

**FOREIGN BUSINESS RESPONSES TO CRISIS: THE 1930s AND  
THE 1990s**

By

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## **ABSTRACT**

In the already vast literature on the Asian crisis strikingly little attention has so far been given specifically to responses by business firms and comparisons with experiences during earlier financial crises seem to be lacking altogether. This paper offers a contribution to filling in this gap in the literature by looking at responses by foreign business firms in particular. In the first section a brief review is given of the classical pattern as witnessed during the depression of the 1930s. Then the focus shifts to the Asian crisis of the late 1990s. The second section draws on macroeconomic indications of foreign business responses whereas the third and final section considers evidence from individual enterprises with most examples pertaining to Indonesia. The paper concludes with identifying some similarities and differences in foreign business responses to financial crisis in Asia in the late 1990s as compared to the 1930s.

## 1 Introduction

The crisis of the late 1990s is said to be an 'epoch-making' or 'defining event' in the economic history of East Asia (Yanagihara 2000: 30; Garnaut 1998: 10). Yet such statements are usually made without much reference to a longer historical perspective. In addition, recovery has been remarkably swift in most countries hit by the crisis, with Indonesia forming the obvious exception to the rule, and foreign direct investment in particular has proved highly resilient. The already vast literature on the Asian crisis has shown a conspicuous lack of attention not only for historical precedents but also for the specific responses by private foreign firms during the crisis. The *Asia Pacific Business Review*, for instance, brought out four special issues during the years 1997/98-2000, none of which was devoted to the experiences of business enterprises during the Asian crisis or even to the crisis in general.<sup>1</sup> This contribution has a twofold aim, first to underscore the need for a historical perspective in the discourse on the Asian crisis and, second, to explore some evidence on responses to crisis by business enterprises, especially foreign firms.

Some differences with the depression of the 1930s are rather straightforward. The crisis then was imported, now endogenous to the economies of the region, then largely rural, now above all urban, then scarcely involving the financial sector which now of course played a key role. Two important similarities must be mentioned as well: over-investment prior to the crisis, whether in export agriculture or real estate, and the fact that solutions were imposed from the outside, at the time by the colonial authorities (except in Thailand), today by the IMF ( Boomgaard and Brown 2000: 12-17).<sup>2</sup> But how about the responses by private enterprises, domestic as well as foreign? Declining market prospects obviously meant adjusting production ceilings, postponing investment and massive layoffs of personnel; many enterprises were forced into bankruptcy. But such generalizations do not get us far enough. We need more detailed information about how

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<sup>1</sup> In all fairness it should be noted that the special issue on 'Korean Business: Internal and External Industrialization' (vol. 4, nos. 2-3) did contain a timely article on the crisis in Korea (Cathie 1997/98). Also, in 2001 this journal published a major survey of the literature on the Asian crisis (Booth 2001).

<sup>2</sup> A more elaborate comparison is offered in Booth 2002.

the crisis affected business strategies at the time of crisis, in the short as well as in the long run.

The discussion of the evidence presented here is divided into several parts. First, the classical pattern known from the depression in the 1930s is briefly reviewed (section 2). This forms the historical background to the subsequent digression on foreign business responses during the recent Asian crisis. The evidence derives from both macroeconomic indicators highlighting trends in the business community at large (section 3) and more specific information on strategies chosen by foreign enterprises (section 4). The focus is primarily on foreign as opposed to domestic business firms. This is in part motivated by the leading role of foreign enterprises in terms of setting new trends in business strategies thereby exerting a far greater influence than one would expect from their share in capital formation. From a more pragmatic point of view, information on foreign business strategies in Asia is often more readily accessible than information on domestic major players.

## **2 The classical pattern**

Expansion of output appeared to be the standard response to virtually any market signal for private enterprises producing for foreign exports in Southeast Asia in the early decades of the twentieth century. This applied equally to foreign-controlled firms and indigenous producers, especially in the two major export-producing economies of colonial Indonesia and British Malaya.<sup>3</sup> International demand was rising faster than supply which translated as high prices encouraging a continuous enlargement of production capacities. But already in the mid-1920s, i.e. several years before the depression began, prices of primary products started to decline. The business response remained the same but now output was enlarged in order to compensate for the decline in unit prices. Constant total returns were secured but at greater effort than before. This was

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<sup>3</sup> The whole notion of 'foreign-controlled' enterprises acquires a special meaning when applied to firms owned and managed by individuals in the metropolitan mother-country, as opposed to both domestic businessmen in the colony and investors from third countries.

also the initial reaction when the depression hit Southeast Asia in 1930. The outcome was predictable: an extreme increase in supplied quantities in an already weakened market which only accelerated the decline of prices. It was a survival strategy which made sense for the individual producer but not for the community of suppliers as a whole.

A differentiation by type of producer and product emerged as the depression deepened in the early 1930s. Western estates were first confronted with downward rigidities in reducing costs of production so far that they would still make even at rock-bottom market prices. Closures and layoffs followed. The sugar industry in Java was especially hurt and in fact never fully recovered, even after the Pacific War. Its collapse was furthered by rising protectionism in overseas market, following the Chadbourne Agreement (1931), and, ironically, also because the scope for increasing efficiency was limited by the productivity advancement in the 1920s (Lindblad 2000b: 136). One sugar company in East Java, which I have studied in detail on an earlier occasion, stayed afloat by abandoning one of its three estates and by using up almost all of its accumulated reserves (Lindblad 1996: 215). In Besuki, also in East Java, eight out of twelve sugar factories closed down while the remaining four reverted to firing personnel and cutting wages and land rent payments (Nawiyanto 2000: 178-179). In Luzon in the Philippines, by contrast, the sugar estates scarcely suffered at all precisely because they benefited from preferential access to the protected American market (Doeppers 2000: 71-72).

The situation in the tobacco industry was akin to the one in Java sugar. Numbers of Javanese coolies working on the plantations in East Sumatra fell from 400,000 in 1929 to 175,000 in early 1933 (Boomgaard 2000: 34). The sharp reduction in the employment of immigrant labour was reinforced by the shift, initiated in 1931, from longer contracts under the penal clause to shorter contracts of the so-called 'free' coolies, a legislative change that as such was totally unrelated to the predicaments of the depression (see further Houben, Lindblad and others 1999).<sup>4</sup> In 1931-1933, the Deli Company, market leader in Sumatran tobacco, experienced an interruption in its long succession of high profit rates (Lindblad 1996: 221). At the Western estates in Besuki, tobacco production fell by more than 50 % in 1932 alone never to recover completely, not even towards the

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<sup>4</sup> The numbers given also include coolie labourers on rubber and palm oil estates.

end of the decade (Nawiyanto 200: 177). This was the type of business response to economic depression familiar from Western Europe and the United States.

Raising output in times of declining prices formed another type of business response to the depression that showed a higher degree of continuity with the prevalent pattern during the preceding period of expansion in regional export production. This pattern was the most pronounced among indigenous producers of rubber and copra but it also applied, perhaps surprisingly, to the fully foreign-controlled oil industry. Owners of rubber estates, especially in Sumatra, were likely to oscillate between the urge to keep up with indigenous competition by enlarging output on the one hand and the necessity on the other to cut back when marginal costs could not be recovered at the abysmally low price levels. Total output of copra in colonial Indonesia rose by 10 % during the initial years of the depression whereas rubber expanded in particular in 1933 and early 1934 as the International Rubber Registration Scheme was about to be enforced (Touwen 2000: 159-161).<sup>5</sup> The situation in the oil industry was different since the international market was still capable of absorbing ever larger quantities throughout the depression of the 1930s. Enlarging output was here aided by raising efficiency in production which presupposed large capital outlays rather than much new employment of labour (Lindblad 2000b: 318-139).

Tin was another case of a major primary product for which an artificial output ceiling was imposed by international agreement, just as with sugar and rubber. Production quotas became effective in Malaya already in 1931 and at a later stage also in colonial Indonesia. The inevitable result was producing far below capacity and the repatriation of large numbers of Chinese coolies. The British authorities in Malaya supported the layoffs by switching to restrictive immigration policies that applied also to Indian workers on rubber plantations (Kratoska 2000: 284-286). Nevertheless, the Billiton Company, owner of the

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<sup>5</sup> An additional explanation to the rapid increase in rubber output in the midst of the depression was the maturation of millions of trees that had been planted during the boom in the second half of the 1920s when prices were still very attractive. In colonial Indonesia the International Rubber Restriction Scheme (1934) was implemented through the imposition of a special surtax which applied only to indigenous exports but only effectively reduced output to the extent that the higher costs of production could not be covered through more intensive use of for instance unpaid family labour. In 1937 quotas had to be installed in order for colonial Indonesia to meet the internationally agreed targets of output reduction.

mines, succeeded in making a profit, albeit a far smaller one than in previous years, even at the nadir of the depression. This company also seized the opportunity to venture into other lines of mining activity in order to reduce the excessive dependency on international tin prices (Lindblad 1996: 219-220).

The basic aim of private business in Southeast Asia during the depression of the 1930s was one of survival but the means to reach that goal differed. Unrestrained further expansion was sometimes the only viable alternative, especially for indigenous producers. For foreign business enterprises, continuity could mostly only be safeguarded through cost reduction, including layoffs, or through a diversification into other types of business. Indigenous producers were in a better position to keep expanding because of their greater flexibility in cost management but foreign business firms had far greater capital resources at their disposal enabling them to tide over the depression and await the recovery. This brief exposition has made clear that the classical pattern of business response to crisis in the region was in fact a dual pattern with two mutually incompatible options where the choice between the two depended on both the type of producer and product.

### **3 Macroeconomic evidence**

In marked contrast to portfolio investment and short-term loans, foreign direct investment is known to remain strikingly stable throughout times of financial crisis. This was the case during the Latin American debt crises in the 1980s, the so-called *tequila* crisis in Mexico in 1994/95 and by and large also during the Asian crisis of the late 1990s.<sup>6</sup> It underscores a unique characteristic of foreign direct investment that finds its origin in a business strategy primarily geared towards securing continuity of operations rather than realizing short-run gains (Razin, Sadka and Yuen 2001: 283). If such a strategy is adopted by most foreign investors, then it will be reflected also in the behaviour of macroeconomic variables during the crisis. This section examines some macroeconomic

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<sup>6</sup> This parallel also applies to a depression in the real economy as in the 1930s. Accumulated foreign corporate holdings in colonial Indonesia, for instance, were reduced only marginally between 1930 and 1940.

evidence on the Asian crisis with particular relevance to foreign business responses. A distinction is made between Northeast and Southeast Asia rather than considering all of East Asia, in the broad sense of the term, as a homogenous economic region.

The general economic context of the Asian crisis is indicated by annual rates of GDP growth during the years 1996-2001 (Figures 1-2; ADB 2002: 203). Even if the predicaments of the crisis must not be underestimated, negative growth was in fact only recorded in both Northeast and Southeast Asia in one single year, 1998, if we leave out the sudden downturn in GDP growth in Taiwan and Singapore in 2001. In addition, substantial negative growth in that sole year applied to five countries – Korea, Hong Kong, Indonesia, Malaysia and Thailand – whereas there was rather a slowdown of growth in five other countries - China, Taiwan, the Philippines, Singapore and Vietnam.<sup>7</sup> Recovery in 1999 and 2000 was spectacular in Korea, Hong Kong, Malaysia and Singapore whereas marked improvements may be reported also for the Philippines, Thailand and even Indonesia (in 2000). But, as the data for 2001 show, recovery was difficult to sustain in several countries, notably Korea, Hong Kong, Indonesia and Thailand while Taiwan and Singapore plunged into a new recession.

Six years is a very short time span in economic history but already a quick examination of GDP developments over such a short period highlight some important characteristics of the Asian crisis that may serve to set this event apart from the depression of the 1930s. The characteristics are:

- (1) The sentiment of crisis may have been universal throughout the region but the impact of crisis was not. It is, as has been pointed out before, somewhat misleading to speak of '*the Asian crisis*': it was a crisis in about five individual Asian countries.
- (2) The immediate impact of crisis was far sharper than experienced by the region on earlier occasions, in particular during the depression in the 1930s. In Indonesia, for example, national income declined in one single year, 1998, by as much as during the entire depression of the 1930s.
- (3) The recovery was more sluggish and differed more by country compared to the overall improvement of economic fortunes in the region in the second half of the 1930s.

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<sup>7</sup> GDP growth in 1998 was around zero in both the Philippines and Singapore.

These characteristics of the Asian crisis are of immediate relevance to business responses, especially by foreign enterprises. Confidence in local financial markets and short-term transactions may have evaporated altogether but there was every reason to remain optimistic in long-run prospects and merely try to tide over the worst moments of crisis.

A cautious belief in future good prospects is borne out by aggregate figures on foreign direct investment (FDI) flowing into Northeast and Southeast Asia with Indonesia forming the only case where FDI has actually declined over time (Figures 3-4; ADB 2002: 219). In Northeast Asia, fresh foreign investment in China, also entering via Hong Kong after 1999, has dwarfed all other FDI flows, including a comparatively steep increase (more than 200 %) of FDI in Korea between 1997 and 2000. A prevalent pattern in Southeast Asia, applying to the Philippines, Singapore and Thailand, has been an increase towards a peak in 1997 or 1998 followed by a decline. In Malaysia, however, it was the other way around: an early decline followed by an increase of which the latter was apparently not hindered by the imposition of currency controls. The downward trend for Indonesia should be largely ascribed to political reasons whereas the stable level of FDI entering Vietnam signals that this country was little affected by the crisis in the first place.

By and large, therefore, FDI survived the Asian crisis. In Korea and Thailand, new FDI has even been encouraged by declining asset prices, cash shortage among domestic partners and institutional reform or at least good intentions in that direction. In Indonesia, plagued by prolonged uncertainties about political developments, the reduction in total FDI was very substantial in the years 1998-2000, about \$ 8.7 billion, which still corresponds to less than 20 % of realized foreign investment as accumulated outside oil and banking since 1967 (Ramstetter 2000: 4, 42). A financial crisis is clearly not a sufficient, perhaps not even a necessary condition for FDI to collapse.

It is also instructive to briefly review the evidence on FDI originating in the crisis-hit region itself. Data on outflows from Northeast Asia display an unmistakable stability for the second half of the 1990s (Figure 5; JETRO 2001: 3; Ramstetter 2000: 31). Investment to Hong Kong remained virtually on par with the very high level of total Japanese investment long after the crisis had begun and also Korean overseas investment were only cut back in 1999. Only for Taiwan among the investor countries in Northeast Asia

can a downward trend in overseas investment be directly associated with the crisis. Such a tendency was even more pronounced in the case of Singapore, foremost among investor countries in Southeast Asia, where outgoing FDI fell by one-fourth already in 1997 and another one-third in 1998 (Ramstetter 2000: 31). The Asian crisis has certainly not wiped out FDI of Asian origin but it has reinforced the leading position of Japan as a source of investment capital in the region at the expense of the smaller NIEs.

Japanese investment in the region is especially important for our exploration of foreign business responses. Viewed in historical perspective the rise of Japanese investment in Northeast and Southeast Asia since the late 1960s or early 1970s has been the most revolutionary long-run change in FDI patterns in the region (Lindblad 1997: 73). Japanese investors have assumed a leading position, in particular in manufacturing, not only in quantitative terms but also as trend setters for the investors from the Asian NIEs arriving since the 1980s. It is likely that other investors watch how Japanese firms are reacting just as governments in the region have looked, often in vain, to Japan for leadership in times of crisis.

Japanese investment in Asia, as inferred from notifications of intended investment, declined dramatically as the Asian crisis began, from \$ 12.1 billion in the fiscal year 1997/98 to \$ 6.5 billion in the fiscal year 1998/99 which was only followed by a slight recovery, to \$ 7.2 billion, in the year after (JETRO 2001: 18).<sup>8</sup> As a consequence, the Asian share in planned total Japanese investment overseas dropped from 23 % to 11 %. This may be conceived as a temporary diversion of fresh funds away from crisis-stricken destinations but it does surely not imply a net withdrawal from the region.

The composition of Japanese investment within Asia also changed in the process. Between 1997/98 and 1999/2000 the share of Northeast Asia in the total rose from less than 30 % to more than 40 % while the share of Southeast Asia fell accordingly. Changes also took place within each half of the region (Figures 6-7; JETRO 2001: 18). In Northeast Asia, the recovery in fiscal 1999/2000 from the low levels in fiscal 1998/99 was accompanied by a steep increase of Japanese investment in Korea, clearly in response to the stunning Korean recovery in 1999, low asset prices and the incentives offered to foreign investors. In Southeast Asia, Indonesia, was superseded in the first rank

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<sup>8</sup> The fiscal year in Japan runs from 1 April to 31 March.

among destinations of Japanese investment in fiscal 1998/99 by Thailand and in fiscal 1999/2000 by Singapore, although in the latter case by a very slight margin. The general effect of the crisis was to level out Japanese investment commitments, tacitly assuming that the ratio between intentions and realizations would not differ very much across destinations. The gap between the three leading destinations, i.e. Indonesia, Thailand and Singapore, on the one hand and the two lesser ones, Malaysia and the Philippines, vanished as Japanese commitments came to be more evenly spread throughout Southeast Asia. This again indicates an adjustment, possibly in the short run only, of plans for expansion rather than a standstill in operations, let alone a withdrawal of funds.<sup>9</sup>

Some summary macroeconomic evidence has been presented here in order to demonstrate both how the context of doing business in East Asia changed during the crisis and how foreign investors as a collective group reacted. The unique characteristics of the Asian crisis and the resilience of FDI during a financial crisis have both been reaffirmed. Japanese investors in particular have adopted a pragmatic strategy opting for short-run adjustment in order to safeguard long-run continuity of doing business at crisis-stricken destinations.

#### **4 Microeconomic evidence**

In a scarce compilation of case studies of individual firm responses to the Asian crisis, it is argued that European and Japanese investors in particular have had a stabilizing influence in the countries hit by the crisis. These investors have redefined their strategies in order to strengthen their regional presence and achieve long-term profitability. For some, especially European firms, has even offered a welcome opportunity to reducing costs and change relationships with local partners and suppliers (Legewie and Meyer-Ohle 2000: 241). The option to withdraw altogether has only been chosen by a small number of Japanese retailers and financial institutions. Yet Japanese firms have generally been more defensive than European competitors, especially with regard to acquisitions of

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<sup>9</sup> It needs to be said that foreign companies may participate in the exodus of short-term capital, for instance by increasing profit remittances or payments of debts by subsidiaries to the head office abroad.

local firms and venturing into new types of operations (Yanagihara 2000: 37; Meyer-Ohle and Hirasawa 2000).<sup>10</sup> This section offers an elaboration of such observations by examining some microeconomic evidence concerning business responses during the crisis. The information draws on surveys among Japanese investors as well as a small sample of seven foreign firms of both Asian and European nationality. For the benefit of comparisons by origin of FDI, the focus in the individual case studies is entirely on Indonesia where crisis experiences were likely to be the most dramatic.

Towards the end of 1999, JETRO (Japanese External Trade Organization) conducted a survey among Japanese manufacturing firms in Asia. Almost 1300 firms, of which 1000 in Southeast Asia alone, responded to questions about the impact of the crisis and the first signs of recovery. The situation clearly changed for the better between 1998 and 1999. Between these two years, the share of firms making losses dropped from 35 % to 21 % whereas the share of firms capable of enlarging sales volumes rose from 52 % to 69 %. Exports were increasing in 45 % of the manufacturing firms in the five major destinations in the ASEAN (Indonesia, Thailand, Singapore, Malaysia and the Philippines) and almost 60 % of the firms stated that they entertained plans for expansion (JETRO 2000: 1-2, 17, 39). This reveals not only a widespread confidence in long-run prospects but also a successful adjustment in the short run, primarily by switching to exports when local demand was failing.

But adjustment entailed more than increasing the orientation towards exports. Just as with the European firms mentioned above, the crisis urged for a revision of relationships with local suppliers. Local content was increased in order to reduce vulnerability to fluctuations in foreign exchange rates. More than 50 % of the firms in Southeast Asia responding to the JETRO questionnaire declared that they intended to raise local procurement ratios in the near future. Significantly, however, the majority of firms procuring locally obtained at least one-half of their supplies from subsidiaries of other

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<sup>10</sup> In the shadow of the Asian crisis there has been a spectacular expansion of European retail stores throughout Southeast Asia. Major players include French Carrefour, Dutch Ahold and Makro and British Marks & Spencer (Davies 2000: 179).

Japanese firms on location (JETRO 2000: 30-31).<sup>11</sup> Other types of short-term adjustment to the situation included using the yen rather than the dollar in international transactions and assisting local partners with cash (Legewie 2000: 95). There is evidence, especially from Indonesia, that such capital injections were often provided in return for a higher Japanese share in the equity of the jointly owned subsidiary.

Although admittedly small in size, the sample of enterprises used here is composed in such a way as to do at least some justice to the variation in FDI origins in Southeast Asia in general and in Indonesia in particular. Of the seven firms, three are Japanese, two Korean representing the most recent pre-crisis trend in FDI in Southeast Asia, and two European (Anglo-Dutch and Dutch). All are in manufacturing, again to facilitate comparisons by origin of investment capital.<sup>12</sup> The following presentation does not aim at giving a full impression of each company's operations in Indonesia but focuses on crisis responses following a brief introduction.

The three Japanese firms are active in electronics (J1), motor car manufacturing (J2) and textiles (J3). Two of them (J1 and J2) count among the pioneers of Japanese investors in Indonesia setting up business already around 1970 whereas the third one (J3) arrived only in 1993, in the midst of the so-called 'new wave' of Japanese investment in the wake of the Plaza Accord and the urge among Japanese multinationals to set up regional supply networks throughout Southeast Asia. Paid-up capital ranges between Rp. 20 billion or \$ 7 million at the pre-crisis rate of exchange in firm J2 and \$ 50 million in firm J3 with J2 taking an intermediate position at \$ 20 million. Yet the lower paid-up capital in firms J1 and J2 implies that these two firms have chosen to finance new large investments by loans, primarily from Japanese banks, rather than through increasing equity. There is a Japanese majority in equity ownership in two firms, J1 (60 %) and J3 (70%), while the minority holding of the third one (49 % in J2) forms a heritage from the

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<sup>11</sup> The latter percentage does not apply to Vietnam, probably because of the far smaller number of Japanese companies present there.

<sup>12</sup> The information was gathered through visits to the various companies in Indonesia in August 1999 and July 2000. Some supplementary information was also obtained from mother companies in Amsterdam and Seoul. Names of companies are suppressed but I readily acknowledge the generous co-operation received by all firms I visited. The JETRO office in Jakarta also kindly supported my field work. .

less liberal foreign investment legislation prevailing in Indonesia in the 1970s. Employment in these firms ranges from only 400 persons in the highly automated spinning and weaving plant of firm J3 to 6,200 persons prior to the crisis in the motor car factory of firm J2 with firm J1 occupying an intermediate position (2600 employees). Before the crisis, there were 31 Japanese expatriates in both J1 and J2 but only eight in J3. Sales in J1 and J2 were traditionally oriented towards the domestic market whereas J3 exported almost its entire output.

The direct impact of the crisis differed considerably. It was worst for firm J2 whose domestic market virtually collapsed in 1998 and least in firm J3 continuing to rely on exports. The profit rate fell to little more than 2 % in firm J1 in 1998 but turnover continued to increase despite a stagnation in volumes since prices were rising in line with the overall rapid inflation that plagued the initial phase of the crisis in Indonesia. An immediate response in firms J1 and J2 was to increase the export ratio in output which was of course aided by the sharp depreciation of the Indonesian rupiah. In the former case, exports were bolstered for audio equipment and to a limited extent also for colour TVs and air conditioners while other products such as refrigerators and water pumps still catered exclusively to the domestic market. Meanwhile firm J2 launched export drives in the region, in particular Malaysia, the Philippines and Taiwan, in an effort to emulate the highly successful sales of family cars in the Indonesian domestic market prior to the crisis. Interestingly, firm J3 chose to reduce its high export ratio by starting deliveries also to a Japanese-affiliated textile manufacturer elsewhere in West Java.

Substantial layoffs only took place in firm J2 when output targets was adjusted downwards. In total 2,600 persons, or 42 % of the work force, were laid off between July and September 1998 after an agreement had been made with the local trade union that employees would be rehired at recovery (which in the event did happen in the course of 1999). The layoffs were accompanied by a thorough reorganization. Cost reduction was essential in the face of very low sales while debt obligations to the Japanese banks still had to be met. The contingent of Japanese expatriates was also decreased in size both in this enterprise and in firm J1. In firm J3 there was only a brief stoppage of production at the time of the turmoil in May 1998 but here continuity in the production process was crucial due to the high fixed cost of expensive machinery. This firm increasingly

encountered problems with the transportation and information infrastructure as the crisis went on in Indonesia.

The two Korean firms are both in traditional labour-intensive lines of production such as food processing (K1) and footwear (K2).<sup>13</sup> The former one was one of the Korean pioneers in Indonesia, setting up its factory for seasoning products in Surabaya already in 1973 whereas the latter one arrived in the Greater Jakarta metropolitan area only in 1989. The former one is listed at the Jakarta Stock Exchange and here the Korean share in equity has dropped to 56 % as funds were raised through emissions of shares. Firm K2, however, is still for 98 % owned by the founder, a shoe manufacturer from Pusan. Employment is especially large-scale in K2 with more than 5,000 labourers against barely more than 1,000 at K1. Numbers of Korean expatriates are traditionally substantial, more than 40 in firm K2. Before the crisis, export ratios ranged from 10 % in firm K2 to 50 % in firm K1.

The crisis meant a near-collapse of domestic sales for both companies but their responses differed. Firm K1 raised its export ratio to about 75 % and did not have to adjust output targets downwards. No layoffs took place but substantial losses were made on account of considerable debt obligations to banks in Singapore and Korea that were denominated in dollars. The Korean contingent was reduced to 21 persons. Firm K2 closed down two of its production lines and laid off about 300 employees with the understanding, however, that they would be rehired as soon as the recovery had set in. They were offered 50 % of normal pay provided that they were prepared to stay around the factory and remain available for re-employment. This kind of privately financed social safety net must be considered rather unique among foreign investors in Indonesia.

The two European firms, finally, manufacture light consumer goods (E1) and electrical products (E2).<sup>14</sup> Both are subsidiaries of large European multinationals, one Anglo-Dutch (E1) and the other fully Dutch (E2). Both can look back on a long history of presence in Indonesia even if the was interrupted by the nationalization of Dutch firms in the late 1950s. Firm E1 returned already in 1969 whereas firm E2 waited until 1992 before

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<sup>13</sup> For details on Korean investment in Indonesia, see Lindblad 2000a.

<sup>14</sup> For details on these companies as well as on four other European firms operating in Southeast Asia, see Lindblad 1999.

starting out anew in Indonesia. In 1997, European participation in equity was 85 % in firm E1 and 60 % in E2. The former firm has about 3,000 employees whereas the latter one offers work for 2100 persons and expatriates numbered only 16 and 10 respectively already before the crisis. Firm E1 caters almost exclusively to the domestic Indonesian market whereas sales of E2 are traditionally evenly divided between domestic sales and foreign exports.

Effects of the crisis were the familiar near-collapse of domestic demand and a subsequent sharp reduction in sales. Firm EJ2 incurred losses in 1997, sought a partial compensation in enlarged exports but still had to reduce output by as much as 20 % in 1998. Yet layoffs took place at a very limited scale and only in a secondary older factory, not in the main production unit. The company was determined to stay on and operate below capacity for the time being. An expansion of facilities which was already in the pipeline was followed through but fully financed with Dutch capital which translated as an increase in the Dutch share in equity to from 60 % to 80 %.

In firm E1 a survival strategy was formulated already in September 1997. Dollar-denominated loans were hedged and various measures to introduced to increase cost effectiveness. Prices in the faltering Indonesian market could be lowered by switching to cheaper and more simple packaging materials. Apparently, this strategy worked quite well as total turnover did not fall and a small profit was even reported in 1998. No layoffs took place. In this firm creativity in adjusting market strategies was aided by the fact that demand is relatively inelastic for the essential light consumer goods produced.

Needless to say, a sample of only seven firms scarcely offer sufficient grounds for firm generalizations about foreign business responses to the Asian crisis. Yet the following observations can be made:

- (1) Export ratios were raised wherever possible (with the notable exception of firm J3) but this apparently offered only a partial relief.
- (2) Layoffs were avoided in five of the seven companies and accompanied by provisions for rehiring in at least one case (K2).
- (3) Japanese firms in particular were keen to cut back on expatriate personnel.
- (4) Cost-reducing measures were introduced in most firms and in at least one case (E1) they formed part of a wider survival strategy.

(5) Only in one case of seven (E2) was the opportunity seized to enhance foreign equity participation.

The most active responses – a social safety net, a survival strategy and continued expansion – were found among Korean and European firms whereas a more defensive attitude – keeping afloat, if need be at a smaller scale of operations – was associated with Japanese enterprises. The evidence from these selected enterprises at any rate suggests that a successful short-run adjustment was accomplished by foreign business in the economy worst hit by the Asian crisis.

## **5 Conclusion**

This paper has become a simultaneous search for historical perspective and more precise information about foreign business during the recent Asian crisis. It has reaffirmed the unique characteristics of the Asian crisis as compared to the depression of the 1930s in particular. It has also reaffirmed the resilience of foreign direct investment in times of crisis and the capability of foreign enterprises to stage a successful adjustment to the changing circumstances.

The classical pattern of business response, as manifest during the depression of the 1930s, was in fact a dual one, either seeking compensation for lower prices by raising output or reducing output, eventually also production capacity as well. Both options reappeared also during the Asian crisis, albeit in different forms. The compensation strategy entailed switching to foreign exports whereas the cutback strategy was often seen as a temporary emergency measure when the former option was not available. Layoffs did occur in foreign enterprises also in the late 1990s but it seems that both scale and duration were limited as firms chose to operate below capacity for the time being.

The key variable in any economic crisis is confidence and here we come across a vital difference between the depression in the 1930s and the Asian crisis. In the latter case, there was a stark contrast between the collapse of financial markets and continued belief in the long-run potentials of the real economy, an optimism that did not find its parallel in Southeast Asia in particular during the 1930s. This optimism clearly eased the path to a

successful short-run adjustment as is illustrated here by evidence on the collective of Japanese investors in the region. This strategy of adjustment was largely reactive but especially in the case of European investors, it has developed into an active policy geared at strengthening the presence in East Asia.<sup>15</sup>

Why did foreign enterprises fare better in Asia in the late 1990s as compared to the 1930s? One explanation may be found in some peculiar characteristics of the Asian crisis: it was not universal even within the region itself, the plunges in levels of economic activity were deep but short, and recovery patterns showed much variation across countries. Perhaps the main benefit to be drawn from a longer historical perspective than the one generally applied in the vast crisis literature is that it makes it realize how different the Asian crisis was.

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<sup>15</sup> I suspect that Korean firms, or investors from the NIEs in general, may form an intermediate case between the Japanese and European variants but the evidence presented here is too limited to formulate strong conclusions in this direction.

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