

# Far East: Opportunity or Headache

*How U.S. electronics firm expanded operations and why it made its important decisions*

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When considering the Far East as a potential area for business expansion, the first consideration must be given to Japan, as it has the second largest Gross National Product in the world and, geographically, it is about the size of the state of California with a population of over 100,000,000. It is rated first or second in the world in many technically sophisticated items, from shipbuilding to watches. Eight of the world's 10 largest blast furnaces are in Japan. What it lacks in raw materials it makes up for in a dedicated population. The Japanese are a very proud people dedicated to the success of themselves and their country. They are highly competitive, constantly trying to match or surpass the output of companies manufacturing a similar product. Traditionally, the Japanese population saves more disposable income than many of the Western countries, while demanding high quality, name-brand consumer items.

In the Far East, Japan is the center of technology in the electronics field. Since a large portion of Japan's growth in the area of sophisticated technology has been through joint ventures and licensing which transferred technical expertise, it would not surprise me if everyone present is not already intimately acquainted with this part of the world. Even though Japan is the center of technology, its inflationary rate and resulting labor unrest is causing many companies in Japan to initiate factories in other countries of the Far East, particularly when it produces a labor intensified product. Today in Japan, in a medium-sized company manufacturing electronic products, the average factory wage ranges between ¥920 and ¥1000 per hour, which is approximately \$3.02 to \$3.40 per hour. It may be approximately ¥200 per hour lower if the factory location is outside of the present industrial areas. By comparison, the wages in Taiwan and Hong Kong would be approximately \$2.50 per hour, and in Malaysia \$1 per hour. However, the further you move away from the industrial centers within Japan, the technical know-how and necessary sophisticated equipment diminishes. To take advantage of the labor rate in Malaysia, the optimum joint venture for us, for example, would be with a Malaysian and a Japanese partner, the Malaysian partner supplying

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the facility and labor, the Japanese partner supplying the technicians and purchasing ability, and ourselves the engineering, a portion of the test equipment and purchase orders.

Every company has its own goals, objectives and limitations. These take many forms and, of course, control the

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basic make-up of any licensing agreement or joint venture. There are many avenues open for us to pursue in obtaining our desired end objective. The final form depends upon many things: for instance, the type of product, process or service that is involved; the basic strengths or weakness of the company's engineering or sales departments; the degree of patent protection that you have on your product or process; the depth of your manufacturing and executive talent; your cash position or tax position; and, of course, the part of the world where you wish to implement this agreement will permeate all of the above considerations.

My discussion today is based on our experience in the Far East and the implementation of our particular goals and objectives in the electronics field. To provide some insight as to why we selected our method of operations, let me tell you a little bit about our company.

Our company was formed 24 years ago in 1951 as a small electronics engineering firm doing business for the United States government, with a net worth of \$5,000. By 1966, it had grown to \$3 million in sales with a net worth of \$480,000. Today, nine years later, its sales are over \$19 million with a net worth of over \$4.5 million. This growth came about through a decision to expand our company through acquisitions into other areas of the economy to provide a cushion against the possible fluctuations in the military electronics market. One overriding requirement was that any acquisition be in a field where we had the technical expertise.

## **Products**

Our company today consists of the parent corporation, Resdel Industries, the Resdel Engineering Corporation, our government products group specializing in the communications field, Digital Systems, Inc., which designs and manufactures numerical control drilling machines for the printed circuit board industry, and the Fanon/Courier Corporation, which handles consumer electronics in the forms of transceivers such as mobile radios, walkie-talkies, pocket pagers, and audio equipment such as intercoms, megaphones, and amplifiers. Over half the corporation's growth has been financed internally.

We did go public approximately five years ago in a limited way, with the company receiving \$1,826,000. Our

stock is carried over the counter in the Western U.S.

Many factors are involved in any licensing or joint venture decision and each of these factors carries different weights depending upon the company involved. Here are some of the overriding considerations that affected our decision. With 24 years' engineering experience in receivers, transmitters, and digital technology in our government products group, we possess ability to provide technical assistance, as required by any company manufacturing our product. Our products require a reasonably high degree of technology, but are of such a nature that patent protection has long since expired. Our capital can be better utilized in the form of product rather than in owning large manufacturing facilities capable of producing the volume of product necessary. Our domestic sales and marketing are sound and progressive. Therefore, our course of action had to be one that would provide us with the ability to obtain a quality product to our specifications at a highly competitive price, and to obtain certain key product on an exclusive basis for distribution into our domestic U.S. market and our recently established international markets.

After considerable research and debate, we elected to open wholly-owned subsidiaries in the areas or countries where we would be doing the predominance of our business. This was done prior to the initiation of any license or joint venture agreement. It offered to our mode of operation three primary advantages:

1. *Currency:* By having a company in the country or area in which we were doing business, we could operate with either a U.S. dollar account under the name of the parent company, or under the currency of the country that we are in. In today's climate of fluctuating monetary values against the U.S. dollar, this has its obvious advantages.

2. *Legal Position:* We elected to have our joint ventures negotiated through our wholly-owned subsidiaries. It reduces risk and eliminates some of the problems of enforcing the agreements in that any disagreements that may arise in the future could be settled under the laws of the country far more efficiently than through the channels of international litigation.

3. *Flexibility:* Each of the countries in which we do business is not only a source and point of manufacture for our product, but is a potential market, not only for our products, but for other products which we may import for sale in that marketplace.

#### Initial Entry

Our initial serious entry into the international marketplace was in Europe through Digital Systems, Inc. The per-unit value of their equipment ranges between \$50,000 and \$150,000. These are many potential customers in Europe that, under today's climate, refuse to operate on a letter-of-credit basis. This poses a potentially serious problem for a U.S. manufacturer because without a wholly-owned company in the common market, the ability to reclaim your equipment for reasons of nonpayment, etc. would be very difficult. In addition, having made the decision that we would seriously enter the marketplace, personnel would be required in the future to provide on-site sales and service support to our representative distribution system.

To provide a platform for future international expansion,

we incorporated Resdel International, B.V., in Holland. Holland was selected for many reasons. A primary advantage is that in Holland dividends received by a Dutch company from its subsidiary where it has at least a 25 percent ownership are not taxed. Holland's proximity to the point of entry of our U.S. product provided an excellent location for bonded storage for those items whose ultimate sales destination would be outside the common market. With an average weight of 6,000 pounds per machine, minimum movement is essential. Any future joint venture or licensing agreement in Europe would be done through this company. In July 1971, when Resdel International B.V. was established in Holland, we had only two companies in the U.S. We had not yet acquired Fanon/Courier Corporation, our consumer electronics company.

We acquired the assets of the Fanon/Courier Corporation in August of 1971. At that time, a portion of the product line was obtained from manufacturers in the Far East, with the balance being produced in the U.S. (As a side note, Murphy's Law came into play ten days after we acquired the company, when President Nixon imposed the 10 percent surcharge on all imported items, and all of the other controls that were applied over the next two years.) Six months after the acquisition, we established Resdel International, Japan, as a wholly-owned subsidiary of Resdel International, B.V. Its primary responsibility is to buy our product, provide engineering liaison, and on-site quality control inspection in plants where our product is manufactured. In addition, it controls joint ventures or license agreements. It is staffed with Japanese nationals and has performed an outstanding service to the corporation. It is incorporated as a Japanese trading company, capable of importing and selling into the domestic Japanese market, as well as exporting anywhere in the world. Being a Japanese company, it can, obviously, operate under the normal terms of trade between two companies in Japan. I might add that for most non-Japanese, the normal terms of trade can be very confusing. For example, a common method of payment in Japan utilizes a "P-Note". The best description in American terms is that it is a post-dated cashier's check, and regardless of how profitable the issuing company is, if a P-Note is not honored on the due date, the issuing company becomes essentially bankrupt because the banks will not deal with it again.

#### Japanese Transactions

All of our joint ventures or licensing agreements in Japan are handled through our Japanese company. They take many forms. For example, we may provide technical assistance to a specific company and for this receive exclusive right to buy the product from them and distribute it throughout the world, or we may find a smaller company that has considerable talent but minimum assets. In that event, we supply the expensive components required, thereby reducing their capital requirements to do the job. This is the normal method by which a Japanese trading company assists a small or captive manufacturer. We have other agreements with certain manufacturers allowing them to sell our product in the Japanese consumer market if they already have a marketing distribution system established for that type of product.

The last several years, the inflation rate in Japan has

driven up the costs such that certain products must now be produced in other parts of the Far East, such as Hong Kong or Taiwan. Labor in Japan has experienced an average 30 percent wage increase per year for the last three years and for the last year and a half there has been a very tight money supply policy imposed by the Japanese government. We moved about 40 percent of our less sophisticated production out of Japan and, realizing that this trend would continue, we established Resdel International Hong Kong in 1974.

### Hong Kong Advantages

Hong Kong offers some very distinct advantages. The laws of incorporation in Hong Kong are not as restrictive as in Japan, and they allow a foreign-owned Hong Kong company to manufacture, as well as buy and sell. It is a major financial center with no government controls on the movement of money in or out of Hong Kong. Many of its electronics companies are affiliated with companies in Malaysia and Singapore. Its income tax rate is 15 percent, and that only when the business is conducted through Hong Kong. For example, if Japanese goods are sold in the United States and are shipped directly from seller to buyer, the commission the Hong Kong company would receive is not taxable. Dividends received from any Hong Kong company which has paid its profits tax are exempt from taxation by the recipient Hong Kong company. The same, of course, would be true for commissions received from the sale of joint venture products if done outside of Hong Kong.

The approximate cost of incorporating a Hong Kong company, not including the capital, is less than \$1,000. Several items of interest for those considering licensing of a patent item is that there is no provision in the laws of Hong Kong to grant original patents. If you wish to be protected in Hong Kong, you must first register the patent in England and then you may register it in Hong Kong. This registration in Hong Kong must occur within five years from the date of issue of the patent in England. The same is true for registration of designs. Trademarks, however, can be recorded directly in Hong Kong.

At this time, our joint ventures and license agreements are predominantly in Hong Kong and Japan. We have reduced our activity in Taiwan. We found it difficult to enforce a contract and the delays experienced in customs in importing necessary key components into Taiwan can be excessive. Because of the reduced technological level, our joint ventures and license agreements in Hong Kong and Malaysia tend to be primarily those of providing engineering know-how and continuing technical assistance in the manufacturing process of our consumer products.

### South Korea Policy

While in Hong Kong the government's attitude is to refrain from injecting itself into business transactions, it is just the reverse in South Korea, where the Korean government exercises a great deal of control over business activities. However, it does provide many tax incentives. South Korea has an excellent labor supply at a low wage rate, because there is no minimum wage law. The United States and certain other countries do allow South Korea's goods to enter under a reduced duty rate.

As mentioned earlier, knowledge of the customs of the

countries in which you plan to do business will permeate your planning and to a large degree could affect the success of the joint venture. The business customs of the individual countries in the Far East vary considerably, and of all of the countries, excluding Mainland China, Japan has a tendency to baffle the Westerner the most. There are certain basic differences in the form of doing business that are unique to Japan and sometimes difficult for the Westerner to understand. The first major difference is the close relationship between government and industry in Japan. Many Westerners have difficulty understanding that much of this relationship is not imposed by specific laws, but is a meeting of the minds between major companies and the government toward a common goal. This relationship has sometimes led Westerners to call the industrial-government relationship, "Japan, Inc." There are many good books on the subject and, in my opinion, this relationship can be used to your benefit, if it is understood. The section of the Japanese government that any foreign company will have the closest interaction with is the Ministry of International Trade and Industry, commonly called "MITI". It is the controlling agency on any import/export operation or repatriation of funds.

### Harmony

Secondly, and more importantly, there is an inbred trait of always harmonizing differences. Some Westerners call it "saving face," but it is considerably more than that. Many times resolution of a problem is not approached directly so that discord can be prevented and there is no need for a party to be put in a difficult position. This is why in most companies the decision comes from the bottom up instead of from the top down. I believe this is a prime reason for tremendous efficiency of Japanese companies. Resolution of a problem passes from the bottom up. Each person, not wanting to impose hardships on the people above him, will strive harder and assume responsibility personally for success.

This decision-making process, when not understood by the Westerner, is a cause of frustration because of the time it takes. If a Westerner is entering into Japan for the first time to conduct business and his business usually takes a week to conclude in the Western world, it might take five to six weeks or more in Japan, with many meetings.

There is a basic premise in doing business in Japan and that is: First you become friends before you enter into an agreement, whereas in America you enter into an agreement and then maybe you become friends. It is very important that when you initially conduct business in Japan, or for that matter in any country, the basic business customs of that country are understood prior to your business contact. It is very strange that many companies have the tendency to spend considerable effort in the definition and legal aspects of any proposed venture and ignore the role the customs of the foreign country may play in conducting that business. In the Far East understanding these customs can make the difference between an opportunity and a headache.