³ *Ministry of Foreign Affairs (MOFA)*, Interview with senior official for South Eastern Europe, Tokyo, May 10, 2005

⁸⁴ *Embassy of Hungary*, Interview with Economic Counsellor, Tokyo, February 10, 2005

initiated either by FDI or exports. In the following, the process will be analyzed and concluded, starting with Export initiation (a), followed by FDI initiation (b), Export continuation (c), and FDI continuation (d), and shown in Figure 5.

The Serbian exporter starts exporting to Japan, via a Japanese importer and initially primarily from Japanese trading houses, as seen from empirical evidence. That is the *Export initialization phase*, shown as (a) in figure 5. While interacting with the Serbian exporters, knowledge about the Serbian market is created among the Japanese business partners involved in the activities of exporting and distributing the Serbian products. The knowledge is then proliferated among those Japanese companies' business partners according to the Network theory; supported by empirical evidence (see chapter 5), for example Itochu offers Hungarian exporters access to over 700 affiliated companies on the Japanese market in business seminars and receptions, as well as via its web trade system I-cross. Knowledge about the Serbian market will then also be channelled through to the Japanese investor community with certain interests in the Serbian market, according to Network theory relating to knowledge diffusion to partners' partners. Such investors may consider the Serbian market for FDI due to a favourable investment climate and investment potential there. Thereby, the Japanese investor will get increased understanding and knowledge about the Serbian market through Serbian exports to Japan, in accordance with empirical evidence supported by Keidanren and Sony. As the Japanese investors gain insights into and knowledge about the Serbian market, the propensity to undertake FDI increases, with empirical evidence supporting the *FDI initialization* due to exports as discussed above, and shown as (b) in figure 5. There will therefore supposedly be a link from the Serbian exporters' activities to Japanese investors undertaking of FDI in Serbia, shown in Figure 5 as "LINK 1".

Then, after the Japanese investor decides to undertake FDI into Serbia, micro-level spillovers will positively benefit Serbian firms in Serbia. A combination of the vehicles for spillovers deriving from FDI creates possibilities for the Serbian exporter to gain knowledge, understanding and organizational capability for exporting to the Japanese market. This includes knowledge and understanding for the market- and industry structure, management and marketing techniques, communication style, and cultural behavior in Japan, hence encouraging the start of exports, and creating a good

Figure 5: The Export-FDI Link Model

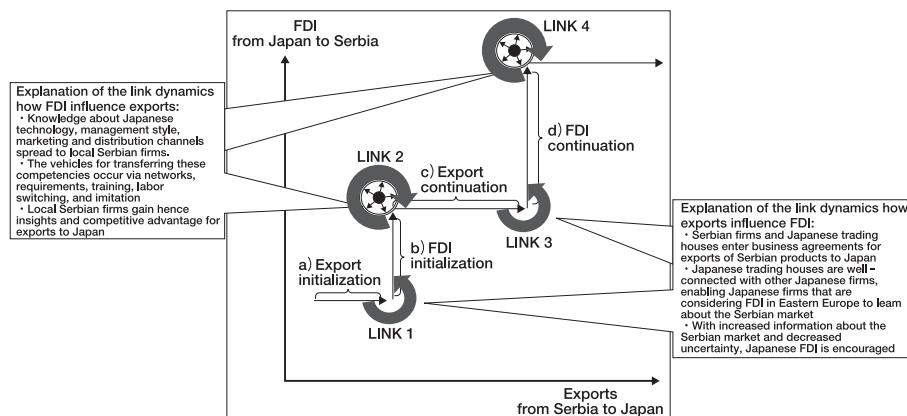
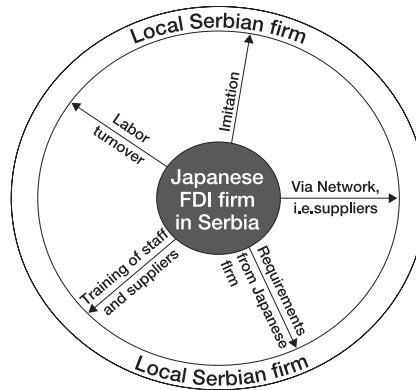


Figure 6: Vehicles for Firm-Level Spillovers



base for the Serbian firm to create an entry strategy for the Japanese market. These *micro level* spillovers from Japanese investors to Serbian local firms can be transferred through five spillover vehicle components: networks, requirements, labor turnover, training of staff & suppliers, and imitation, illustrated in Figure 6 (the figure is recalled from section 4.4.1).

Via *networks* between Japanese and Serbian firms, competencies and insights on business opportunities are transferred, as with evidence from Magyar Suzuki's offering to local Hungarian exporters of agro-products to preferentially use Suzuki's empty containers for transportation of export products to the Japanese market, creating a competitive advantage for those local exporters. *Requirements* from Japanese firms force local suppliers and related firms to adapt to Japanese processes that they subsequently can utilize and spread to other local firms, with evidence of firm-level spillovers originating in requirements in the cases of Daido Metal in Serbia, as well as Sony and Suzuki in Hungary. With *labor turnover* in Japanese firms, local managers that are trained in Japanese management style and business practices can assist local firms with their exports to Japan, as shown in the case of Sony where managers have switched to local industry involved in exporting to Japan. Certainly, if labor turnover is getting too high, it would influence further Japanese FDI negatively since Japanese firms would hesitate to invest due to losses in competency—such an issue would be limited in the case of Serbia for the next years due to the very high unemployment in the country, hence conditions for a balanced labor turnover from Japanese firms in Serbia at least in the medium term. *Training of staff and suppliers* is a powerful tool as a spillover on a micro-level, since it assists for example suppliers to become more efficient, quality minded and opens up new markets, as shown in the case of Daido Metal's suppliers in Serbia that thanks to training and requirement from Daido Metal now also are able to satisfy demanding Japanese customers when exporting their components to Japan. *Imitation* has been found to be of limited impact on micro-level spillovers in Eastern Europe, supported by empirical evidence from TDK.

With network theory from Holm (1995) as discussed in 4.2, the firm-level spillover of Japanese know-how and competency will not only affect the industry that Japanese firms undertake FDI in, but will with time spread to other industries as well. It has been found that know-how on Japanese management techniques, and distribution

systems is in fact more likely to spread to local firms in other industries, due to less resistance of letting trained local managers in a Japanese FDI firm migrate to local firms in industries in which the Japanese firm is not in competition with, as can be found in the empirical evidence from Sony in Hungary. Along the logics for local firms in Hungary, local staff in the Japanese FDI firm would supposedly also be attractive for local Serbian exporting firms thanks to their insights, understanding and knowledge about Japanese marketing, business dynamics and distribution systems. As Serbian industry has a tradition in a much more market oriented environment than other East European countries (Serbian firms were after the 2nd World war increasingly exporting to Europe and the US, and faced western competition and influences, while other East European countries were confined to trade more or less exclusively with socialist countries)⁸⁵, acceptance and acquisition of Japanese methods may be even smoother than in Hungary. The Serbian exporter, even in unrelated industries, are hence expected to with time gain access to Japanese management techniques, technical knowledge, and knowledge about the Japanese market thanks to the micro-spillovers from the Japanese investor as discussed above. This implies a strengthening in the competitive advantage for Serbian firms, with *Export continuation*, shown as (c) in Figure 5. Hence there's a link between Japanese FDI in Serbia and Serbian exports to Japan, shown as "LINK 2" in Figure 5.

The Serbian firms that started with exports to Japan gain further insights to the Japanese market through the spillover effects of Japanese investors in Serbia, enabling a further strengthening of the exports to the Japanese market. In addition, other Serbian exporters may also gain insights that facilitate market entry to Japan through the effects of the Japanese FDI in Serbia as discussed above, leading to more Serbian companies opting for market entry to Japan, a process expected to be facilitated thanks to the JICA trade specialists dispatched by the Japanese government to promote export from Serbia to Japan. More Serbian exports to Japan implies increased networking with Japanese investors, increased knowledge about the Serbian market among potential investors in Japan, and reduced uncertainty about doing FDI in Serbia, stimulating both a continuation of FDI from firms that initialized FDI to Serbia, according to the "fish behaviour" investor pattern, as well as among other Japanese firms that have not yet undertaken FDI to Serbia. This is shown in Figure 5, with *FDI continuation* (d), along the same logic reasoning as in (b), hence a link between exports and FDI (LINK 3). With continued and expanded Serbian exports to Japan, the knowledge about the Serbian market will grow further in Japan.

Considering the "flying geese pattern" found among Japanese firms (once one Japanese firm has undertaken a successful FDI, more Japanese firms may be ready to follow), additional Japanese firms may be expected to do FDI in Serbia. Further FDI stimulates more positive spillover effects to local Serbian firms, indicated in LINK 4 in Figure 5 (the dynamics for LINK 4 are as described for LINK 2), and so the process continues in the early phases of Serbian firms' exports to Japan and Japanese firms' FDI into Serbia.

As a final remark, as the Japanese FDI to Serbia in manufacturing is expected to target exports of products to third markets (primarily the EU and Russia) based on factor advantages with production in Serbia, the impact on wider import reduction of

⁸⁵ *Meiji Gakuin University*, Interview with Professor Nozomu Abe, Faculty of International Relations, Totsuka, March 15, 2005

products from Japan to Serbia will be limited since the primary aim is not to increase market share in the relatively small and low purchasing power Serbian market. Furthermore, the increased competitiveness among Serbian local firms due to spillover from Japanese FDI is expected not to significantly decrease Japanese exports (mainly advanced machinery, automotive, high-tech electronics) to Serbia since the type of end-products manufactured by local Serbian firms (main base in agriculture products and textile) are quite different in character.

Based on the network theory, it has in this article been shown how competencies in Japanese management techniques, marketing, processes and technology from Japanese FDI are transferred to local Serbian firms. With theoretical analysis and empirical evidence, it has been shown that knowledge and understanding about Japanese management techniques, marketing, processes and technology is transferred (or “spilled over”) from Japanese firms to local Serbian exporters via firm-level vehicles for competency transfer. It has then been analyzed how Serbian firms that get access to these competencies, gain a competitive advantage to export to the Japanese market, hence a link between FDI and exports. It has been shown that with network theory, keiretsu dynamics and the influence of trading houses, Serbian exports to Japan can increase the awareness about investment opportunities in Serbia for Japanese investors. With increased awareness, risk averseness for undertaking FDI in Serbia will then decrease among Japanese investors, hence a link between exports and FDI on a firm-level.

This is a *unique* analysis in the sense that most studies done until now on the connection between FDI and exports have been performed on a macro-level within one industry with aggregate data. As opposed to those previous macro-studies, the study in this article analyzed how the link dynamics work on a micro-level, or *firm-level*, applied on the case of Serbian firms’ exports to Japan, and Japanese firms’ FDI in Serbia.