

# Localization Strategies in Response to Recent Changes in the Southeast Asian Labor Market Environment

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This study investigates the background and causes of the major changes in the labor market environment in Southeast Asia, while also identifying characteristics of the labor market. The increase in foreign direct investment (FDI) in Southeast Asian countries serves as a starting point for this analysis, because the flow of FDI, we believe, is the most important cause of changing conditions in the labor market. In addition, we explored whether investment decisions of firms are affected by changes in South-

east Asia's labor markets, through both empirical analysis and a corporate survey on the strategies they employ in responding to the changes. We found that small and medium sized enterprises in particular mainly focus on localization at the management level. Furthermore, based on the findings, we proposed better ways to support firms operating in Southeast Asian countries.

## 1. Recent Changes in the Labor Market Environment in Southeast Asia

The labor market environment in Southeast Asia has been changing at a very swift pace as of late. The following is a list of the main causes behind labor market changes. First, there has been a huge influx of FDI in the region. As the increase in FDI improves the total factor productivity of firms operating in Southeast Asia, the wages of workers in this region have accordingly skyrocketed. Second, as income growth led workers in the region to devote greater attention to democracy and human rights, the governments face increasingly pressing workers' demands for higher pay and better working conditions. Third, governments in the region have recognized that high external dependence may hinder sustainable development in the aftermath of the global financial crisis. Since the governments are aware of the necessity to expand domestic markets to avoid this risk, they have become noticeably pro-worker in terms of their labor policies. Fourth, ASEAN countries are pursuing employment expansion and the enhancement of industrial structure to prepare for the ASEAN Economic Community (AEC), which will be established at the end of 2015. Populist political activities have also led to pro-worker policies. Since the changes in the labor market environment can reflect the needs of both governments and workers, in sum, we conclude that changes in the labor market environment will persist further down the road.

We understand that these changes are part of the typical development procedure. It is time for foreign investors to prepare appropriate countermeasures to adapt to the changes. Firms operating in Southeast Asia should

seek new opportunities amid these changes.

## 2. Characteristics of the Labor Market Structure in Southeast Asia

We analyze the characteristics of the labor market structure in Southeast Asia from labor supply and demand perspectives. The features of labor supply in the region can be summarized as follows. First, this area exhibits a relatively high population growth rate as well as a high proportion of youth among the entire population. Second, the quality of human resources is expected to improve. In Vietnam, Indonesia, and Cambodia, where Korean corporations have been relatively active in expanding their businesses compared to in other countries, we have observed a rapid increase in the enrollment rate in tertiary education. Third, if the ASEAN Economic Community succeeds with its plan, skilled workers can migrate more freely within the region. The characteristics of labor demand can be summarized in the following two sentences. First, the structure of labor demand is becoming diversified in Southeast Asia as both domestic consumption and demand for export will expand. Second, economic growth creates a number of jobs in the region due to the fact that the increase in investment contributes to employment. In addition, comparing the wages of white-collar and blue-collar workers, white collar workers receive more wages than blue-collar workers across all countries in the region, as we observe in other countries. However, we could not confirm whether these wage differences are attributable to individual capabilities, due to limitations in the data.

### 3. Changes in Labor Markets in Southeast Asia and Reactions on the Firm level

Two analyses were carried out. First, we empirically analyzed the determinants that led Korean firms to increase their FDI into Southeast Asia. We also investigated, through a corporate survey, how they responded to the recent changes in labor market environments.

According to the results of our empirical analyses, the increase in wage rates in Southeast Asia has a significantly negative impact on Korean firms' FDI decisions, as we expected. The manufacturing sector was in particular more sensitive to the rise in wages than the service sector. We also found significant evidence that technical characteristics determine the sensitivity of wage on FDI decisions across manufacturing sectors. For example, the impact of wage on FDI is much greater in a manufacturing sector utilizing either high-level technology or low-level technology than in a sector utilizing lower-mid-level technology. In addition, we found that small investors are more likely to decrease investment in response to an increase in wages compared to big investors. Moreover, we found evidence that the higher the education level of labor workers in Southeast Asia, the higher the investment into the country from Korean firms.

In the analysis focusing only on new investment decisions, we found that Korean firms continue to choose these areas as bases for labor-intensive production processes, despite the rise in local production costs, such as labor cost. This result accords with survey results that firms already operating in this region have no intention to move, neither com-

ing back to Korea nor to other countries. Interestingly, 57.3% of the surveyed companies answered that they overcame the recent wage increase by raising productivity.

[Table 1] Korean Firms' Expected Reaction to Labor Market Changes

Strategy	Frequency	Ratio (%)
Moving to Korea	1	1.33
Localization by improving productivity	55	73.33
Moving to third countries	14	18.67
Other	5	6.67
Total	75	100

Source: Survey by authors.

Furthermore, where labor market conditions are even worsening, 73.3% of firms chose a localization strategy, such as raising the productivity of labor and capital, to surmount the difficulties, rather than choosing to move to other countries (Table 1). Why do we observe these interesting results? First, the increase in variable costs is smaller than the increase in the fixed cost of relocating production facilities. Second, countries that are generally considered as alternative locations, such as Myanmar, have also undergone similar changes in their labor markets. In addition, our survey showed that firms located in Indonesia also chose to leave city centers to move to local areas. Indonesia, Malaysia, the Philippines, and Vietnam have different minimum wage systems across regions within the country. Of particular note is that the ratio of the highest minimum wages to the lowest across regions is 37.3% in Indonesia and 70.4% in Vietnam.

[Table 2] Detailed Strategy of Korean Firms' Localization

Detailed Strategy	Frequency	Ratio (%)
Offset by improving labor productivity	32	59.26
Downsizing	0	0
Investment in Facilities and R&D	11	20.37
Utilizing outsourcing companies	2	3.7
Moving domestic production facilities to other areas	5	9.26
Reduction of production lines	1	1.85
Etc.	3	5.56
Total	54	100

Source: Survey by authors.

Note: The above localization strategies come from the definition of Lee (1994, pp.225~227).<sup>1</sup>

We also surveyed the detailed strategies used for Korean firms' localization in Southeast Asia (Table 2). Up to 59.3% of firms answered that they plan to offset the wage increase by improving labor productivity, and 20.37% of firms said that they will invest more in R&D and production facilities. Based on this survey, we find that the localization strategies of Korean firms mainly focus on business management elements such as production, human resources, R&D, and marketing.

#### 4. Localization Strategies in Response to Changes in Southeast Asia's Labor Markets

Based on the above discussion, we believe that Southeast Asia still has the potential to

attract FDI from Korean firms. Ongoing changes in Southeast Asia's labor market are likely to have an adverse impact on Korean firms operating in the region, though the extent of the impact will differ across industries, firm sizes, and technology levels. Therefore, we suggest that government policies for FDI should be redirected to support localization efforts of firms operating in Southeast Asia. As these firms operate in foreign countries, they do not create jobs domestically. The existing literature, however, tells us that they positively affect domestic productivity and employment. This provides a reason for governments, including Korea's, to identify effective policy measures that can support firms to successfully meet challenges and localize in these ever-changing markets of Southeast Asia. **KIEP**

<sup>1</sup> Lee, Kwangchul. 1994. "Localization strategies of Korean firms operating in Southeast Asia," *Dong-NamAsiaYeonGu*, No. 3. pp. 217~254.