

# Going Abroad to Innovate? The Role of Entrepreneurial Orientation in Foreign Business Expansion for Japanese Small and Medium-Sized Manufacturers<sup>1</sup>

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## Abstract:

This paper explores why a specific group of highly specialized Japanese toolmakers have chosen to expand their limited customer base to include Germany, despite strong cultural and geographical differences. Analyzing the phenomenon through the theoretical lens of International Entrepreneurship research, we find that compared to existing Japanese customers, Japanese SMEs perceived the German customers as less hierarchically dominant and more open and appreciative of their products. Japanese SMEs cited a highly interactive learning relationship with their German customers as a strong potential source for product and process innovation. In sum, we find that this the aspiration for innovativeness is a key motivator for these specialized Japanese SMEs to expand their business to Germany.

## Keywords:

Innovativeness, Internationalization, IEO, Japanese manufacturers, German Customers

## 1. Introduction

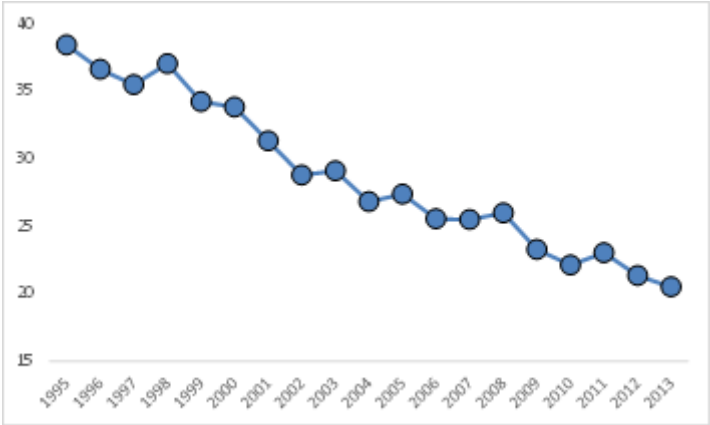
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The purpose of this paper is to investigate a surprising phenomenon: some highly specialized Japanese toolmakers have recently expanded their customer base to Germany, despite large geographical and cultural differences and a highly competitive environment. We find that the pull of a large market explains only part of this phenomenon and that Japanese toolmakers seem to derive strong innovative impulses from these customer/supplier relationships. We analyze this phenomenon through the theoretical lens of International Entrepreneurship (IE) research, which accounts for the fact that for small toolmakers, expanding abroad can be similar to setting up an entire new business and doing so successfully can ask managers to be highly innovative

The Japanese automotive industry has achieved high levels of international competitiveness. At the core of this competitiveness lie prominent subcontracting relationships between large manufacturing companies (for example, assemblers and tier-one parts suppliers) and a multitude of small and medium-sized parts suppliers, which have developed during the postwar period. However, the managerial environment has changed following the intensified global competition and the shrinking of the domestic market due negative demographic trends.

**Graph 1 The Number of SMEs in Japan (10 thousands)**



Source: White paper on SMEs in Japan (2016).

Consequently, many large Japanese carmakers started to change their managerial policies and accelerated overseas business expansion and procurement. Many Japanese small and medium-sized parts suppliers risked losing their main customers and faced

pressures to change their managerial behaviors. In order to maintain their revenues, Japanese firms started to expand their businesses internationally. Based on the IE research context, we can say that a global revival phenomenon or the “born-again global” phenomenon started to occur for Japanese parts suppliers in the automotive industry<sup>2</sup>.

For parts suppliers, foreign market entry is a complex task. It comes close to the complexity of an acquisition process of new customers in foreign markets because of the high complexity of B2B relationships in this type of business. Also, customers’ behaviors are heterogeneous across countries in the parts supplier business. Every company has its own transactional attitudes and behaviors as the customer, based on its national industrial culture (Dore, 1983 and Kim, 2008). Hence, in the process of internationalization, they must carefully select the target country and potential customers in that country to minimize risks such as the liability of newness (Stinchcombe, 1965; Zahra, 2005), the liability of foreignness (Zaheer & Mosakowski, 1997), the liability of smallness and etc. This means that it is critical to analyze the international customer selection process which will lead us to a better understanding of the reasons and entrepreneurial intentions underlying the foreign market entry process by manufacturing SMEs.

A broad body of research shows that the major part of Japanese SMEs prefers Asian countries as the destination for their business expansion due to physical and psychic proximity (Hakanson and Ambos, 2010; Ojala and Tyrväinen, 2007, 2009). Surprisingly, some Japanese manufacturing SMEs are eager to build business relationships with German customers notwithstanding the longer physical and psychic distance between Japan and Germany, comparing to more common destinations such as China, Thailand and Korea. While single studies analyze Japanese and German companies’ transactional behaviors (Szwejcowski et al., 2005), the reasons why some Japanese manufacturing SMEs choose German customers remain largely unexplained.

We suggest that for Japanese parts suppliers entering business relationships with

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<sup>2</sup> See survey results such as the 29th Report on Overseas Business Operations by Japanese Manufacturing Companies for more details (<https://www.jbic.go.jp/en/information/press/press-2017/1122-58812.html>).

different national firm groups such as “Japanese companies in foreign countries”, “Korean companies”, “Chinese companies” “South Eastern Countries’ companies” and “German companies” are different phenomena, and the entrepreneurial intentions and motivations hidden behind are not the same. Focusing our analysis on the “innovativeness”, which is mediated by top managers’ attitudes and strategic decisions as an important dimension of IEO in the global mindset (Gupta and Govindarajan, 2002) of Japanese manufacturing SMEs who enter business relationships with German customers, we argue that it is an aspiration for innovativeness that plays an important role in the emergence of born-again global firms (BAGs), and which is not yet fully explored in empirical EO and IEO research.

From this conceptual point of view, we analyze in-depth data from interviews with Japanese automotive parts suppliers to explore the specific reasons why they preferred German companies as their customers. We review the existing literature in the next section, explain the methodology and the results of our analysis in sections 3 and 4, and discuss our findings and implications in sections 5 and 6.

## **2. Literature review**

### **BAGs and IEO research**

The recent foreign market entry behavior of Japanese SMEs has been called the “born-again global” phenomenon (Takai and Kanda, 2003; Nakamura, 2015). BAGs are companies which are well established in the domestic market, and accomplished rapid internationalization (Bell et al., 2001).

This phenomenon can be seen as the extension of “born global companies (BGs)” highlighted by Rennie (1993), Oviatt and Mcdougall (1994, 1997), Jones and Coviello (2005), Knight and Cavusgil (2004). Related studies refer to “international new ventures” (Oviatt and Mcdougall, 1994), “early internationalizing firms” (Rialp et al., 2005), “rapidly internationalizing ventures” (Cesinger et al., 2012), etc. Knight and Cavusgil (2004) define BGs, as “business organizations that, from or near the founding, seek superior international business performance from the application of knowledge-based resources to the sale of outputs in multiple countries”.

However, Sheppard and McNaughton (2012) using the degree and pace of internationalization to differentiate between BGs that quickly achieve a global presence (a broader market scope), and other groups of new ventures or older domestic firms that are less internationalized or have expanded their business abroad at a slower pace. Such “Born-again-Globals” (BAGs) are defined as firms that have re-invented themselves to include a truly global presence. Schueffel, Baldegger and Amann (2014) suggest that due to their idiosyncratic characteristics, BAGs deserve consideration as a separate group of research objects in the field of IE. Stieg, Martin, et al. (2017) focus on family firms and suggest that succeeding generations internationalize their firms (and become BAGs) due to their long-term orientation. These authors find that succession is more likely to lead family businesses on the born-again global internationalization pathway if the succeeding generation has a higher level of education than the preceding generation, has international experience and seeks self-actualization.

Other studies point to an attitude called International Entrepreneurial Orientation (IEO) as a cause for the rebirth of firms as BAGs. This is defined as the attitude to discover, enact, evaluate, and exploit business opportunities across borders (Zhou, 2007; Yamakawa, Peng, and Deeds, 2008; Zhang, et al., 2016). IEO is an extension of the concept Entrepreneurial Orientation (EO) originally suggested by Covin and Slevin (1988, 1989) and Lumpkin and Dess (1996) to include aspects of international management. Covin and Slevin (1988, 1989) propose that top managers determine the degree of Entrepreneurial Orientation in firms, with their entrepreneurial values, personality, attitudes and managerial styles. EO is further linked to success variables such as managers' ability to make strategic decisions, set goals, maintain core values, and create their own competitive advantages (Lyon, Lumpkin, and Dess, 2000; Rauch et al., 2009). Recent studies have highlighted EO as a key factor contributing to the internationalization processes (Gupta and Gupta, 2015; Etemad 2015).

Similar to the original EO concepts, we can distinguish two definitions of IEO as the indicator of international entrepreneurship level. The first, basic definition of IEO highlights three elements: “proactiveness”, “innovativeness”, and “risk-taking”, based

on Miller (1983). The second, broader definition of IEO proposed by Lumpkin and Dess (1996, 2001) adds “competitive aggressiveness” and “autonomy” to the three aspects of the basic definition. “Innovativeness” in this context can be entrepreneurial Schumpeterian creative destruction based on opportunity creation such as the introduction of new products, processes, and business models or can refer to opportunity identification (Kirznerian stream)<sup>3</sup>. It can manifest itself in the creation of new resources or in new combinations of existing ones (Zahra et al., 1999). “Proactiveness” implies the active pursuit of new market opportunities and “risk-taking” - the tendency to engage in projects with uncertain outcomes, while “autonomy” implies the striving for independent actions. “Competitive aggressiveness” is defined as intense efforts to outperform rivals (Lumpkin and Dess, 2001).

Due to its simplicity, the former definition has been frequently utilized in empirical studies focusing on both EO and IEO (Anderson and Eshima, 2013; Wiklund and Shepherd, 2005; Zhou, 2007, and Dai et al., 2014). Additionally, Kusumawardhani, McCarthy and Perera (2012) argue that the effect of each EO/IEO dimension can be observed independently to analyze firm performance.

In this paper, we follow these previous studies by using the basic definition.

### **Transformation of Japanese SMEs into BAGs**

The automotive industry with its close supplier relationships shaped by the demands of post-war scarcity and technological catch-up has been a dominant part of Japan’s modern economy (Cusomano, 1985; Fujimoto, 1999). This has created a prominent example of long-term subcontracting relationships between large manufacturing companies (*Oya*) and a multitude of small parts suppliers (*Shitauke*). The close cooperation generated by this supplier network has arguably been a key cause of the high international competitiveness of the Japanese automotive industry and has attracted the attention of many scholars (Clark and Fujimoto, 1991; Sambharya, and Banerji, 2006). Large Japanese automotive companies outsourced a substantial

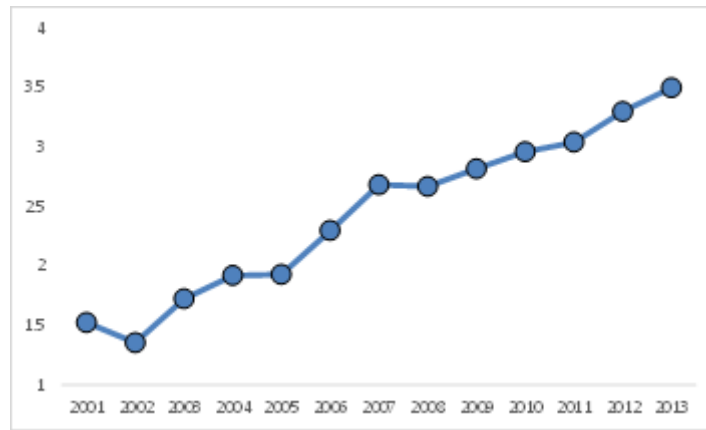
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<sup>3</sup> For more details see Žur, A. (2015). Opportunity Identification and Creation as Factors of Firm Internationalisation. *Entrepreneurial Business and Economics Review*, 3(2), pp.25-39.

part of their manufacturing to small parts suppliers during periods of high domestic and international demand, driven by the need to rapidly build up technological knowledge in the postwar era (Womack et al., 1991). Japanese automobile assemblers have historically outsourced a higher degree of business processes than their American and European counterparts (Brouthers et al., 2014). Therefore, the international competitiveness of Japanese automobile industry is attributable not only to large companies such as Toyota, Nissan, Honda and Denso, but also to a large number of SMEs which were integrated into “quasi-vertical” organizational structures. Die and mold makers play a key role in this network of SMEs, and thus in the international competitiveness of the Japanese automobile industry, being placed within this “closed” web of subcontracting relationship.

However, over the last decades, mainly due to factors such as the growth of manufacturing industry of East Asian countries, shrinking domestic markets and currency appreciation, many large Japanese manufacturing companies have accelerated their overseas expansion and procurement. Die and molds are essential to industrial manufacturing as they are positioned as a critical link in the value chain and determine the lead-times and quality of discrete parts (Altan et al., 2001). Japanese toolmakers increasingly face strong competitors from emerging economies. For example, the Chinese tooling industry alone employed over one million people in more than 30.000 toolmakers in 2010, more than in the United States (Jhavar et al., 2013). Hence, Japanese toolmakers had to change their managerial policies to maintain their business and many of them started to attempt foreign market entry.

**Graph 2 Percentage of SMEs conducting direct exports**



Source: White paper on SMEs in Japan (2016).

The major part of them gained new customers in the neighboring countries of East and South-East Asia, pulled by increasing demands for automotive parts and arguably helped by lower degrees of physical and psychic distance from Japan (Hakanson and Ambos, 2010; Ojala and Tyrväinen, 2007, 2009). However, surprisingly, other manufacturing SMEs attempted to enter business relationships with German companies, despite a highly competitive market environment, and much longer physical and psychic distance from Japan.

Some concepts of IE research can help us to analyze the foreign market entry strategies of those manufacturing SMEs. Nakamura (2016) shows that some Japanese BGs and BAGs started to internationalize driven by business opportunities for their products and technologies outside of Japan, or because they could not survive if they would target only domestic Japanese market. Yamamoto and Oe (2016) pointed out that autonomy is the basis for toolmakers' internationalization decision making toward German customers. Yamamoto (2017) also explored the role of a proactive attitude as a key factor to develop durable business relationships with German customers for Japanese toolmakers. However, there are almost no studies that explore the reasons why Japanese BAGs are eager to build business relations with German customers.

### **Research Question: Why Germany?**

We approach this puzzle with innovativeness as an important dimension of the IEO of Japanese top-managers in manufacturing industry. To understand what key factors





with their customers, and might be one of the reasons why Japanese BAGs would like to expand their business internationally.

We suggest that innovativeness played an important role, mediated by top managers' attitudes and strategic decisions. Since Japanese tool makers have been entirely dependent on their domestic main customers for their organization and management, some of them seek business relationships with German customers as a seedbed for innovation.

Innovativeness is not a frequently used construct in empirical EO and IEO research. Kimberly (1981) depicted innovativeness represents a basic willingness to depart from existing technologies or practices and venture beyond the current state of the art. We define Innovativeness here as “a firm's tendency to engage in and support new ideas, novelty, experimentation, and creative processes that may result in new products, services, or technological processes” (Lumpkin and Dess, 1996).

From the above review of the literature, we derive the following three research questions to guide our subsequent empirical analysis.

1. How do business relationships to Japanese and German customers differ for Japanese manufacturing SMEs?
2. What motivates Japanese manufacturing SMEs to establish business relationships with German customers?
3. How do Japanese manufacturing SMEs perceive aspects of innovativeness in their business relationships with German customers – regarding both, innovations in their own organizational structures and innovations in their business relationship with the German customers?

In the following sections, we analyze the internationalization process of Japanese manufacturing SMEs based on case study evidence.

### **3. Methodology**

Using the concepts defined above, we analyze the internationalization process of Japanese manufacturing SMEs based on empirical evidence from in-depth interviews with automotive parts suppliers and focusing on the informants' insights related to

internationalization, and more specifically the engagement of business relationship with German customers. Our methodological approach follows the case study method which was presented in Eisenhardt (1989, 1991), and aims to explore key variables and motivations of industry participants to build hypotheses. To triangulate and form a richer picture on these issues, we collected background data such as project plans, asked for duration and cost indicators and company data (Yin, 2003).

The motivations to internationalize were explored in four representative case studies, using semi-structured interviews with top-managers in Japanese tool makers that had entered business relationships with German customers since the 1990s. Table 1 provides an overview of these interviews.

**Table 1. Interviewed Firms**

Firm ID	Employee	Industry	Year of Establishment	Year to start business with German Companies
J4	240	Tool and Die / Automotive Parts	1953	1992
J5	186	Tool and Die / Automotive Parts	1951	1995
J6	76	Tool and Die / Automotive Parts	1973	2015
J7	62	Tool and Die / Automotive Parts	1970	2013

The interviews were recorded and took about two hours each. We analyzed the content and coded the data with key words that described categories of motivations for starting international business with German customers. We summarized carefully the conceptual categories that emerged as distinct aspects of the driving force to establish business relationships with the German customers. In the next section, we will indicate

the main results of the interviews and use these data to derive a conceptual framework.

**4. Results**

We summarized the conceptual categories that emerged as distinct aspects of the driving force to establish business with the German customers. We found strong similarities among respondents’ answers regarding aspects of such motivations, especially relating to the dimension of innovativeness. A representative example of the results is shown in Tables 2 and 3.

As for our first research question that asked for differences between German and Japanese customers from the toolmakers’ perspective, we find that German companies treated Japanese toolmakers not only as a mere subcontractor, but rather as a “partner”. In other words, business relationships with German customers are more horizontal than those with Japanese customers and less driven by power differentials.

**Table 2. Summary of the Interview Results 1**

Partnership	
J4	<i>“In our business, German engineers’ reactions are always based on valid reasoning”</i>
J5	<i>“German companies are different from Japanese, because they perceive our parts suppliers as partners,” (...they appreciate and point out the good enhancements in the product, while Japanese counterparts often tend to convey the critical points only...)</i>
J6	<i>“In a meeting with a German company, the buyers mentioned that the prices of our products were fairly high, but the technical experts from the customer were able to understand our prices; following this, the technical experts started to persuade the buyers to accept the prices; that was rare for us in Japanese negotiations”</i>
J7	<i>“When we have discussions with the German staff, they stress their preference for high-quality products by saying ‘it’s better to have</i>

	<i>better products' and they are ready to purchase our products at appropriate prices”</i>
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Moreover, German customers tend to interact with their suppliers more frequently than Japanese customers do. This links to our second research question that aimed to shed light on the motivations of Japanese toolmakers to enter into business relationship with the German customers. As a result of more frequent and less hierarchical interactions, some of the Japanese toolmakers regarded business relationship with German customers as a potential source for innovation.

**Table 3. Summary of the Interview Results 2**

Interaction	
J4	<i>“German engineers always mention that if we want to improve the parts, we must improve the process. They emphasized the process review and strongly asked us to set up the measurement environment”</i>
J5	<i>“We must spend several years to produce tools and parts in a convincing manner. We frequently have to discuss face to face with German engineers to analyze technical details”</i>
J6	<i>“Only in Germany, engineers show their strong interest and respect for the quality of our products. We hope to take a long time to share our technical expertise with customers in-depth. German customers accepted our way. They are more open and innovative”</i>
J7	<i>“In German automobile companies, engineers treated me as their teacher and asked me many of technical questions so friendly. I clearly learned technical issues in the advanced areas”</i>

Concerning our third research question, we find that innovativeness plays a key role in Japanese toolmakers' business relationship with German customers (Table 2 and 3). We use these data to derive a conceptual framework that links the motivation to

start international business with German customers within the framework of IEO with driving forces that influence their “innovative” decision making.

## **5. Discussion**

From the main comments made by the informants, we find that the dimension of “innovativeness” for Japanese manufacturing SMEs comprises mainly two key elements which are “partnership” and “interaction” for new technological process with customers. At the same time, our results show that all the informants claim that they were surprised to find fundamental differences between German industrial culture and the Japanese subcontracting system. These companies made progress in business relationships with German customers for the partnership, interaction and new technological processes that they couldn’t experience and obtain from Japanese traditional networking as subcontractors. Therefore, these elements seem to function as the driving force for them to start and develop business relationships with their German customers, representing for Japanese manufacturing SMEs new challenges and opportunities to innovate at the same time.

In other words, longer innovation processes provide more opportunities for in-depth supplier/buyer interaction which can nurture innovation. Such learning opportunities are especially important for manufacturing SMEs that are part of long and complex design processes such as toolmakers. It takes time to achieve and implement innovations in demanding industries such as high-end toolmaking. This may suggest, paradoxically, that the short lead times which has been for a long time one of the major comparative advantages of Japanese subcontracting system on the one hand, could be an obstacle for innovative Japanese SMEs to fully realize and implement all the new and original ideas they might have had. As we have mentioned earlier in section 2, Japanese subcontracting system with its strong hierarchical relationship placed Japanese parts suppliers in the position where they became historically embedded in these structures and accumulated relation specific skills (Asanuma, 1989; Dou, Hope, and Thomas, 2013). To increase productivity, large companies (*Oya*) adopted superior small parts manufacturers as their dedicated long-term suppliers. They also financed, supervised, and transferred their unique

technologies to these suppliers through exchanges of key personnel.

This means that Japanese small parts suppliers were largely dependent on their main customers for their organizational and management strategies. Therefore, we find that under the growing pressures of the need to internationalize their businesses in order to survive, Japanese BAGs followed two different paths. The first and biggest group of Japanese manufacturing SMEs started to expand their businesses broadly, by using the technological gaps between Japan and other developing countries, entering new international markets with existing products, building relationships with Japanese companies in foreign countries as well as with Korean, Chinese and other customers from mainly South-Asian countries. Many previous studies have focused on this particular group of SMEs.

By contrast, based on our findings, we propose another distinct group of BAGs, who show an aspiration for innovativeness as a driving force for manufacturing SMEs to start and develop their business relationship with German customers.

We suggest that the second group of BAGs was more entrepreneurial in the Schumpeterian way and challenged themselves in building more complicated business relationships with highly competitive customers, competing with counterparts in developed countries, such as Germany. Since Japanese toolmakers were strongly embedded in the complex subcontracting system (*Keiretsu*) and grew up in such an environment of long-term business relationship with their main customers, some of them seek business relationships with German customers as a “seedbed for innovation”. In other words, they were innovative enough to become unsatisfied with the Japanese traditional subcontracting system. Considering the above, we argue that innovativeness is a key factor to explain the internationalization phenomenon of the manufacturing SMEs in the Japanese automotive industry.

## **6. Conclusions and Implications**

In this paper, we discussed the aspiration of innovativeness as the dimension of international entrepreneurial orientation for the born-again global phenomenon of Japanese automotive parts suppliers. There is exploratory evidence that innovativeness

drives some Japanese manufacturing SMEs to internationalize and build business relationships with German companies. Moreover, analyzing the different aspects of innovativeness mentioned in the interview data, we find two major aspects: partnership and the high frequency of interaction with customers for new technological process.

This is the contribution to IEO research, which enriches its theoretical framework with a deeper understanding of contextual factors that are specific to the Japanese business environment and manufacturing industry. Our findings stress the aspiration for innovativeness as the component of IEO in the global mind set (Gupta and Govindarajan, 2002) for Japanese parts suppliers that had entered business relationships with German customers.

Several limitations apply to our results. First, these are preliminary results of an explorative nature and we only look at a relatively small sample of firms. We will try to further enrich the picture we paint here using additional triangulation with published sources, discussions with industry experts and further interviews. At this stage however, our findings remain tentative due to their small empirical basis. Second, our informants are from the management level and we typically talk to one or two key informants per company, which may distort our findings. Third, we look only at Japanese parts suppliers in this study and thus cannot compare how specific these findings are to this particular national group of firms. This would be a valuable area for future research.

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